

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF NEW YORK

In re:

Carolyn A. Muscatello,

Debtor.

Chapter 13
Case No. 03-11143

Carolyn Muscatello and James F. Muscatello,

Plaintiffs,

- against -

Adv. Pro. No. 05- 90127

Helen G. Nitzsche,

Defendant.

Appearances:

Wilson, Elser, et.al.
Attorneys for Carolyn Muscatello and James F. Muscatello
677 Broadway
Albany, NY 12207

Peter A. Lauricella, Esq.

Rodriguez & Doern, PLLC
Attorneys for Helen G. Nitzsche
100 West Avenue
Saratoga Springs, NY 12866-2141

James E. D. Doern, Esq.

Andrea E. Celli, Esq.
Chapter 13 Trustee
350 Northern Boulevard
Albany, NY 12204

Hon. Robert E. Littlefield, Jr., United States Bankruptcy Court Judge

Memorandum-Decision & Order

On August 30, 2005, the court rendered an oral ruling granting the motion of Carolyn Muscatello (the “Debtor”) and her husband, James F. Muscatello (collectively, the

“Muscatellos”), brought on by order to show cause, for a preliminary injunction pursuant to Federal Rule of Civil Procedure 65, made applicable by Federal Rule of Bankruptcy Procedure 7065. To supplement and clarify the court’s oral ruling on the record, the court *sua sponte* renders this written decision.

Jurisdiction

The court has core jurisdiction over this matter pursuant to 28 U.S.C. §§ 157(a), (b)(1), (b)(2)(A) and (E) and 1334(b).

Facts

The following constitutes the court’s findings of fact and conclusions of law pursuant to Federal Rule of Bankruptcy Procedure 7052, incorporating Federal Rule of Civil Procedure 52. Helen G. Nitzche (“Defendant”) owned a summer camp known as Lot 3, Charley Lake Road in Wells, New York (the “Property”). In or about late 1999, early 2000, the Muscatellos purchased the Property from the Defendant. In connection with the purchase, the Muscatellos executed and delivered to the Defendant a purchase money note and mortgage in the amount of \$61,000 (the “Note and Mortgage”). In or about May 2001, the Defendant commenced an action to foreclose the mortgage in Supreme Court, Hamilton County (the “Foreclosure”).¹ On or about February 25, 2003, the Debtor filed her petition for relief under Chapter 13 of the Bankruptcy Code staying the Foreclosure. On March 24, 2004, the Defendant filed a motion for relief from the automatic stay to permit her to proceed with the Foreclosure (the “Motion”) (No. 31). The Debtor filed opposition to the Motion (No. 35). The court’s docket indicates that on May 20, 2004, the

¹ The Muscatellos have not challenged the validity of the Mortgage against the Property held by the Defendant or the Foreclosure.

Motion was marked “[m]otion settled; [o]rder due.” Based upon the Defendant’s failure to submit a proposed order in conformance with the parties’ agreed upon settlement within 30 days of the hearing, the court executed and entered an order denying the Motion pursuant to Local Bankruptcy Rule 9021-1(a) on or about July 14, 2004 (No. 38). Meanwhile, the Defendant and the Muscatellos did enter into a stipulation settling the Motion, which was executed by the parties, their respective attorneys, and the Chapter 13 Trustee and filed with the court on September 16, 2004 (the “Stipulation”) (No. 41). On that same date, the court signed an order approving the Stipulation (the “Order”) (No. 42).

Pursuant to the terms of the Stipulation, *inter alia*, the Muscatellos agreed to (1) make certain payments to the Defendant to satisfy their mortgage arrears, including a lump sum payment of \$10,000, and monthly payments through May 2005, at which time, the entire unpaid balance of the Mortgage would be due, (2) provide proof of insurance for the Property, (3) extend the notice of pendency filed in connection with the Foreclosure, and (4) pay the Defendant her attorney’s fees incurred in connection with the bankruptcy and the Foreclosure. In exchange for the additional time to cure their default, the Muscatellos executed a quitclaim deed for the Property in favor of the Defendant (the “Deed”) to be held by her escrow agent and only released and recorded should the Muscatellos fail to comply with the terms of the Stipulation.

