Please note that since the original publication of this article, additional case law has resulted in some of the information below being possibly out of date. To see the updated article, please click on the following link: **Washington Court of Appeals Overturns Erroneous Interpretation of their Prior Decision: A Borrower's Bankruptcy Discharge Does Not Accelerate Entire Debt!**

WFZ CASE ALERT:

WASHINGTON SUPREME COURT REFUSES TO REVIEW COURT'S IMPOSED ACCELERATION OF DEBT UPON THE BORROWER'S BANKRUPTCY DISCHARGE: OTHER STATES BEWARE!

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On January 5, 2022, the Washington State Supreme Court denied West Coast Servicing, Inc.'s petition for review of the Division I Court of Appeals decision in *Luv v. West Coast Servicing, Inc.*[1] With this denial, Washington has solidified the creation of a bankruptcy court-imposed acceleration, while doing everything in their power *not* to call it an acceleration, of a borrower's debt upon discharge in bankruptcy, including secured debts. While this is bad news for lenders in Washington, lenders in other states should beware as we are already seeing this argument taking hold in Colorado, Arizona and Nevada, with some success. Servicers with discharged loans in other states should take note.

This article will walk the reader through the current state of law, explain how we got here, explore the spread of related decisions in other states, identify potential exposure to loan servicers and investors (watch out for FDCPA and state consumer protection exposure for making demands on loans where recovery may be barred), and discuss steps that servicers and investors can take to limit their exposure.

How we got to *Luv*: The *Edmundson* dicta

The Washington statute of limitations on written contracts and enforcement of negotiable instruments is 6 years.[2] Absent acceleration, if the contract is repaid in installments, the 6 years runs against each installment as it becomes due.[3] If acceleration or maturity occurs, the 6 years runs against the entire debt from the date of acceleration or maturity.[4] It has been well settled law that acceleration could only be triggered through the actions of the lender, as written in the contract itself.[5]

Initially, the 2016 opinion in *Edmundson v. Bank of America, N.A.*[6], appeared to merely confirm that: (a) the statute of limitations applies differently to contracts payable on demand and installments; and (b) the borrower's bankruptcy discharge did not effectively void the deed of trust and note based upon the borrower's lack of personal liability.

Quoting the 1945 Washington State Supreme Court decision, *Herzog v. Herzog,* the court in *Edmundson* wrote "when recovery is sought on an obligation payable by installments, the statute of limitations runs against each installment from the time it becomes due; that is, from the time when an action might be brought to recover it."[7] The court in *Edmundson* then reasoned that the statute of limitations accrued each month until the borrower no longer had personal liability under the note, i.e., the date of their bankruptcy discharge.[8] The problem with the Court's logic is that it was equating the lack of personal liability with calling the loan due, signaling that an "action might be brought to recover it" as stated in *Herzog.* It is important to note that the borrowers in *Edmundson* obtained a chapter

[1] *West Coast Servicing, Inc. v. Prince Eric Luv,* WA Supreme Court Case no. 100188-6.
[2] RCW 4.16.040(1) and RCW 62A.3-118(a).
[3] *Herzog v. Herzog,* 23 Wn.2d 382, 388, 161 P.2d 142, 144-45 (1945) (*review denied).*
[4] RCW 62A.3-118(a).
[5] *Puget Sound Mut. Sav. Bank v. Lillions,* 50 Wn.2d 799, 803 (1957).
[6] *Edmundson v. Bank of Am., NA,* 194 Wn. App. 920 (2016).
[7] *Edmundson,* at 930 (2016) (quoting *Herzog v. Herzog,* 23 Wn.2d 382 (1945)).
[8] *Edmundson,* at 931 (2016) (The borrowers defaulted in November 2008, filed for ba.nkruptcy in June of 2009, was discharged in December of 2013, and they commenced quiet title in March 2015.)

13 discharge of their debts.

If we follow *Edmundson*'s interpretation of *Herzog*, then immediately upon discharge, the lender should commence enforcement proceedings, regardless of the borrower's continued payments, because the Court is deeming the loan due in its entirety and accrued for recovery. Of course, taking this approach would harm borrowers who are trying to make good on their loan obligations post-discharge. In light of this illogical interpretation, this section of *Edmundson* was seen only as dicta.

