UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF NEW YORK

IN RE:

MARILYN D. FINDLEY — CASE NO. 9l-00762

Debtor — Chapter l3

APPEARANCES:

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STEPHEN D. GERLING, U.S. Bankruptcy Judge

MEMORANDUM-DECISION, FINDINGS OF FACT,
CONCLUSIONS OF LAW AND ORDER

The Court has considered the Objections to Chapter l3 Plan ("Objections") filed herein by Merchants National Bank & Trust Company of Syracuse ("Merchants"). An evidentiary hearing on the Objections and Confirmation of the Debtor's Plan was held at Utica on September 25, l99l after which both the Debtor and Merchants were given an opportunity to submit memoranda of law. The contested matter was finally submitted for decision on October l5, l99l.

JURISDICTIONAL STATEMENT

This Court has jurisdiction of this contested matter by virtue of 28 U.S.C. §§1334(b), l57(a), (b)(l) and (b)(2)(A, L & O).

FACTS

On April 27, l987, Debtor's spouse, Craig P. Findley, d/b/a Comtec Marketing ("C.Findley") executed a promissory note ("Note") to Merchants in the sum of $85,000.00. Said Note was payable over seven years and four days from its date of execution, with interest at the variable rate of 9 3/4%. In the event of a default on the Note by C. Findley, re-payment to Merchants was partially guaranteed by the U.S. Small Business Administration ("SBA"). (See Objectant's Exhibit #l).

Simultaneously with the execution of the Note, the Debtor executed a Mortgage, also dated April 27, l987, which encumbered Debtor's residence known as 306 Hefler Lane, Minoa, New York and which was given to Merchants to secure the Note executed by C. Findley "and all consolidations, modifications, extensions and renewals thereof and to secure the guaranty of mortgagor to said note." The Mortgage further secured payment of C. Findley's or Comtec's indebtedness only to the extent of $65,000. (See Objectant's Exhibit #2).

At some point subsequent to the execution of the Note and the Mortgage, C. Findley defaulted in re-payment and in fact, C. Findley filed a petition pursuant to Chapter l3 of the Bankruptcy Code (ll U.S.C. §§101-l330) ("Code") some time in l988. By Order dated June 5, l989, C. Findley's Chapter l3 Plan was confirmed. The Order confirming that Plan reflects C. Findley's

indebtedness to Merchants as of June 5, l989 as $7l,892.90. (See Debtor's Exhibit A).

Prior to confirmation of C. Findley's Chapter l3 Plan, Merchants obtained payment of 90% of the outstanding indebtedness under its SBA guarantee, or the sum of $69,l78.95. (Objectant's Exhibit #3).

Subsequent to June 5, l989, Merchants received six payments on C. Findley's indebtedness, with the latter two payments being the proceeds of auction sales of C. Findley's property pursuant to security interests in said property held by Merchants which followed conversion of his Chapter l3 case to a Chapter 7 case on October l7, l989. (See Objectant's Exhibits #4 and #9).[1]

Merchants applied all six payments to the principal of C. Findley's indebtedness with 90% of each payment being remitted to the SBA and l0% being retained by Merchants.

After crediting the last payment received on the C. Findley indebtedness on June l5, l990, Merchants' records indicate a principal balance due of $49,182.42 plus accrued interest of $2l,280.77 for a total of $70,463.l9. (See Objectant's Exhibit #l0).

Debtor's Chapter l3 Plan filed with the Court on March l9, l99l, proposes to re-pay C. Findley's indebtedness to Merchants by payment of the sum of $44,000 at the rate of $800.00 per month for sixty (60) months.

ARGUMENTS

[1] The first auction sale of C. Findley's property occurred on January 20, l990 and was conducted by ERA Action Auction. The property was appraised prior to the sale by Stanley Rubenstein at $9,640.45 and was sold in bulk to Robert Primo for $9,000.00. The second auction sale of C. Findley's property occurred on June 7, l990 and was conducted by Brzostek's Auction Service, Inc. No appraisal of the property auctioned was provided to the Court, however, the total of all bids was $3,730.00.

Merchants contends that the Debtor guaranteed her husband's debt to it in an amount not to exceed $65,000 in principal and that as of the date of her Chapter l3 filing, the balance due on the debt was $70,463.l9, representing a principal balance of $49,l82.42 and accrued interest of $2l,280.77.

Merchants further contends that despite being reimbursed by SBA to the extent of 90% of the outstanding C. Findley indebtedness, it is the servicing agent for SBA and, therefore, is authorized to collect the amount presently due under Debtor's guarantee.

Finally, Merchants asserts that whatever the balance due, it must be paid through Debtor's Plan in accordance with the terms of the original note, and since that note was to be paid in full in installments through May l994, the Debtor's Chapter l3 Plan cannot extend its payment over sixty months from the date of confirmation. Merchants relies on §1322(b)(2) of the Code.