Pursuant to the terms of the Stipulation, if the Muscatellos defaulted, the escrow agent was required to send the Muscatellos’ attorney a 7 day notice to cure by facsimile and overnight courier. The Musatellos defaulted on their payment due for October 2004. On or about October 13, 2004, the escrow agent sent a letter to the Muscatellos’ attorney advising him that his clients had not made their October 2004 payment and indicating that they had 7 days to cure their

default. (*See* Doern Affirmation (No. 11) Ex. A2 at 23.) On October 25, 2004, the escrow agent caused the Deed to be recorded in the office of the Hamilton County Clerk. (*Id.* at 23-24.) Shortly thereafter, the Defendant commenced an eviction proceeding against the Muscatellos in the Wells Town Court. On December 7, 2004, the Wells Town Court signed a warrant of eviction.

On January 12, 2005, the Muscatellos commenced an action against the Defendant in New York State Supreme Court, Hamilton County (Index No.: 6190-05) (the “State Court Action”) seeking to enforce their right of redemption with respect to the Property. In the context of the State Court Action, the Muscatellos obtained a temporary restraining order staying the warrant of eviction. The Muscatellos moved for a preliminary injunction in the State Court Action, and the Defendant cross-moved for dismissal. The State Court, however, did not decide the issues on the merits, but rather, indicated that the Bankruptcy Court would be the proper forum to adjudicate the dispute being the Stipulation governed the rights of the parties. (*See* Doern Affirmation Ex. D.) The State Court continued the stay of the warrant of eviction until July 1, 2005, to allow the Muscatellos to seek relief from this court. (*Id.*)

The Muscatellos filed the underlying adversary complaint on June 29, 2005 pursuant to Federal Rules of Civil Procedure 60(b), 65, and 70, and Federal Rules of Bankruptcy Procedure 7065, 7070, and 9024 against Defendant seeking a declaration that (1) the Stipulation and the Order are null and void, and (2) the Muscatellos are entitled to exercise their right of redemption with respect to the Property. (No. 1.) Although the Muscatellos also moved pursuant to Federal Rule of Civil Procedure 57, Rule 57, relating to declaratory judgments, is not applicable to bankruptcy cases. Declaratory judgments are, nonetheless, covered by adversary proceedings

under Federal Rule of Bankruptcy Procedure 7001.

It is within the context of this adversary proceeding that the Muscatellos moved by order to show cause for the issuance of a temporary restraining order and presented an application for a preliminary injunction directing the Defendant to convey the Property back to them and allowing them to comply with the terms of the Stipulation and/or to exercise their right of redemption with respect to the Property (No. 6). A hearing was set for July 6, 2005 and pending the hearing the court granted a temporary restraining order staying (1) the execution of the warrant of eviction, and (2) the Defendant from transferring or taking steps to transfer the Property until further order of the court. The hearing was not held on July 6, 2005; instead, the parties agreed to the terms of an order extending the temporary restraining order beyond the 10 day period provided for in Federal Rule of Civil Procedure 65 pending the outcome of the Muscatellos' request for a preliminary injunction. (*See* Order dated July 18, 2005 (No. 10).) In addition, the court gave the parties an opportunity to submit further pleadings in support of their positions. The Muscatellos were given until July 14, 2005, with the Defendant having until July 21, 2005 to reply, and the Muscatellos until July 27, 2005 to respond. Oral argument was heard on July 28, 2005, and the matter was submitted for an oral decision.

Discussion

The typical preliminary injunction is prohibitory and seeks to maintain the status quo pending a trial on the merits. *Tom Doherty Assoc., Inc. v. Saban Entm't, Inc.*, 60 F.3d 27, 34 (2d Cir. 1995). To prevail on a motion for a preliminary injunction to maintain status quo, the movant must show: (a) irreparable injury in the absence of the injunction, and (b) either (1) a likelihood of success on the merits, or (2) sufficiently serious questions going to the merits and a

balance of hardships tipping decidedly in the movant's favor. *Green Party of New York State v. New York State Bd. of Elections*, 389 F.3d 411 (2d Cir. 2004). A mandatory injunction alters the status quo by directing some positive act. *Id.* A movant must show a greater likelihood of success if he seeks a mandatory injunction that either changes the status quo or provides the movant with substantially all of the relief sought which cannot be undone if the defendant ultimately prevails. *Id.* at 33-34. The Muscatellos are presumably seeking a mandatory injunction since they want an order directing the Defendant to convey the Property back to the them and allowing them to comply with the terms of the Stipulation and/or to exercise their right of redemption with respect to the Property. The Muscatellos, however, have not argued the higher standard, and thus, the court will apply the ordinary preliminary injunction standard.

