UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF NEW YORK

IN RE:

PHILIP FINLEY — CASE NO. 03-62212

Debtor — Chapter 13

APPEARANCES:

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Hon. Stephen D. Gerling, Chief U.S. Bankruptcy Judge

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

Presently before the Court is a motion filed on May 1, 2003, by Chase Manhattan Bank ("Chase") seeking to lift the automatic stay pursuant to § 362(d) of the Bankruptcy Code, 11 U.S.C. §§ 101-1330 ("Code"), in order to proceed with the foreclosure sale of real property

located at 305 Easterly Terrace, Dewitt, New York (the "Property"). An objection was filed by Philip Finley ("Finley" or the "Debtor") on May 16, 2003, and Chase filed a response on July 18, 2003. The Court heard the motion at its regular motion term in Utica on July 22, 2003. The Court provided the parties an opportunity to file memoranda of law, upon which a hearing was held during the Court's regular motion term in Utica on August 19, 2003. The matter was submitted on September 23, 2003.

JURISDICTIONAL STATEMENT

The Court has core jurisdiction over the parties and the subject matter of this contested matter pursuant to 28 U.S.C. §§ 1334, 157(a), (b)(1), (b)(2)(A), (B), (G), (K), and (O).

FACTS

On June 29, 1993, Xiaoling Zhang and Hongli Liu (the "Mortgagors") granted Chase a mortgage on the Property and the Mortgagers executed a note in the amount of $74,300 on the same date. *See* Affirmation of Kathleen N. Bollon, Esq., filed May 1, 2003 ("Bollon Aff."), at Ex. A. Section 17 of the mortgage includes a due-on-sale clause, which provides the following:

> Lender may require immediate payment in full of all Sums Secured by this Security Instrument if all or any part of the Property, or any right in the Property, is sold or transferred without Lender's prior written permission. . . . However, Lender shall not require immediate payment in full if this is prohibited by federal law on the date of this Security Instrument.

Id. In addition, the mortgage lists Chase's address as One Lincoln First Square, Rochester, New York 14643. *See id.* Under section 14 of the mortgage, Mortgagors were to provide any notices mandated by the terms of the mortgage to that address. *See id.* On August 29, 1995, Mortgagors transferred the Property to Finley and his wife for valid consideration but without Chase's consent (the "Mortgagors-Finley Transfer"). *See id.* ¶ 6; *id.* at Ex. B. Mortgagors continued to pay their agreed-upon monthly payments to Chase, while Finley paid the same amount to the Mortgagors. *See id.* ¶ 3. According to Finley's counsel, at a certain point Finley began paying Chase directly at one of its branch offices. *See* Letter of Michael J. Balanoff, Esq., dated September 9, 2003 ("Balanoff Letter").

Mortgagors filed a bankruptcy petition with this Court under chapter 7 of the Code on March 2, 2001 (the "Zhang-Liu Case"). Chase claims that Mortgagors failed to pay their monthly mortgage obligation due on April 1, 2001 and consequently defaulted on the note and mortgage. *See* Affirmation in Opposition of Michael J. Balanoff, Esq., filed May 15, 2003 ("Balanoff Aff. in Opp'n"), at ¶ 2. On August 10, 2001, this Court in the Zhang-Liu Case granted the chapter 7 trustee's motion to sell the Property to Finley for $1,500. *See id.* at Ex. C. The parties dispute whether Chase was provided with notice of the sale. *See* Bollon Aff. ¶ 5; Balanoff Letter. However, Mortgagors listed on their schedule of secured creditors an entity identified as "Chase Mortgage" located at P.O. Box 9001068, Louisville, KY 40290-1068. Certificates of service in the Zhang-Liu Case indicate that this entity was served with notices concerning the commencement of the case and the date of the initial meeting of creditors, the bar date, and the sale of the Property.

Chase filed a proof of claim in the Zhang-Liu Case on January 11, 2002. Chase

then brought a foreclosure action against the Property before the New York Supreme Court, Onondaga County (the "State Court"), on July 23, 2002. *See* Bollon Aff. ¶ 8. The State Court entered a foreclosure judgment in Chase's favor on January 31, 2003. *See id.* at Ex. C. On March 11, 2003, Chase provided notice to Finley and the Mortgagors, among others, of the foreclosure sale of the Property scheduled for April 8, 2003. *See id.* at Ex. D. Finley filed a Chapter 13 petition with the Court on April 4, 2003, thereby automatically staying the foreclosure sale.

ARGUMENTS

Chase contends that the Court must permit it to proceed with the pending foreclosure sale of the Property because there are no grounds permitting the Debtor to cure the default on the note and mortgage in his Chapter 13 plan. *See id.* ¶¶ 18, 20. Specifically, Chase contends that, because there is no privity between the Debtor and Chase, Debtor lacks the right to cure Mortgagors' default. *See id.* ¶ 18. As for the event that provided Chase its right to foreclose, Chase cites Mortgagors' failure to pay the full balance of the note and mortgage that became due under the due-on-sale clause upon execution of the Mortgagors-Finley Transfer. *See id.* ¶ 22. Chase argues that the Debtor must step in the shoes of Mortgagors and pay the full amount due under the note and mortgage. *See* Reply Affirmation of Patricia A. Kavanaugh, Esq., filed on July 18, 2003 ("Kavanaugh Aff."), at ¶ 34. Chase further submits that anything less would be a impermissible modification of its rights. *See* Supplemental Affirmation of Patricia A. Kavanaugh, Esq., filed on August 11, 2003 ("Kavanaugh Supp. Aff."), at ¶ 32.

