



SO ORDERED.

SIGNED this 10 day of February, 2006.

Dale L. Somers

Dale L. Somers
UNITED STATES BANKRUPTCY JUDGE

**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF KANSAS**

In re:

**DANIEL LEE ROSS and
MARY GINA ROSS,**

DEBTORS.

**CASE NO. 05-42544
CHAPTER 7**

**MEMORANDUM AND ORDER GRANTING
TRUSTEE'S OBJECTION TO EXEMPTION OF TRUTH-IN LENDING ACT CLAIM**

The matter before the Court is the Trustee's Objection to Debtors' Amended Exemptions¹ in which they claim as exempt "possible TILA [Truth in Lending Act]² violations on 1st & 2nd Mortgage" pursuant to K.S.A. 60-2301, the Kansas homestead exemption.³ The Trustee, Robert

¹ Doc. 27.

² 15 U.S.C.A. §§ 1601, *et. seq.*

³ Doc. 23.

L. Baer, appears by John T. Houston, Cosgrove, Webb & Oman. The Debtors, Daniel Lee Ross and Mary Gina Ross, appear by their counsel Dan M. McCulley, Hornbaker, Alterhoffen, McCulley & Alt, Chartered. There are no other appearances. The Court has jurisdiction.⁴

At the request of the parties, the matter has been submitted on the briefs.⁵ The Court, having studied the briefs and conducted its own research, sustains the objection.

The property at issue is a potential, but as yet undetermined, claim that the Debtors' mortgage lender violated the Federal Truth in Lending Act (TILA) because of failure to deliver multiple copies of the Notice of Right to Rescind. Debtors contend that the statutory penalties imposed for violation of TILA "are so intertwined with the equity of the Debtors in their homestead" that the claim is exempt. Debtors' primary authority is *In re Stroble*,⁶ in which Judge Berger of this court held that a settlement awarded in an unfair and deceptive mortgage practices class action lawsuit was exempt under the Kansas homestead exemption. The Trustee asserts that *Stroble* is distinguishable, that the TILA claim is unrelated to damage to Debtors' homestead, and that exemption of the claim would not further the purpose of the Kansas homestead exemption.

⁴ An objection to a claim of exemption is a core proceeding. 28 U.S.C.A. § 157(b)(2)(B). This Court has jurisdiction pursuant to 28 U.S.C.A. § 157(a) and §§ 1334(a) and (b) and the Standing Order of the United States District Court for the District of Kansas that exercised authority conferred by § 157(a) to refer to the District's Bankruptcy judges all matters under the Bankruptcy Code and all proceedings arising under the Code or arising in or related to a case under the Code, effective July 10, 1984. There is no objection to venue or jurisdiction over the parties.

⁵ See Docs. 22, 36, & 38.

⁶ No.03-24926-7 (Bankr. D. Kan. Sept. 7, 2005)(Berger, J.).

"Congress enacted the TILA to regulate the disclosure of the terms of consumer credit transactions in order 'to aid unsophisticated consumers and to prevent creditors from misleading consumers as to the actual costs of financing.'"⁷ "To encourage lender compliance, TILA violations are measured by a strict liability standard, so even minor or technical violations impose liability upon the creditor."⁸ A consumer may recover actual damages, statutory damages, costs, and attorney fees.⁹ In addition, in some TILA transactions involving loans secured by a consumer borrower's principal dwelling, the consumer may have a right to rescind the transaction,¹⁰ for up to three years after the date of consummation, if the lender fails to give the required disclosure and notice of the right to rescind.¹¹ In the event of rescission, any security interest given by the consumer is void, and the consumer is not liable for finance charges, interest, and other charges, such as closing costs and broker fees.¹² A court may order that amounts awarded to the consumer be offset from the principal amount of the loan for which the consumer remains liable notwithstanding the rescission.¹³ The creditor's lien in the financed property is not released until the consumer has paid the post-rescission obligation.¹⁴

⁷ *Merriman v. Beneficial Mortgage Co. of Kansas, Inc. (In re Merriman)*, 329 B.R. 710, 714 (D.Kan. 2005) (quoting *Morris v. Lomas & Nettleton Co.*, 708 F. Supp. 1198, 1203 (D. Kan. 1989).

⁸ *Id.*, 329 BR. at 715.

⁹ 15 U.S.C.A. §§ 1640(a)(1), (a)(2)(A), & (a)(3).

¹⁰ 15 U.S.C.A. § 1635(a).

¹¹ 15 U.S.C.A. § 1635(f).

¹² 15 U.S.C.A. § 1635(b).

¹³ *In re Merriman*, 329 B.R. at 717-18.

¹⁴ *In re Merriman*, 329 B.R. at 727.

In a chapter 7 case, all prepetition causes of action held by the debtor are property of the estate under 11 U.S.C.A. 541(a).¹⁵ TILA claims are included in this rule.¹⁶ Absent a showing that the claim is exempt or was abandoned by the trustee, the debtor lacks standing to bring a TILA action that arose before filing.¹⁷ This Court's ruling on the exemption question therefore determines not only ownership of the proceeds from settlement or litigation of the TILA claim, but also who has standing to pursue the matter. Courts have found some causes of action against creditors for wrongful lending practices exempt under wildcard statutes and have held that the exemption, even if partial, sufficient to confer standing upon the debtor to pursue that action. In this circumstance, however, the estate retains an interest in the claim if it has value above the exempt amount, thereby retaining the trustee's standing to conduct *In re Polis*, 217 F.3d at 904. the litigation. For example, a claim alleging bad-faith banking practices and outrage was held exempt up to the value of \$7,900 under the West Virginia state wild card exemption statute.¹⁸ As to standing, the court held the debtors could bring the action because of the exemption, but the

¹⁵ See *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 205 n.9 (1983) (estate property includes causes of action). This case was filed before October 17, 2005, when most provisions of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 become effective. All statutory references to the Bankruptcy Code are to 11 U.S.C.A. §§ 101 - 1330 (2004), unless otherwise specified. Future references to the Code in the text shall be to the Code section only. Any references to the Federal Rules of Bankruptcy Procedure are to Fed. R. Bankr. P. (2004), unless otherwise specified.