Irreparable injury is one that cannot be redressed through a monetary award. *See Jackson Dairy, Inc., v. H.P. Hood & Sons, Inc.*, 596 F.2d 70, 72 (2d Cir. 1979). If money damages are adequate compensation for the injury suffered, a preliminary injunction should not issue. *Id.* The Muscatellos argue that a preliminary injunction should be issued because they have been irreparably injured as they are being deprived of title to the Property and full control over the Property. Argued this way, it would appear that the damage is done. Upon information and belief, the Muscatellos are actually asserting that if injunctive relief is not granted they will be irreparably injured. Defendant does not dispute that irreparable harm would result if a preliminary injunction is not granted, and the court finds the Muscatellos have demonstrated irreparable harm by virtue of the fact that the Property may be sold by the Defendant to a bona fide purchaser for value if the injunction is not granted, resulting in the loss of an estate asset.

The real issue here centers around the second prong of the test, namely, the Muscatellos'

likelihood of success on the merits. The Muscatellos also argue that the Stipulation, which provided for the delivery of the Deed and its later recording, is invalid because the Defendant's underlying motion for relief from the automatic stay was denied. The Muscatellos assert that the only reason they entered into the Stipulation was that they believed the Defendant's motion for relief from the automatic stay had been granted, and thus, if they did not enter into the Stipulation, the Property would be foreclosed. The court's docket indicates otherwise. The Motion was filed on March 24, 2005. The Muscatellos filed opposition on April 15, 2005. A hearing was scheduled for April 22, 2004, and then adjourned until May 20, 2004, after which time, the court's docket was marked "[m]otion settled; [o]rder due." Although an order setting forth the settlement terms was not submitted to the court within the time period contained in Local Rule 9021-1(a), the parties did eventually enter into the Stipulation, and the Stipulation was approved by the court. (See Order dated September 16, 2005 (Doc. 42).) Parties are free to enter into voluntary settlements. The Muscatellos do not deny that they owed the amounts set forth in the Stipulation, or argue that they were coerced into executing the Stipulation, or disadvantaged by it. Based upon the foregoing, the court finds it unlikely that the Muscatellos will succeed on their argument that the Stipulation and the Order are null and void.

The Muscatellos second argument is that they should be given the opportunity to exercise their right of redemption under state law. The Muscatellos assert that the Deed was given as security for their performance under the Stipulation so that it is the nature of a mortgage, rather than a deed of conveyance. As a result, the Muscatellos assert the Defendant did not acquire title to the Property by recording the Deed. Relying upon *Meyerson v. Werner*, 683 F.2d 723 (2d Cir. 1982) and federal estoppel, the Defendant asserts that the equity of redemption does not apply in

this situation because the Deed was given as part of an agreement and a federal court order approving the same.

The court must look to applicable non-bankruptcy law to determine property rights in the assets of a debtor's estate. *See Butner v. United States*, 440 U.S. 48, 48- 49 (1979). Because the Property is located in New York, and all events relevant to the Stipulation, including execution of the Deed, took place in New York, New York law governs. New York Real Property Law § 320 provides in pertinent part:

A deed conveying real property, which, by any other written instrument, appears to be intended only as a security in the nature of a mortgage, although an absolute conveyance in terms, must be considered a mortgage; and the person for whose benefit such deed is made, derives no advantage from the recording thereof, unless every writing, operating as a defeasance of the same, or explanatory of its being desired to have the effect only of a mortgage, or conditional deed, is also recorded therewith, at the same time.

Real Property Law § 320 (McKinney's 1989).