Debtor argues that the balance due Merchants under her guarantee does not exceed $44,000, that Merchants did not properly conduct the sales of C. Findley's assets pursuant to their security interests so as to realize the greatest return to be applied against the outstanding debt, and that the actual amount due Merchants based on the testimony of Merchants' witness at the evidentiary hearing was approximately $9,200 or less as a result of the SBA's payment to Merchants in January l989.

DISCUSSION

Merchants' Objection presents two issues to the Court, the first being the amount actually due Merchants at the time the Debtor filed her petition, which amount must be dealt with in the Debtor's Chapter l3 Plan. The second issue implicates §1322(b)(2) of the Code, the so-called

"anti-modification" provision, and whether or not Debtor's proposed Plan to extend payments over sixty months runs afoul of that Code section.

Debtor contends that because SBA paid 90% of C. Findley's indebtedness to Merchants in January l989, Merchants' claim against C. Findley must be reduced by that amount, as well as any amounts received from C. Findley, his Chapter l3 Trustee, or from the forced sale of his assets in January and June l990.

Merchants' witness testified that in spite of payment by the SBA, Merchants is obligated to "service" the loan pursuant to a contract with the SBA which contract was not produced, nor offered in evidence.

This Court cannot conclude however that Merchants does not have the right to enforce a claim to full payment against the Debtor in spite of any payments received from SBA. Merchants is still lawful holder of the note which Debtor guaranteed and has pursued payment of that Note from both C. Findley and the Debtor, and Debtor cites no authority that would entitle it to the benefit of any payments made to Merchants by SBA.

Merchants' witnesses' unrefuted testimony was that Merchants was obligated contractually to service the loan on behalf of SBA until it was repaid in full and, therefore, the Debtor cannot assert payment by SBA as a partial defense to the claim of Merchants.

Turning to the dispute regarding the limit of Debtor's liability under the Mortgage which she executed on April 27, l987, it is Debtor's contention that the entire indebtedness, both principal and interest which that Mortgage secures, cannot exceed the $65,000. Merchants' witness testified that it was his understanding that the $65,000 "cap" applied only to the principal, not principal and interest.

The Mortgage itself does not specify the components which are intended to be

included in the "cap". It simply refers to securing "payment of any and all further liability and indebtedness now existing or hereafter incurred by said mortgagor, Craig P. Findley or Comtec Marketing ... in an amount not to exceed the sum of Sixty-Five Thousand and no/100 Dollars ($65,000.00)."

> The rule that an ambiguous guarantee should be construed in favor of the guarantor and against an obligee who has prepared it is particularly applicable where an obligee seeks to create an obligation and impose a liability where none would otherwise exist, and in cases where the strictissimi juris rule applies.

63 N.Y.Jur.2d Guaranty and Suretyship §100.

While the law appears to be well settled that where a mortgage is given to secure a debt, it secures both principal and interest, even though interest is not referred to in the obligation secured by the mortgage, such a rule applies where the obligation exists directly between mortgagor and mortgagee. See 77 N.Y.Jur.2d Mortgages §67.

Here, the primary obligation runs between Merchants and C. Findley, the Debtor has guaranteed that obligation and while that creates a secondary obligation, it is one that would not have existed but for the guaranty.

If Merchants had wanted the "cap" on Debtor's liability to be fixed at $65,000, plus any accrued interest thereon, it could have simply drafted the guaranty provisions contained in the Mortgage to so provide.

Further, the Debtor testified that prior to the time she executed the Mortgage securing her guaranty of C. Findley's indebtedness, Merchants appraised her residence as having a value of $80,000. There was a prior mortgage on the residence which secured an indebtedness to Chase Lincoln Bank in the amount of approximately $l3,000. The Debtor testified, without dispute, that her guarantee was capped at $65,000 because that was the extent of her unencumbered

equity in the residence.

Merchants contends that paragraph l6 of the Mortgage put the Debtor on notice that she was liable for payment of both principal and interest under the guaranty. Merchants' reliance on paragraph l6 as proof that Debtor guaranteed payment of C. Findley's indebtedness in excess of $65,000 is misplaced.

Paragraph l6 did nothing more than permit Merchants to make payments to Chase Lincoln in the event of Debtor's default, and add those payments with any interest accruing thereon to the amount of the indebtedness secured by the Mortgage.

Based on the foregoing, the Court must conclude that the total indebtedness due Merchants, guaranteed by Debtor and secured by the Mortgage, does not exceed $65,000, inclusive of both principal and interest.

Having reached that conclusion, the Court turns to the question of the actual indebtedness due Merchants as of the date of debtor's Chapter l3 filing.