To further illustrate why *Edmundson*'s unreasoned interpretation of *Herzog* should not be relied upon, in the same opinion, the court stated, "to the extent the trial court ruled that some event during the bankruptcy proceeding triggered (the acceleration) provision, the court is wrong. Under the plain terms of the deed of trust, this is an option to be exercised by the lender, not something triggered by events in bankruptcy proceedings."[9] Unfortunately, this confirmation of well settled law is ignored or circumvented as the bankruptcy discharge argument continues, gaining momentum in Washington and, eventually, elsewhere in the country.

***Edmundson*'s Bankruptcy Dicta Becomes Gospel in the Ninth Circuit**

Using *Edmundson*, borrowers increasingly argued that, because they were no longer personally liable for payments after being discharged, the last payment that "became due" was the payment that immediately preceded the discharge. In other words, the 6-year statute of limitation on foreclosing for non-payment started to run upon discharge, regardless of the language in the loan agreements stating otherwise.[10] Unfortunately, the Western District of Washington and subsequently the Ninth Circuit, began siding with the borrowers.

In a ruling by the Western District of Washington in *Jarvis v. Fannie Mae*[11], the *Edmundson* dicta took flight. The court in *Jarvis* stated that "(b)ecause the Edmundsons owed no future payments after the discharge of their liability, the date of their last-owed payment kickstarted the deed of trust's final limitations period. (…) The holder of the deed of trust had six years from that date to foreclose on the Edmundsons' home."[12] In the same ruling, the Court in *Jarvis* stated that the opinion in *Edmundson* "do(es) not demand that acceleration automatically accompany discharge because acceleration occurs at the creditor's option when certain conditions are met." The Ninth Circuit affirmed *Jarvis* in June of 2018 relying entirely on *Edmundson*.[13]

In essence, the courts in *Edmundson* and then *Jarvis* deemed the bankruptcy discharge an accelerating event, without calling it an accelerating event, while continuing to say that only lenders have the right to accelerate the debt. This became a divisive issue with Washington bankruptcy courts.

Relying on *Edmundson*, in November of 2018, debtor Nazario Hernandez commenced a bankruptcy adversary action to deem his loan time barred.[14] The bankruptcy court dismissed the proceeding stating it was not required to follow *Edmundson* because it was dicta, that the statute of limitations is only triggered by maturity or acceleration, there was no law supporting the argument that the discharge of the note was the equivalent of maturity or acceleration, and the reliance on this position "would lead to potentially absurd results."[15] On appeal, the Western District of Washington, citing to their ruling in *Jarvis*, overturned the bankruptcy court's ruling. The Western District did not see *Edmundson*'s arguments as dicta, citing back to *Herzog* for support.[16] This reversal was upheld by the Ninth Circuit - "a straightforward application of Washington law that the bankruptcy court was not free to ignore renders this result" while citing only to *Edmundson.*[17]

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[9] *Edmundson,* at 932 (2016).
[10] *Edmundson,* at 922 and 926; *Jarvis v. Fannie Mae*, No. C16-5194-RBL, 2017 U.S. Dist. LEXIS 62102, at *5 (W.D. Wash. Apr. 24, 2017).
[11] *Jarvis v. Fannie Mae,* No. C16-5194-RBL, 2017 U.S. Dist. LEXIS 62102 (W.D. Wash. Apr. 24, 2017).
[12] *Jarvis,* at *8-9 (W.D. Wash. Apr. 24, 2017).
[13] *Jarvis v. Fannie Mae,* 726 F. App'x 666, 667 (9th Cir. 2018).
[14] *Hernandez v. Franklin Credit Mgmt. Corp.,* No. C19-0207-JCC, 2019 U.S. Dist. LEXIS 136543, at *3-4 (W.D. Wash. Aug. 13, 2019).
[15] *Hernandez,* at *3-4 (W.D. Wash. Aug. 13, 2019).
[16] *Hernandez,* at *6-7 (W.D. Wash. Aug. 13, 2019).
[17] *Hernandez v. Franklin Credit Mgmt. Corp. (In re Hernandez),* 820 F. App'x 593, 594 (9th Cir. 2020).