Real Property Law § 320 does not require a conclusive showing that the transfer was intended as security; it is sufficient that the conveyance "appears to be" intended only as a security in the nature of a mortgage. *Thomson v. Daisy's Luncheonette Corp.*, 7 Misc.3d 1019(A), 801 N.Y.S.2d 243, 2005 WL 1083698, at *1 (N.Y. Sup. May 3, 2005) (citing *Leonia Bank v. Kouri*, 3 A.D.3d 213, 217, 772 N.Y.S.2d 251, 254 (N.Y. App. Div. 1st Dep't 2004)). The burden of establishing that a deed absolute on its face was intended as a mortgage rests on the party seeking to recharacterize the transaction. *In re UNI-RTY Corp.*, 1:96 CV 04573, 1998 WL 299941, at *3 (S.D.N.Y. June 9, 1998) (citing *Bielawski v. Bazar*, 47 A.D.2d 435, 367 N.Y.S.2d 322, 324 (N.Y. App. Div. 3d Dep't 1975)). Where a deed is intended to serve as security and not as an absolute conveyance of property, the holder must proceed by foreclosure to obtain fee title.

Gioia v Gioia, 234 A.D.2d 588, 652 N.Y.S.2d 63 (N.Y. App. Div. 2d Dep't 1996); *Basile v. Erhal Holding Corp.*, 148 A.D.2d 484, 538 N.Y.S.2d 831 (N.Y. App. Div. 2d Dep't 1989).

Whether a deed was meant as security depends on the intent of the parties.

The Stipulation on its face provides some evidence that the Deed was intended to be security for the Muscatellos' performance under the Stipulation and not an absolute conveyance of ownership. Pursuant to the Stipulation, the Muscatellos were to continue to make payments to the Defendant under the Mortgage, as specified in the Stipulation and keep the Property insured. The Deed was not to be recorded unless the Muscatellos defaulted under the Stipulation. This conclusion is also buttressed by the fact that the Muscatellos did not give up possession of the Property. An event of default under the Stipulation would not somehow transform the Deed, given as security, to an outright conveyance. The Defendant has not disputed that the Deed was given as security. Instead, she argues federal estoppel prevents the Muscatellos from exercising their right of redemption. The Defendant's position rests entirely upon *Meyerson*, 683 F.2d 723, which the court finds distinguishable from the case *sub judice*.

In *Meyerson* the parties negotiated an open court settlement which included execution of a deed by defendant to ensure payments to plaintiffs were made pursuant to the agreement reached by the parties. Upon his default, the defendant argued the deed was actually a mortgage in accordance with New York Real Property Law § 320. The court held that although ordinarily parties cannot waive protections provided under New York statutory provisions governing foreclosures since the state judicial procedure is designed to protect debtors against overreaching creditors, it found the clear intention of the parties, approved and ordered by the district court, was that the transaction was not to be treated as a mortgage pursuant to New York Real Property

Law § 320. *Id.* at 727. The court also remarked this was an unusual case and noted the defendant's long and extraordinary history of misconduct, including violations of court orders and subpoenas. *Id.* at 728.

In this case, the Stipulation was not entered into in open court. The court did not question the parties on their understanding of the Stipulation, specifically if the transaction at issue was meant to be in the nature of security or an absolute conveyance. Although the Defendant has been dealing with the Muscatellos defaults under the mortgage and their subsequent promises to become current for years now, there have been no allegations that the Muscatellos' behavior has risen to the level of that of the defendant in *Meyerson*.

It appears the Muscatellos are likely to succeed with their argument that the Deed is in the nature of a mortgage and, thus, in order for the Defendant to obtain fee title to the Property she will need to foreclose under the Deed. If the Muscatellos are in fact successful, they would in turn be entitled to exercise their right of redemption at any time prior to the actual sale of the Property. *See* New York Real Property Actions and Proceedings Law §1341.

Conclusion

While the court sympathizes with the Defendant and her plight to enforce the terms of her mortgage, especially in light of her attempts to work with the Muscatellos over the years, based upon the foregoing, the court finds the Muscatellos have satisfied the necessary elements for the issuance of a preliminary injunction maintaining the status quo pending a trial on the merits.

IT IS HEREBY ORDERED, that until further order of this court or the adjudication of the adversary proceeding, the Defendant is restrained from (a) seeking enforcement of the warrant of eviction issued by the Town Court of Wells based upon the Deed; and (b) transferring the

Property, or taking steps to transfer title to the Property under the Deed.²

Dated: 1/11/06
Albany, New York

/s/ Robert E. Littlefield, Jr.

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

²This Decision and Order is not meant to limit any rights the Defendant may hold under the Note and Mortgage.