FOR PUBLICATION

UNITED STATES BANKRUPTCY COURT

EASTERN DISTRICT OF CALIFORNIA

In re:	) Case No. 09-28900-C-7
JESTINA PICKETT,	)
Debtor.	)

OPINION REGARDING UNCLAIMED FUNDS UNDER 28 U.S.C. § 2042

CHRISTOPHER M. KLEIN, Bankruptcy Judge:

This unclaimed money situation is part of the hangover from the real estate bubble that burst into the Great Recession.

The chapter 7 trustee sold the debtor's over-encumbered real estate because no deed of trust was recorded, leaving the mortgagee with an unsecured claim. The trustee distributed $228,288.47 as the mortgagee's pro rata share but the check was not cashed. The funds are now on deposit in the Treasury.

The debtor and the mortgagee's servicer have filed competing petitions for payment of the unclaimed funds from the Treasury pursuant to 28 U.S.C. § 2042, which requires "full proof" of being the "rightful owner" who is "entitled" to the funds.

The debtor's petition poses the question whether a debtor can be a "rightful owner" and "entitled to" money distributed to a creditor under 11 U.S.C. § 726(a)(2) on account of an allowed claim solely because the creditor did not cash the trustee's distribution check. The answer is: no.

As to the servicer, has it provided "full proof" it is "entitled" to the funds? The answer is: not yet.

Facts

In May 2005, Jestina Pickett executed an Adjustable Rate Note promising to pay GreenPoint Mortgage Funding, Inc., $536,000 over 40 years, to be secured by a deed of trust on 424 East Heritage Drive, Mountain House, California. Proceeds were used by GreenPoint to pay itself $467,000 and release the deed of trust on a prior GreenPoint loan.

The note was endorsed to the order of Wells Fargo Bank, N.A. as Trustee for Structured Asset Mortgage Investments II Inc., GreenPoint Mortgage Funding Trust 2005-AR4, Mortgage Pass-Through Certificates, Series 2005-AR4.

JP Morgan Chase Bank-EMC, doing business under the name EMC Mortgage Corporation became the loan servicer.[1]

The title company handling the transaction released the former deed of trust but neglected to record a new deed of trust.

Ms. Pickett filed a chapter 7 case May 5, 2009, scheduling 424 East Heritage as worth $320,000, subject to $671,000 in mortgage debt. She did not reside there. None of her prior residences dating back to January 2006 were at 434 East Heritage.

She claimed 424 East Heritage as exempt under the 2009 version of California Code of Civil Procedure § 703.140(b)(1) in the amount of zero. And, she claimed only $1,950 of the $18,350 she could have exempted "in any property" under § 703.140(b)(5),[2]

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[1]For clarity in the face of the prestidigitation in the structured finance industry, JP Morgan Chase-EMC is referred to in this opinion by the misnomer "mortgagee." Formally, it is the servicer and Specialized Loan Servicing LLC is subservicer.

[2]California opted out of the § 522(d) federal exemptions but cloned them by enacting Cal. Code Civ. P. § 703.140(b). In re Petruzzelli, 139 B.R. 241, 244 (Bankr. E.D. Cal. 1992).

leaving $16,400 in exemptions "in any property" unclaimed.

In her Statement of Intention, she said she planned to retain 424 East Heritage and "reaffirm at market value," but the mortgagee did not agree to reaffirm.

Discharge was entered, and the case was closed August 14, 2009, as a routine no-asset case.

The case was reopened in 2012 when it was discovered that no deed of trust was recorded.[3] The chapter 7 trustee marketed and sold the property free and clear of liens for $292,000.[4]

Although the debtor could have amended her claim of exemptions in the reopened case to include the extra $16,400 "in any property" available under state law, she did not do so.

JP Morgan Chase-EMC, the loan servicer, filed a timely proof of claim for $671,000. There was no objection to the claim, which was allowed and paid to the extent permissible.

The chapter 7 trustee ultimately distributed 34 percent pro rata on allowed unsecured claims under § 726(a)(2), leaving $459,472.22 in claims discharged without payment.

The trustee's check to JP Morgan Chase-EMC for $228,288.47 was not cashed.[5] As required by 11 U.S.C. § 347(a), the trustee

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[3]The reopening motion papers include a declaration from the chapter 7 trustee describing the circumstances. Motion of United States Trustee to Reopen Case. Dkts. #23 & 24 (March 21, 2011).