In December of 2020, in *Brown v. Deutsch Bank N.A. (In re Plastino),* another bankruptcy court declined to follow *Edmundson* and *Jarvis.* This was the first time a judge calls a spade a spade - highlighting that following the *Edmundson* dicta is effectively accelerating the loan.[18] This time, the court dug deeper into *Edmundson* to try to find out where this reasoning, which was not based upon any law, other than a reference to *Herzog*, could have originated. The court found a reference to a Western District Court case with no precedential value, *Silvers v. U.S. Bank, N.A.,* cited in lender counsel's brief in *Edmundson*. The court in *Silvers*, with only a previous reference to *Herzog* regarding installment payments, deemed the bankruptcy discharge an event starting the running of the clock.[19] As this language was not supported by any law that included the effects of a bankruptcy discharge, the *In re Plastino* court dug deeper into *Silvers,* finding similar language in the lender's brief, without legal authority, stating that the statute began running at the earliest, the month before discharge.[20] The court in *Silvers* took legal argument from counsel, removed qualifying language, and deemed that to be their interpretation of the law.

Based upon this, the *In re Plastino* court determined that the prior bankruptcy "did not cause acceleration of future installments on the note."[21] Unfortunately, *In re Plastino* settled mid-appeal in July of 2021 so there was no substantive review of the effect of *Silvers* on *Edmundson* by the Ninth Circuit.

Washington Revisits *Edmundson* in *Luv v. West Coast Servicing, Inc.*

In August of 2021, Division I of the Washington State Court of Appeals had the opportunity to revisit their decision in *Edmundson* and the effect of the primarily federal cases that followed. Unfortunately, Division I further supported their findings in *Edmundson*.[22]

In *Luv v. West Coast Servicing, Inc.,* the borrower obtained a discharge in March of 2009, made no payments after discharge, and commenced an action to quiet title of the deed of trust in April of 2019.[23] Relying on *Edmundson,* Division 1 ruled that "Edmundson cannot be read to stand for the proposition that bankruptcy discharge eliminates or accelerates the debt; rather, discharge triggers the statutory limitation period during which a creditor may enforce the deed of trust."[24] However, these two statements are incongruous. The triggering of the statutory limitation period on an entire debt is done through maturity or acceleration, and as the Court in *Edmundson* noted, "(u)nder the plain terms of the deed of trust, (acceleration) is an option to be exercised by the lender, not something triggered by events in bankruptcy proceedings."[25] Don't be fooled into thinking that the court is not accelerating the loan, but instead causing an early maturity. An early maturity, under well settled law, only occurs through acceleration… by the lender.[26]

The lender petitioned the Washington State Supreme Court to review *Luv*. Unfortunately, on January 5, 2022, the Supreme Court refused to review the issue, solidifying the *Edmundson* dicta as law.

Is there still hope? *Merritt v. USAA Federal Savings Bank*

While *Luv* was pending, another matter challenging *Edmundson* was appealed – *Merritt v. USAA Federal Savings Bank.*[27] In finding for the lender, the trial court reasoned that the statute of limitations did not begin to run on installments that were not yet due at the time of the bankruptcy filing and that the entire note is not yet barred by the statute of limitations.[28] Essentially, everything due prior to the bankruptcy discharge was accelerated but any

[18] *Brown v. Deutsch Bank N.A. (In re Plastino),* Nos. 17-11760-MLB, 20-01012-MLB, 20-01013-MLB), 2020 Bankr. LEXIS 3597, at *6-7 (Bankr. W.D. Wash. Dec. 29, 2020).
[19] *Id.*
[20] *Id.*
[21] *Id.*
[22] *Luv v. W. Coast Servicing, Inc.,* No. 81991-7-I, 2021 Wash. App. LEXIS 1924 (Ct. App. Aug. 2, 2021).
[23] *Luv,* at *2 (Ct. App. Aug. 2, 2021).
[24] *Luv,* at *9 (Ct. App. Aug. 2, 2021).
[25] *Edmundson v. Bank of Am., NA,* 194 Wn. App. 920, 932 (2016).
[26] *4518 S. 256th, LLC v. Karen L. Gibbon, PS, 195* Wn. App. 423, 435, 382 P.3d 1, 6-7 (2016).
[27] *Merritt v. USAA Federal Savings Bank,* WA Court of Appeals, Division I, 82162-8-I.
[28] *Id.*