Merchants' witness testified that following September l988 all payments on C. Findley's indebtedness were applied in reduction of principal. It appears that both Merchants and the Debtor were fairly close in their computations as to the principal balance on C. Findley's obligation. Merchants computed the principal balance as of June l990 at $49,l82.42, while Debtor calculated the indebtedness at approximately $44,000. Merchants, however, seeks to recover accrued interest in the sum of $2l,280.77.

Debtor does not dispute the methodology utilized by Merchants to accrue interest on the C. Findley indebtedness and though she contended that she never received any demand for payment from Merchants until she was served with a summons and complaint in the mortgage foreclosure action, it is clear that in early May of l990 she was advised by certified mail that prior

to the final sale of C. Findley's collateral, the debt due Merchants Bank was $76,493.31. (See Debtor's Exhibit E).

In the absence of any proof to the contrary, the Court concludes that the balance due on C. Findley's obligation to Merchants as of the date of Debtor's Chapter 13 filing was at least $70,463.19.

In reaching this conclusion, the Court has considered the auction sales conducted by Merchants in January and June 1990 and is not convinced that such sales were conducted other than in a commercially reasonable manner, in spite of the relatively minimal amount generated by the sales, and the fact that the bulk purchaser at the January sale was the attorney at whose office the sale was conducted, and who is a tenant in Merchants' office building.

The Court now turns to the final issue concerning the impact of Code §1322(b)(2) on Debtor's ability to extend payment of the Merchants' debt through her Plan beyond May 1994.

It is the majority view that Code §1322(b)(2), insofar as it prohibits the modification of a secured creditor's claim where that claim is secured only by a lien on debtor's residence, applies to both long term purchase money mortgages, as well as short term collateral mortgages. See In re Bradshaw, 56 B.R. 742 (S.D.Ohio 1985); In re Hobaica, 65 B.R. 693 (Bankr. N.D.N.Y. 1986); In re Diquinzio, 110 B.R. 628 (Bankr. D.R.I. 1990); contra, In re Morphis, 30 B.R. 589 (Bankr. N.D.Ala. 1983).

Thus, in the instant case, there is no question that Merchants' claim secured by the mortgage on Debtor residence is entitled to the protection of Code §1322(b)(2) if that section is otherwise applicable.

The instant case, however, presents a somewhat unique fact pattern since the claim sought to be modified by Debtor's Plan is the claim which is embodied in the Note executed by C.

Findley on April 27, l987. Debtor's liability on that claim arises only by virtue of her execution of a guaranty and Mortgage on the same date.[2]

It cannot be said that Merchants holds a separate and independent claim against the Debtor for purposes of Code §1322(b)(2) since her liability is wholly dependent on C. Findley's payment or non-payment on that Note.[3]

Thus, when the transaction of April 27, l987 is viewed as a whole, it is clear that Merchants held security other than Debtor's Mortgage for the re-payment of its Note as is evidenced by its security interest in property of C. Findley and the fact that it conducted two auction sales of that collateral in January and June of l990 thereafter applying the proceeds to the Note.

Conversely, if one were to view Merchants as having a claim against the Debtor separate and independent from the claim which arose under the Note of April 27, l987, then the same result must be reached.

"A claim secured by any other real property or by personal property of the estate or of the debtor, or by the property of another may be modified by the Chapter l3 plan." 5 COLLIER ON BANKRUPTCY l5th Ed. ¶1322.06. (l99l) (emphasis supplied).

Again, the C. Findley collateral previously liquidated by Merchants would constitute "property of another" thereby prohibiting application of the "anti-modification"

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[2] It is noted that no separate guaranty was produced by Merchants, however, the language contained in the Mortgage (Objectant's Exhibit 2) is sufficient to bind the Debtor.

[3] The Court acknowledges that the execution of a guaranty may well "import the existence of two different obligations". See 63 N.Y.Jur.2d Guaranty and Suretyship §2. However, for purposes of code §1322(b)(2), the transaction of April 27, l987 with Merchants must be viewed in its entirety not in its individual components. See In re Hemsing, 75 B.R. 689, 69l (Bankr. D.Mont. l987).

provision of Code §1322(b)(2).

Based on the foregoing, it is

ORDERED that Merchants Objection to Debtor's Plan is sustained insofar as the Plan lists an indebtedness to Merchants Bank in the sum of $44,000, and it is further

ORDERED that Merchants' Objection to Debtor's Plan is denied insofar as the Plan proposes to amortize Merchants' claim over a period extending beyond May l994; and it is finally

ORDERED that Debtor shall file an amended plan within thirty (30) days of the date of this Order which shall propose amortization of the debt to Merchants in the sum of $65,000.

Dated at Utica, New York

this day of January, l992

STEPHEN D. GERLING
U.S. Bankruptcy Judge