[4]The trustee describes tussle with the mortgagee for control of the property in his Narrative Supplement to Trustee's Final Account. There apparently was much jawboning, some activity in state court, including a lis pendens filed by the mortgagee, but no adversary proceeding. Dkt. #61 (Feb. 3, 2012).

[5]The trustee notes his understanding that the mortgagee was concerned that it not "jeopardize insurance claim recovery." Trustee's Narrative. Dkt. #61, at 3 (Feb. 3 2012)

stopped payment and paid that amount into court on June 19, 2012.

The Clerk of Court, pursuant to 28 U.S.C. § 2041, deposited $228,288.47 with the Treasurer of the United States "in the name and to the credit" of the court.

After five years, in accordance with 28 U.S.C. § 2042, the Clerk of Court deposited that sum in the Treasury "in the name and to the credit of the United States," where it now reposes.

Brighton Capital Corporation, an unclaimed funds finder, contracted with the debtor in 2019 to assist her in obtaining the funds in exchange for $43,374.80.

Upon reviewing the petition presented by Brighton, this court ordered that there be a hearing on notice to the United States attorney with a view to "full proof" that the debtor is "entitled" to the funds. This court also ordered that notice be directed to the agent for service of process of JP Morgan Chase.

Specialized Loan Servicing LLC emerged to file an opposition to the debtor's petition, asserting it is the authorized servicer of the loan, and countered with a request that the $228,288.47 be paid to it for the benefit of the loan's beneficiary.

The United States attorney did not take a position.

Faced with competing petitions, this court issued a scheduling order, fixed a discovery deadline in the contested matter, and proceeded toward an evidentiary hearing.

Jurisdiction

Jurisdiction is founded on 28 U.S.C. §§ 1334(a) & (e)(1). This is a core proceeding a bankruptcy judge may hear and determine. 28 U.S.C. § 157(b)(2)(A).

This court retains exclusive jurisdiction over bankruptcy case funds deposited in the Treasury as a custodial escheat pursuant to 28 U.S.C. § 2042 that are held "in the name and for the credit of the United States" subject to the requirement of a court order for payment. The funds in a status of custodial escheat have not been abandoned pursuant to 11 U.S.C. § 554 and retain their character as property of the estate subject to exclusive bankruptcy jurisdiction. 28 U.S.C. § 1334(e)(1).

Discussion

It is undisputed that the $671,000 allowed claim was valid, that claims required to be paid under § 726(a)(2) were not paid in full, and that no funds were abandoned.

I

Statutes Applicable to Unclaimed Funds

Bankruptcy Code § 347(a) requires that 90 days after a final distribution under §§ 726, 1194, 1226, or 1326, the trustee shall stop payment on any check remaining unpaid and any remaining property of the estate shall be paid into the court and disposed of under chapter 129 of title 28. 11 U.S.C. § 347(a).

Chapter 129 of title 28 consists of only two provisions: §§ 2041 and 2042.

Deposit of moneys in pending or adjudicated cases is governed initially by 28 U.S.C. § 2041:

> All moneys paid into any court of the United States, or received by the officers thereof, in any case pending or adjudicated in such court, shall be forthwith deposited with the Treasurer of the United States or a designated depositary, in the name and to the credit of such court.

> This section shall not prevent the delivery of any such money to the rightful owners upon security, according to the agreement of parties, under the direction of the court.

28 U.S.C. § 2041.

The withdrawal provision has two independent aspects embedded in 28 U.S.C. § 2042 - the requirement of court order to withdraw funds and the requirement of custodial escheat:

> No money deposited under section 2041 of this title shall be withdrawn except by order of court.
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> In every case in which the right to withdraw money deposited in court under section 2041 has been adjudicated or is not in dispute and such money has remained so deposited for at least five years unclaimed by the person entitled thereto, such court shall cause such money to be deposited in the Treasury in the name and to the credit of the United States. Any claimant entitled to any such money may, on petition to the court and upon notice to the United States attorney and full proof of the right thereto, obtain an order directing payment to him.

28 U.S.C. § 2042.

Key terms distilled from these provisions are "rightful owner" and "entitled to" and "full proof of the right thereto."

Case law clarifies that proof requires proof of a "present entitlement" to funds. E.g., In re Pena, 600 B.R. 415, 421-22 (9th Cir. BAP 2019), aff'd, 974 F.3d 934 (9th Cir. 2020).

In the meanwhile, the funds in custodial escheat in the Treasury retain their status as property of the estate because they have not been abandoned and continue within the exclusive jurisdiction of the bankruptcy court. 28 U.S.C. § 1334(e)(1).

