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Colo. Bankruptcy Ruling Clarifies Debt Collection Rules

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On April 24, the Colorado Supreme Court issued its highly anticipated decision in U.S. Bank National Association v. Silvernagel.

The decision made Colorado the latest state to recognize that a borrower's bankruptcy discharge does not accelerate secured installment debt or trigger the final statute of limitations period to recover the debt.

The opinion provided needed clarity on Colorado's debt collection statute of limitations commencement rules.

Over the last several years, borrowers have increasingly filed quiet title and declaratory judgment complaints in Colorado, Arizona and Washington courts, alleging their bankruptcy discharge matured their secured installment loans — typically first and second position mortgages on the borrowers' real estate — and started the respective states' foreclosure clock.

As background, these three states are similar in that their six-year statutes of limitations to collect a loan's installment payment starts running the month that the installment comes due. In other words, the lender or servicer has six years to collect that missed payment through a collection action or foreclosure.

The limitations period to collect subsequent, future monthly installments commences each month until the loan fully matures. A loan's maturity date — typically 15 or 30 years from the date the loan originated — is generally set out in the loan's promissory note and security instrument, i.e., the deed of trust or mortgage recorded against the property.

Each state also allows the lender to accelerate the loan's maturity date early through an affirmative act that clearly and unequivocally notifies the borrower it accelerated the debt. Through acceleration, the lender avoids needing to pursue the borrower separately for each single missed payment.

The Colorado, Arizona and Washington borrowers' theory that their bankruptcy discharge constituted a sufficient action to accelerate their loans' maturity date and trigger the final limitations period originated from a line of cases out of Washington, starting with Edmundson v. Bank of America in the Court of Appeals of Washington, Division

One, in 2016.

Edmundson stated in dicta that the statute of limitations for monthly installments stops accruing when “the [borrower] no longer [has] personal liability under the note.”

From this language, subsequent Washington federal and state cases interpreted Edmundson’s holding to mean that the final statute of limitations period to collect on the loan must commence with the last payment due before the borrower obtains his or her bankruptcy discharge.

The Colorado Court of Appeals in Silvernagel found these Washington opinions persuasive.

The appellate court held that Colorado’s six-year statute of limitations to enforce the borrower’s mortgage loan debt began running upon the borrower’s bankruptcy discharge in 2012.

Because six years lapsed since the purported statute of limitations commencement date, the court determined the lender was barred from enforcing the debt in any manner.

But after the court of appeals issued its decision in Silvernagel, both Arizona and Washington rejected the borrowers’ bankruptcy discharge arguments and the various courts’ erroneous interpretation of Edmundson.

Specifically, Arizona’s First and Second Court of Appeals Divisions determined in 2022 in Diaz v. BBVA USA and Luu v. Newrez LLC that a borrower’s bankruptcy discharge does not trigger the final statute of limitations period to foreclose an Arizona deed of trust that passes through bankruptcy.

And in 2022, the Washington Court of Appeals explained in Copper Creek (Marysville) Homeowners Association v. Kurtz and Merritt v. USAA Federal Savings Bank that it was error for Washington courts to interpret Edmundson as holding a bankruptcy discharge accelerates debt and triggers the final statute of limitations period to foreclose.

The Washington Court of Appeals confirmed that a bankruptcy discharge does not constitute sufficient evidence the lender intended to accelerate the debt and thereby start the foreclosure clock. It also stated that “[n]o Washington Supreme Court case has established such a rule.”

Now, the Colorado Supreme Court has spoken in its pivotal Silvernagel decision, in which it follows Arizona and Washington’s recent precedent. The decision is the final determination of the issue for Colorado lenders and borrowers.

In the Silvernagel opinion, the Colorado Supreme Court reversed its appellate court’s decision, holding a bankruptcy discharge cannot trigger acceleration or the running of the statute of limitations for installment payments that have not come due in Colorado.

In reaching its conclusion, the court explained that a payment under a security agreement comes due on the date specified in the note or deed of trust in Colorado. Accordingly, the statute of limitations period to collect a payment does not commence until the borrower misses each periodic payment.

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Promissory notes or deeds of trust with optional acceleration clauses allow the lender to accelerate any future payments' due date, but the lender "must perform some clear, unequivocal affirmative act evidencing [its] intention to take advantage of the acceleration provision."

When the lender triggers the acceleration provision, all remaining payments become immediately due and the lender's cause of action for the entire debt accrues. The lender then has six years to enforce the debt before the statute of limitations period runs.

The Colorado Supreme Court went on to determine that a borrower's bankruptcy discharge does not constitute a clear, unequivocal affirmative act evidencing the lender's intent to accelerate.

It reasoned that, "by allowing [the borrower] to unilaterally accelerate the due date of his payments through bankruptcy, the [court of appeals] effectively grafted a new provision onto the contract."

The Colorado Supreme Court also explained that, although the bankruptcy discharge extinguished the lender's ability to enforce the debt against the borrower, it left intact the lender's ability to collect the debt in rem through foreclosure. This is commonly referred to as passing through bankruptcy.

Therefore, the debt itself survives bankruptcy, and the lender can enforce the deed of trust through foreclosure within six years after the maturity date or the lender's acceleration.

The Colorado Supreme Court's Silvernagel opinion, as well as the Arizona and Washington appellate court decisions, give lenders with loans secured by properties in these states breathing room to pursue foreclosure after their borrowers receive a bankruptcy discharge.

This can be especially helpful in situations where decreased property values make the loan undersecured and the lender is unlikely to recover all or part of the loan unless it waits for better market conditions.

The decisions also avoid the inequitable result of a lender having to pursue foreclosure to avoid the debt becoming time-barred, despite the borrower voluntarily making post-discharge loan payments. And the rule gives lenders the opportunity to explore loss mitigation options without having to rush to foreclose.

The Washington appellate court opinions in Copper Creek and Merrit are currently before the Washington Supreme Court for review. Accordingly, the fate of Washington's statute of limitations commencement rule remains to be determined.

The Washington Supreme Court heard oral argument in February, so we may see a decision before the end of the summer.

The borrowers in the Arizona Diaz and Luu cases did not petition the Arizona Supreme Court for review.

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Disclosure: Edwards and Balser represented the loan servicers in the Diaz and Luu cases.

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