payments due after the discharge had their own statute of limitation as they came due. Thus, the lender was barred from recovering any amounts due prior to the bankruptcy discharge and any other post-discharge payments that were more than 6 years old, absent tolling and post-discharge acceleration. This reasoning is more in line with traditional practice because installments do continue to come due post discharge and borrowers continue to have the opportunity to pay those monthly payments to hold foreclosure at bay, which would not occur if the loan's maturity date had been accelerated.

Through *Merritt*, the complete lack of authority to modify the bankruptcy code argument could be the primary issue on review. Nothing in the bankruptcy code provides for the maturity or acceleration of the debt upon discharge. Moreover, the code specifically states that the mortgaged property will remain liable for the debt. [29] This falls in line with the reasoning that payments continue to become due each month post discharge. Nothing in the Washington statutes provide for an alteration of a contract regarding how acceleration or maturity occurs either.[30]

As of the time of this article, *Merritt* is scheduled for review on January 20, 2022 without oral argument. Perhaps Division I will consider the trial court's unique interpretation of *Edmundson*, and the conflict between bankruptcy law, Washington statutes, and the contract itself. If not, 2022 will see these arguments take hold in more states.

Arizona, Colorado, and Nevada Take on *Edmundson* and *Jarvis* – Who will be next?

The Bankruptcy Code is federal and, in theory, uniform across the country. While that may not always be true in practice, there is a very real possibility that the *Edmundson* and *Jarvis* decisions could spread across the country. In fact, we are already seeing some examples in other western states.

***Arizona*:** Both divisions of the Arizona Court of Appeals have had an opportunity to hear cases applying *Jarvis* and *Edmundson* in Arizona - *Diaz* v. *BBVA* and *Luu v. Rez*. Like Washington, Arizona has a 6-year statute of limitation on debts, each installment has its own statute of limitation, and acceleration can only be commenced by the lender.[31]

In *Diaz v. BBVA*, Division II refused to follow *Jarvis* based upon the lack of bankruptcy code authority modifying the effect of the discharge, and *Jarvis*'s non-precedential value in light of already established Arizona case law.[32] As argued heavily by the lender in *Luv*, the court in *Diaz* noted that the effect of the bankruptcy discharge is controlled by the bankruptcy code alone. The discharge does not extinguish a lien or bar enforcement of the debt against the property that secured it. Quoting its decision in *Stewart v. Underwood*[33], the court in *Diaz* stated, "there is (no) indication that Congress intended the bankruptcy discharge to interfere with state statute of limitation. In fact, . . . the intent was to recognize the continued existence of the debt for purposes not inconsistent with the discharge of personal liability."[34]

Still before Division I is *Luu v. Rez.*[35] In *Luu*, the borrowers argue that *Stewart* did not analyze the impact of the discharge on commencing the statute of limitation and that the majority of the case's opinion is dicta. They instead want the Arizona Court to rely upon *Edmundson*'s dicta because it went beyond *Stewart* by analyzing the installment contract differences. As of this writing, *Luu* has not been decided but is fully briefed and under advisement as of November 10, 2021.