II

Debtor's Theories

The debtor's principal legal theory is that years of inaction by JP Morgan Chase-EMC amounts to withdrawal or

abandonment of the claim, with the asserted consequence that the estate has become a so-called "surplus" estate in which the debtor is entitled to a distribution under § 726(a)(6).

A

The flaw in the debtor's logic about § 726(a)(6) is that it assumes away the adjudication inherent in the allowance of the proof of claim. The allowance and payment of $228,288.47 on the $671,000 claim, to which there was no objection, operated as an adjudication, within the meaning of § 2042, that JP Morgan Chase-EMC is entitled to be paid up to $671,000.

To be sure, it is possible, even at this late date, to reconsider and disallow a claim for "cause" according to the equities of the case. 11 U.S.C. § 502(j); Fed. R. Bankr. P. 3008 & 9024. But no motion has been made and equities are dubious.

As the Collier treatise authors note, it is not clear whether a trustee or debtor may seek to have a claim disallowed and the funds reallocated if a check is unclaimed for a long period of time or a creditor cannot be located during a case. 3 Collier on Bankruptcy ¶ 347.02 (Richard Levin & Henry J. Sommer, eds., 16th ed.). What should be clear, however, is that a chapter 7 debtor cannot leapfrog unpaid creditors in the § 726 distribution regime.

At a minimum, there must be some reason to depart from the norm established by the statute. Here, none suggests itself. JP Morgan Chase-EMC has suffered the indignity of demotion to unsecured status and having to share pro rata with less privileged creditors, but no question has been raised about the

merits of the claim itself. Whatever else "cause" may mean in § 502(j), creditor sloth does not qualify as § 502(j) "cause."

Unless the JP Morgan Chase-EMC $671,000 claim is either withdrawn or disallowed, it is impossible for the § 726 waterfall to yield a "surplus" distribution to the debtor per § 726(a)(6).

The fact that JP Morgan Chase-EMC may have been reclining on its rights for nearly a decade is mere self-inflicted economic harm not affecting the merits of its claim. It could have been paid $228,288.47 in 2012 dollars, now it stands to be paid $228,288.47 in 2021 dollars.

B

The debtor argues that the case should not have been reopened in the first instance. The theory is that § 554(c) operated to abandon 424 East Heritage to the debtor and to deem it administered for purposes of § 350 when the bankruptcy case was first closed. 11 U.S.C. § 554(c).

However, property of the estate that was not abandoned by operation of § 554(c) included the unscheduled cause of action to avoid the defective secured interest on 424 East Heritage. That cause of action remained property of the estate after closing of the case. 11 U.S.C. § 554(d).

Moreover, what led to the case being reopened was the act of the debtor's agent - her bankruptcy counsel - informing the then-former trustee that the deed of trust had not been recorded. If she had done nothing, foreclosure loomed with no value for her.

Nobody questioned the reopening at the time. Nobody raised a § 554(c) technical abandonment issue. Nobody formally challenged

either the trustee's authority to administer and sell 424 East Heritage as property of the estate or this court's assertion of jurisdiction over the property. Nobody objected to closing the fully-noticed sale free and clear of liens. Title was transferred to buyers in a market transaction that would be inequitable to upset. The matter is final and beyond cavil.

C

The debtor also appeals to equity. She says that she should be entitled to the funds because the sale of her property is their source. That does not suffice to overcome the provisions of the Bankruptcy Code.

The protection for the debtor was her ability to exempt some of the sale proceeds. As noted, in the reopened case she could have amended her claim of exemptions to exempt $16,400 of the proceeds under the California Code of Civil Procedure § 170.140(b)(5) "in any property" on a no-questions-asked basis. Fed. R. Bankr. P. 1009(a); Goswami v. MTC Distrib. (In re Goswami), 304 B.R. 386, 392-93 (9th Cir. BAP 2003); cf. Martinson v. Michael (In re Michael), 163 F.3d 526, 529 (9th Cir. 1998) (right to amend includes exemptions). She did not do so.

In short, there is no dispute about validity of the $671,000 claim. There is no dispute that claims required to be paid under § 726(a)(2) were not paid in full. And, there is no basis to argue that the funds were in any way abandoned by the trustee.

The debtor cannot help herself to the property of a creditor merely because the creditor has not been paying attention.

III

Case Law

Reported cases regarding unclaimed funds, none of which is on all fours with this case, are consistent with this conclusion.