¹⁶ *Polis v. Getaways, Inc. (In re Polis)*, 217 F.3d 899, 902 (7th Cir. 2000); and *Rowland v. Novus Fin. Corp.*, 949 F. Supp. 1447, 1443 (D. Haw. 1996).

¹⁷ *Rowland v. Novus Fin. Corp.*, 949 F. Supp. at 1453-54.

¹⁸ *Wissman v. Pittsburgh Nat. Bank*, 942 F.2d 867 (4th Cir. 1991)

trustee should have an opportunity to intervene in the action because of the estate's interest in any recovery above the exempt amount.¹⁹

In *Stroble*, the case relied upon by the Debtors, Judge Berger held that \$950.83 exempt under the Kansas homestead law where the funds were received in settlement of a class action suit initiated by officials of fifty states and the District of Columbia.²⁰ The settlement resolved "concerns about unfair and deceptive mortgage lending practices raised by an investigation into the lending practices of [debtors'] mortgage lender."²¹ The court reasoned that the moneys were restitution "for abusive mortgage lending practices regarding loan points and origination fees, interest rates, monthly payment amounts, prepayment amounts, balloon payments, etc.,"²² which, if not charged, would have increased the debtors' equity in their exempt homestead. Equitable considerations were found to warrant application of the doctrine of equitable conversion. The exemption was allowed because denial would have been "incongruous with the Kansas homestead exemption's basic applied effect of protecting equity in the homestead."²³

¹⁹ *Id.* at 873; see *In re Polis*, 217 F.3d at 904 (holding when a debtor was entitled to claim up to \$900 of a TILA claim as exempt under the Illinois wildcard statute, the exemption conferred standing on the debtor to bring a class action suit; but, because of the trustee's lack of interest in suing the creditor, the court would decline to examine the question of whether the debtor or the trustee should control the litigation).

²⁰ *In re Stroble*, sl. op. at 2.

²¹ *Id.* at 2.

²² *Id.* at 5.

²³ *Id.*

This Court finds the reasoning of *Stroble* convincing as to proceeds from claims relating to abusive lending practices which increased the cost of credit secured by a homestead and where the recovery is applied to the debt secured by the homestead. However, the posture of this case is materially different from *Stroble*, and the Court declines to hold the TILA claim described by Debtors exempt under the authority of *Stroble*. In *Stroble* the issue was the exemption of known proceeds for specific wrongful lending practices from the settlement of a class action initiated by government officials. Here the exemption is claimed in a cause of action, where the litigation has not been commenced and perhaps no demand has been made against the creditor. In *Stroble* the elements of the recovery were known. Here, the Debtors have provided no details as to the recovery they seek or about the transactions, other than to allege in their brief that the "lender failed to deliver multiple copies of the Notice of the Right to Rescind."²⁴ It would appear that Debtors hope to rescind one or more consumer transactions, but the transactions are not identified, and neither the elements of such a claim nor the remedies sought are disclosed.

As pointed out by the Trustee, some of the remedies permitted by TILA, such as statutory damages, have to do with what the lender failed to do, not any damage suffered by the debtors in their homestead. Other damages, such as the actual damages and attorney fees and costs, have to do with personal loss to the Debtors, not damage to the homestead. It appears unlikely to this Court, if the issue were presented, that a debtor's claim of homestead exemption for such damages would survive an objection. On the other hand, if the TILA remedy of rescission were ordered and a court were to hold that the Debtors were entitled to credit against the principal

²⁴ Doc. 36.

debt secured by the homestead of the finance changes, interest, and so forth, such an order would increase the Debtors' equity in the homestead. It appears more likely, if that issue were presented, that a court would hold that such an increase in equity would come within the purpose of the Kansas homestead exemption. In other words, there is a likelihood that the Debtors' TILA claim has both exempt and nonexempt aspects, which, as examined above, raises issues as to the ownership of the claim, standing, and control of litigation. Neither the Debtors nor the Trustee has briefed these issues. The Court does not wish to rule on the issue of partial exemption and questions relating to control of litigation without input from the parties.

For the forgoing reason, the Court sustains the Trustee's objection to the Debtors' claimed homestead exemption for "possible TILA violations on 1st & 2nd Mortgage." Such denial is without prejudice to the Debtors' amendment of their claimed exemption consistent with this opinion, in which case, if the Trustee objects, the Court will expect the Debtors and the Trustee to address the issues identified in this opinion.

The foregoing constitute Findings of Fact and Conclusions of Law under Rule 7052 of the Federal Rules of Bankruptcy Procedure and Rule 52(a) of the Federal Rules of Civil Procedure. A judgment based upon this ruling will be entered on a separate documents as required by Federal Rule of Bankruptcy Procedure 9021 and Federal Rule of Civil Procedure 58.

IT IS SO ORDERED.

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