***Colorado*:** In *Silvernagel v. U.S. Bank,* the Colorado Court of Appeals unequivocally accepted *Jarvis*. Like Washington and Arizona, Colorado has a 6-year statute of limitation on debts and each installment has its own statute of limitation.[36] Relying entirely on *Edmundson* and *Jarvis,* the court stated that "(t)he division concludes that

[29] 11 U.S.C. § 522(c).
[30] *Merritt v. USAA Federal Savings Bank,* WA Court of Appeals, Division I, 82162-8-I.
[31] A.R.S. § 12-548(A)(1); *Navy Fed. Credit Union v. Jones*, 930 P.2d 1007, 1009 (Ariz. App. 1996); *Baseline Fin. Servs. V. Madison*, 278 P.3d 321, 322-323 (Ariz. App. 2021).
[32] *Diaz v. BBVA USA,* No. 2 CA-CV 2021-0046, 2021 Ariz. App. Unpub. LEXIS 1181 (Ct. App. Dec. 1, 2021)
[33] *Stewart v. Underwood,* 146 Ariz. 145, 704 P.2d 275 (Ct. App. 1985).
[34] *Diaz,* at *13 (Ct. App. Dec. 1, 2021).
[35] *Luu v. Rez*, 2021 Az. App. Ct., Case No. 1 CA-CV 21-0007.
[36] CRS 13-80-103.5(1)(a); *Igou v. Bank of Am., N.A.,* 459 P.3d 776, 2020 COA 15, ¶ 12 (citing *Castle Rock Bank v. Team Transit, LLC,* 292 P.3d 1077, 2012 COA 125, ¶¶ 22-23).

the discharge in bankruptcy of a borrower's personal liability on a debt commences the six-year limitations period during which the bank may foreclose on the deed given as security for the debt."[37] Since this opinion is relatively recent (October 2021), lenders in Colorado should expect increased litigation from borrowers attempting to clear their discharged liens from title.

***Nevada*:** Nevada is dissimilar to Washington in that Nevada has different standards and timelines for commencing a foreclosure action depending on if it is judicial or non-judicial enforcement. In *Ramanathan v. Bank of N.Y. Mellon*, the United States District Court of Nevada considered the effect of a bankruptcy discharge on both options for recovery and split their opinion, relying on *Jarvis* for one.[38]

In Nevada, there is no statute of limitations on proceeding with a non-judicial foreclosure under a deed of trust.[39] However, borrowers and third-party purchasers have attempted to use NRS 106.240, Nevada's equivalent of an "ancient lien" statute, to impose a timeline for enforcing a non-judicial foreclosure, arguing that a default automatically accelerates the debt such that a lender must foreclose within ten years after acceleration or face extinguishment of the deed of trust from title. The court in *Ramanathan* rationalizes that this statute means a debt becomes due only upon maturity or acceleration of the debt.[40] The court then confirmed that in the terms of NRS 106.240, that neither the bankruptcy discharge nor a lender's request for relief from the bankruptcy stay is an acceleration.[41]

The court then reviews the lender's claim for judicial foreclosure, which has a 6-year statute of limitation under NRS 11.190(1)(b). Relying exclusively on *Jarvis*, the court determined that the ability to commence a judicial foreclosure accrued when the debtor was discharged or the court lifted the bankruptcy stay because "(a)t that point, BONY knew or should have known that it had six years to pursue a judicial foreclosure based on the breach of the note and deed of trust."[42] In a footnote, the court states "my ruling does not mean that BONY is precluded from pursuing a non-judicial foreclosure because 'statutes of limitations only apply to judicial actions, and a nonjudicial foreclosure by its very nature is not a judicial action.'"[43]

This decision occurred in September of 2021 and no appeal was taken on this district court ruling. While this is not precedential, as we have learned from *Silvers* and *Jarvis*, a district court ruling can take on a life of its own. For now, it would seem the safest bet for enforcement of an aged debt in Nevada is to proceed non-judicially.

What Next?

Whether they call it an acceleration, early maturity, or "the result of discharge" the effect of continued reliance on *Edmundson*, *Jarvis*, and now *Luv* is the same – the courts have unilaterally modified bankruptcy code and the note and deed of trust to hold that a bankruptcy discharge starts the statute of limitations running on a lender's ability to foreclose. Perhaps it will take a lender, relying on the manufactured "acceleration" caused by these rulings, to foreclose on a borrower who wants to continue making monthly payments post-discharge, for the courts to realize the effect of their haphazard application of the law. Alternatively, perhaps the U.S. Supreme Court will take issue with the judicial modification of the bankruptcy code as more states adopt *Jarvis.* Until then, we will continue to watch the spread of *Edmundson* and *Jarvis*, and how it affects loans in Washington and nationwide.