The Ninth Circuit decided an analogous unclaimed funds issue by ruling that rents are assets separate from the underlying properties. Pena, 974 F.3d at 939-40, aff'g 600 B.R. 415, aff'g No. 12-13170-A-7, Dkt. #707 (Bankr. E.D. Cal. Mar. 29, 2018).

It ruled in Pena that a debtor does not meet the burden of establishing his entitlement to funds by simply alleging that other parties are not entitled to them. Pena, 974 F.3d at 940.

In what the Ninth Circuit's Pena panel described as a "careful, well-reasoned opinion," the BAP's Pena decision detailed how a petitioner for funds must have a "present entitlement" to them and that, as between a debtor and unsecured creditors who have not been paid in full, unpaid creditors have the superior right. Pena, 600 B.R. at 422-24.

There cannot be a "surplus" entitled to distribution to the debtor under § 726(a)(6) when unpaid claims remain. Pena, 974 F.3d at 940. That is the situation here.

Petitioners for unclaimed funds have the burden of proof of present entitlement to receive the funds. E.g., Pena, 600 B.R. at 421-22; In re Percolla, 2008 WL 1969584, at *3-4 (Bankr. E.D. Cal. 2008). The debtor has not carried her burden of proof.

It has also been held that a chapter 11 debtor cannot capture unclaimed funds when the terms of the confirmed chapter 11 plan prohibit equity security holders from receiving a distribution before all higher priority classes are paid. In re

Connor Corp., 2008 WL 2414316, at *2 (Bankr. E.D.N.C. 2008).

That is the situation here; according to the trustee's Final Account, $459,472.22 was discharged without payment. There could be no distribution to the debtor under § 726(a)(6) until those unpaid claims are dealt with.

IV

Specialized Loan Servicing LLC

Specialized Loan Servicing LLC has presented copies of the debtor's signed promissory note, the cover page to the Subservicing Agreement (Non-Agency Securitized Loans) between JP Morgan Chase Bank, National Association, as Servicer and Specialized Loan Servicing LLC as Subservicer Effective as of November 6, 2014, and a Notice of Servicing Transfer addressed to the debtor dated December 8, 2014.[6]

It also has represented that it would be satisfactory if this court were to order that payment from the Treasury be made to the order of JP Morgan Chase-EMC, as stated on the allowed proof of claim. This provides some assurance that Specialized Loan Servicing LLC is not an imposter.

Two difficulties, however, fall short of "full proof" within the meaning of § 2042.

First, the text of the Subservicer Agreement is not provided. Counsel for Specialized Loan Servicing LLC asserted in

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[6]Why would Specialized Loan Servicing LLC address a "we-are-your-new-loan-servicer" communication to a discharged debtor regarding a debt that is not supported by a lien? See 11 U.S.C. § 524(a)(2). JP Morgan Chase-EMC and Specialized Loan Servicing LLC might have explaining to do.

open court that the text is "privileged" without articulating any basis for privilege.

This court doubts that there is an applicable evidentiary privilege independent of a court's plenary ability to protect confidential commercial and financial information from public disclosure. See, e.g., 11 U.S.C. § 107(b)(1); Fed. R. Civ. P. 26(c), incorporated by Fed. R. Bankr. P. 7026.

Moreover, this court has had the experience of a lawyer for a servicer confidently asserting in open court that a servicing contract authorized "X", then after being forced to produce the contract it turned out to forbid "X". Once bitten, twice shy.

"Full proof" for purposes of § 2042 requires producing the full text of the Subservicing Agreement.

Second, the trustee's Narrative Supplement to Trustee's Final Account, Dkt. # 61, alludes to his understanding that the mortgagee was reluctant to release its lis pendens and to agree to the sale of 424 East Heritage out of concern that such "would jeopardize insurance claim recovery."

If there was an insurance claim recovery on account of a title company's failure to record a deed of trust, then it follows that the insurer may have subrogation rights that affect the requirement of "present entitlement." "Full proof" for purposes of § 2042 requires demonstration that there is not a competing subrogation claim.

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For the reasons stated in this decision, which contains findings of fact and conclusions of law:

The debtor's petition for payment of $228,288.47 from the Treasury will be DENIED with prejudice. The application of Specialized Loan Servicing LLC will be DENIED without prejudice to being renewed upon demonstration of the actual terms of the Subservicing agreement with JP Morgan Chase Bank, N.A. and upon demonstration that no insurer has competing rights.

An appropriate separate order will issue.

Dated: August 11, 2021

United States Bankruptcy Judge