

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF NEW YORK

In re

MARTHA J. LEGAULT

Case No. 01-16175

Debtor

MARTHA J. LEGAULT

Plaintiff

-against-

Adversary No. 02-90169

FULL SPECTRUM LENDING, INC.

Defendant

APPEARANCES:

PAUL M. FISCHER, ESQ.
Attorney for Plaintiff
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Canton, New York 13617

ESCHEN & FRENKEL, LLP
Attorneys for Defendant
93 East Main Street
Bay Shore, New York 11706

Hon. Robert E. Littlefield, Jr., U.S. Bankruptcy Judge

MEMORANDUM-DECISION AND ORDER

The current matters before the court are motions for summary judgment regarding the validity of a mortgage lien held by Full Spectrum Lending, Inc. (“Creditor” or “Defendant”). The court has jurisdiction pursuant to 28 U.S.C. §§ 157(b)(2)(k) and 1334.

FACTS

Based on the pleadings of the parties and the exhibits submitted, the following facts are not in dispute:

1. Martha Legault (“Debtor” or “Plaintiff”) filed a petition under chapter 13 on October 2, 2001.
2. The Association for Neighborhood Rehabilitation, Inc. (“ANR”) and the Plaintiff entered into an agreement, dated May 11, 1999, which provided \$23,187 for the repair of certain premises known as 189 Dezell Road, Lisbon, New York.
3. The agreement is delineated “Agreement - ANR Rehabilitation Grant” (“ANR Grant”).
4. The ANR Grant was recorded in the St. Lawrence County Clerk’s office on February 22, 2000 at Instrument No. 2000-00003191.
5. The County Clerk’s office identifies the ANR Grant as a mortgage in the amount of \$23,187.
6. Defendant is a secured creditor of the Plaintiff by way of a note and mortgage executed by the Plaintiff on September 21, 2000 evidencing a debt in the principal sum of \$26,000.
7. Defendant’s note is secured by a lien on premises known as 189 Dezell Road, Lisbon, New York.
8. Defendant recorded its mortgage in the St. Lawrence County Clerk’s office at Instrument No. 2000-20355 on the 13th day of October, 2000.

ARGUMENTS

The Defendant argues that the ANR Grant is not a true mortgage because the Plaintiff is not required to make any payments; the Debtor is only required to reside at the subject residence for six years from the origination date of the loan.¹ The ANR Grant would then be forgiven, and the cost to

¹In its motion for summary judgment, Defendant states that the Debtor’s chapter 13 plan will be completed after the six year provisional period terminates. However, the Debtor filed the petition on October 2, 2001 with a plan term of 36 months. If the Debtor’s plan payments commenced within 30 days of plan filing as required by 11 U.S.C. § 1326(a)(1), then the plan would be completed prior to the provisional six year time frame referred to in the ANR Grant.

Plaintiff would be zero. Plaintiff would thus receive a windfall at Defendant's expense by avoiding the mortgage lien of Defendant while at the same time paying nothing toward the ANR Grant. In effect, the property would be placed in the Debtor's hands gratis except for the real property taxes. Thus, the Defendant states that its lien is the only true mortgage² on the property and, as such, should be accorded a first priority on the title. Any other interpretation would be contrary to the legislative intent of §§ 506(a) and 1322(b)(2).³

The Plaintiff argues that questions regarding valuation and priority of liens are determined as of the bankruptcy filing date. As of that date, the ANR lien was first in time and therefore would be accorded a first position against the property in any chain of title. Any junior liens would thus be susceptible to lien avoidance in accordance with *In re Pond*, 252 F. 3d 122 (2nd Cir. 2001).

DISCUSSION

This case presents an interesting twist to the standard *Pond* dilemma faced by junior lien interests. When a chapter 13 petition is filed, junior liens on residential real property are subject to avoidance if there is not some equity that may attach to that mortgage. *Pond* 252 F.3d at 126. Ordinarily, when a creditor agrees to make a loan secured by property already encumbered by a first mortgage, that creditor goes into the relationship knowing it is in a junior position and accepting the potential ramifications. In the instant controversy, however, the Defendant apparently believed it was

²Defendant's argument that ANR does not hold a true mortgage is centered on the grant's provisional repayment terms and not the language of the grant itself. Defendant's position is inconsistent in that even though Defendant argues it holds the only mortgage, it refers in its motion for summary judgment to the ANR "mortgage" (¶ 12) and ANR's "lien" (¶¶ 19, 24).

³Defendant does not cite to any specific provision of legislative intent.

not in a subordinate position even though the Defendant's refinancing proceeds satisfied only two of the three existing mortgages of record. The ANR obligation was not satisfied because, according to Defendant, it is a provisional grant with no specific amortization amount to repay. There is only the six year time commitment to fulfill. Thus, according to the records of the St. Lawrence County Clerk, the ANR obligation not only survived the refinancing of Debtor's obligations by Defendant but also was elevated to a first position in the chain of title.⁴

Defendant argues that ANR does not hold an actual debt; therefore, it cannot be a valid mortgage for *Pond* evaluation purposes. However, BLACK'S LAW DICTIONARY 1026 (7th ed. 1999) defines a mortgage as

A lien against property that is granted to secure an obligation (such as a debt) and that is extinguished upon payment or *performance according to stipulated terms*. (Emphasis added).

Clearly, there is a term to perform by the Plaintiff for ANR's benefit, i.e. to reside in the home for six years, or ANR would have the right to demand repayment of the funds advanced.

Defendant states that "it is painfully clear that the Debtor has no intention of selling the property..." (Defendant's motion for summary judgment, ¶ 23). However, this court does not have a crystal ball to predict whether Plaintiff will attempt to sell the property, abandon the property, or even survive the six year requirement of residency. Additionally, any attempt to modify the ANR mortgage and its residency requirement will be met with the firewall protection of 11 U.S.C. § 1322(b)(2).⁵

⁴It is unclear whether the Defendant endeavored to obtain a subordination agreement from ANR which would have eliminated the possibility of any *Pond* adversary proceeding.

⁵11 U.S.C. § 1322 is entitled "Contents of Plan" and sub (b) provides in part: "(b) Subject to subsections (a) and (c) of this section, the plan may -

Public policy also would support the validation of the ANR Grant and its residency requirement. The funds advanced by ANR allow for the rehabilitation of premises which might otherwise be abandoned or torn down. To rule, in effect, that an ANR grant is not a true lien might have the effect of chilling such grants leading to the further decay of certain residential areas.

It is clear that ANR has a first lien of record and that the Defendant is in a subordinate position. The Defendant's mortgage is thus ripe for a *Pond* determination. However, in that regard, Defendant is correct that no finding has been made by this court as to the value of the property. The court is also unaware of any stipulation by the parties addressing the value of the realty. If the value of the property is less than the ANR lien, thus extending no equity to support the Defendant's mortgage, that lien may be avoided as per *Pond*. Therefore, the court is simultaneously issuing a scheduling order to determine the value of the real property at issue and whether there is any equity that could attach to the Defendant's mortgage.

CONCLUSION

Plaintiff's summary judgment motion is granted, and Defendant's summary judgment request is denied to the extent that this court finds that the Defendant's mortgage is junior to ANR's lien.

It is so ORDERED.

Dated: May 14, 2003

Hon. Robert E. Littlefield, Jr.
U.S. Bankruptcy Judge

(2) modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence..."