How Can Loan Servicers and Investors Limit Their Exposure?

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[37] *Silvernagel v. US Bank Nat'l Ass'n, No.* 20CA1035, 2021 Colo. App. LEXIS 1441, at *1 (App. Oct. 21, 2021).
[38] *Ramanathan v. Bank of N.Y. Mellon,* No. 2:19-cv-02009-APG-EJY, 2021 U.S. Dist. LEXIS 188265 (D. Nev. Sep. 30, 2021).
[39] *Facklam v. HSBC Bank USA*, 133 Nev. 497, 401 P.3d 1068 (2017).
[40] *Ramanathan*, at *8-9 (D. Nev. Sep. 30, 2021).
[41] *Ramanathan,* at *9 (D. Nev. Sep. 30, 2021). This appears consistent with Nevada case law requiring some affirmative conduct on the party of the lender to accelerate a debt. *See Clayton v. Gardner*, 107. Nev. 468, 813 P.2d 997 (1991) (quoting *U.S. v. Feterl*, 849 F.2d 354, 357 (8th Cir. 1988) ("acceleration is seldom implied, and courts usually require that an acceleration be exercised in a manner so clear and unequivocal that it leaves no doubt as to the lender's intention…").
[42] *Ramanathan,* at *15 (D. Nev. Sep. 30, 2021).
[43] *Ramanathan,* at *15 n.5 (D. Nev. Sep. 30, 2021)(citing *Facklam v. HSBC Bank USA*, 401 P.3d 1069 (2017)).

The rulings in *Edmundson*, *Jarvis* and *Luv* put loan servicers and investors at significant risk. Not only do these rulings potentially bar enforcement of the loan; but they can also expose loan servicers to federal and state fair debt collection practices and other statutory violations. With regards to the latter, we have already seen several claims by borrowers alleging that demanding amounts barred by *Edmundson,* et. al. violates the FDCPA and local consumer protection statutes. These cases argue that just demanding, not enforcing, money that is not owed (as a result of *Edmundson,* et.al.) is misleading and deceptive.[44]

Below are some suggestions that loan servicers can take to limit potential exposure (not just in Washington, but across the Country):

1. Audit your existing loan portfolios to identify any loans that are over 6 years past due where the loan was discharged in bankruptcy;
2. Audit new loan portfolios to identify the same loans;
3. Develop a company policy on how to handle loans that are discharged in bankruptcy;
4. Develop procedures that "red flag" loans that are discharged in bankruptcy and, track the applicable statute of limitations running from the date of discharge if enforcement is not going to be pursued;
5. Document borrower's post-discharge reaffirmation of the debt, i.e., monthly payments, loan modifications, etc.; and
6. Consult with counsel before making any demands[45] or initiating foreclosure on any loans where there may be a statute of limitations issue following the borrower's discharge.

What else can investors do to protect themselves:

1. Work with their loan servicers on the items identified above; and
2. Audit prospective loan pools for potential statute of limitations issues prior to bidding on the pool.

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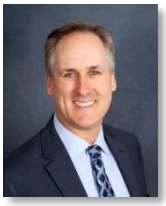

[44] *See Stimpson v. Midland Credit Mgmt.*, 944 F.3d 1190, 1200 (9th Cir. 2019); *Eng v. Specialized Loan Servicing,* No. 82378-7-I, 2021 Wash. App. LEXIS 2909 (Ct. App. Dec. 13, 2021) (pending publication).

[45] Another recent Washington case has deemed the demand of time barred installments without making it clear what portion of the payments are time barred and which are still recoverable, misleading to consumers and opening servicers up to liability under the Washington Consumer Protection Act. *Eng v. Specialized Loan Servicing,* No. 82378-7-I, 2021 Wash. App. LEXIS 2909 (Ct. App. Dec. 13, 2021) (pending publication); *see also Stimpson v. Midland Credit Mgmt.*, 944 F.3d 1190, 1200 (9th Cir. 2019).