The Debtor argues that, pursuant to the Supreme Court's opinion in *Johnson v.*

Home State Bank, 501 U.S. 78 (1991), and the cases that follow it, the Debtor has a right to cure Mortgagors' default on the note and mortgage, notwithstanding the absence of privity between Finley and Chase, because Chase has a claim against Debtor's property. *See* Balanoff Aff. in Opp'n ¶ 12. The Debtor also argues that he has a right to propose in his chapter 13 plan to cure any default under the note and mortgage—whether it be arrearages or the accelerated amount due by operation of the due-on-sale clause. *See id.* ¶ 24.

DISCUSSION

The controversy this Court must decide is whether a debtor who lacks privity with the holder of a mortgage secured by the debtor's property can include that mortgage as a claim in his chapter 13 plan and, if so, whether he may cure defaults on that mortgage.

The Supreme Court in *Johnson* established the foundation upon which the majority of subsequent cases following it have held that debtors owning property subject to a mortgage but lacking privity with the mortgagee can include the mortgage as a claim in their chapter 13 plans, even though *Johnson* dealt with a debtor who was the original mortgagor. *See In re Curinton*, 300 B.R. 78, 84-85 (Bankr. M.D. Fla. 2003); *In re Garcia*, 276 B.R. 627, 631 (Bankr. D. Az. 2002); *In re Trapp*, 260 B.R. 267, 271 (Bankr. D.S.C. 2001); *In re Rutledge*, 208 B.R. 624, 628 (Bankr. E.D.N.Y. 1997)*; In re Allston*, 206 B.R. 297, 299 (Bankr. E.D.N.Y. 1997); *In re Wilcox*, 209 B.R. 181, 182 (Bankr. E.D.N.Y. 1996); *Citicorp Mortgage, Inc. v. Lumpkin (In re Lumpkin)*, 144 B.R. 240, 241-42 (Bankr. D. Conn. 1992). *Johnson* held that "a claim enforceable against the debtor's property nonetheless [is] a 'claim against the debtor'" that can be included in a debtor's chapter 13 plan. *Johnson*, 501 U.S. at 85.

This Court in *In re Owens*, Case No. 02-63751 (Bankr. N.D.N.Y. January 29, 2003), aligned itself with the courts that have extended the *Johnson* holding to permit a debtor who succeeds to the obligation of the original mortgagor without the consent of the mortgagee to include the mortgage secured by the debtor's property in a chapter 13 plan. *Owens* involved a debtor who as executrix of her mother's estate transferred to herself a residence upon which the mortgagee sought to foreclose. *See Owens*, at 3. Notwithstanding the factual dissonance between the case at bar and *Owens*, the Court will once again follow the post-*Johnson* line of cases and hold that the Debtor can include the note and mortgage encumbering the Property as a claim against his property in his chapter 13 plan despite his lack of privity with Chase.

Regarding the Debtor's right to cure, the Court will call attention to the Bankruptcy Reform Act of 1994, Pub. L. No. 103-394, 108 Stat. 4106 (1994) (the "1994 Amendments"), which added section 1322(c)(1) to the Code. Section 1322(c)(1) provides that "a default with respect to, or that gave rise to, a lien on the debtor's principal residence may be cured under paragraph (3) or (5) of subsection (b) until such residence is sold at a foreclosure sale that is conducted in accordance with applicable nonbankruptcy law." 11 U.S.C. § 1322(c)(1). Code § 1322(b)(3) permits debtors to cure "any default within a reasonable time and maintenance of payments while the case is pending on any unsecured claim or secured claim on which the last payment is due after the date on which the final payment under the plan is due," *id.* § 1322(b)(3), while Code § 1322(b)(5) allows debtors to "provide for the curing or waiving of any default." *Id.* § 1322(b)(5). These provisions expressly permit the Debtor to cure the default on the mortgage secured by the Property in this case. Furthermore, this Court in *Owens* permitted the debtor to cure defaults on the mortgage secured by her property. *See Owens*, at 8.

The mortgage in this case contains a due-on-sale clause that, according to Chase,

accelerated the full balance due under the note upon the execution of the Mortgagors-Finley Transfer. Chase argues that the amount accelerated under the due-on-sale clause may only be cured by Mortgagors and that the Debtor's only recourse is to pay the accelerated amount. This Court finds that prevailing case law and the Code hold otherwise. The Second Circuit in *In re Taddeo* permitted the debtor in that case to cure and de-accelerate the amount that became due under his mortgage as a result of the operation of a due-on-sale clause, *see In re Taddeo*, 685 F.2d 24, 26 (2d Cir. 1982), and courts within and without the Second Circuit have extended *Taddeo*'s right to cure an accelerated mortgage balance to a non-party to the original mortgage. *See, e.g.*, *Garcia*, 276 B.R. at 642; *Trapp*, 260 B.R. at 272; *Rutledge*, 208 B.R. at 628-29. Furthermore, Chase's reliance on *First National Fidelity Corp. v. Perry* for the argument that its rights arising from the mortgage cannot be modified is clearly misguided, as Congress expressly overruled *Perry* in the 1994 Amendments. *See* H.R. Rep. 103-835, at 52, *reprinted in* 1994 U.S.C.C.A.N. 3340, 3361 ("The changes made by this section, in conjunction with those made in section 305 of this bill, would also overrule the result in *First National Fidelity Corp. v. Perry*, 945 F.2d 61 (3d Cir. 1991)."). Accordingly, Code § 1322(c)(1) empowers, as Congress intended, the Debtor to de-accelerate the full amount due under the due-on-sale clause and cure any defaults that have arisen under the note and mortgage in his chapter 13 plan so long as the Property has not been sold at a foreclosure sale.

However, there are a minority of courts that have held that a debtor lacking privity with a mortgagee cannot cure defaults on the mortgage. *See In re Allen*, 300 B.R. 105, 118-19 (Bankr. D.D.C. 2003); *In re Parks*, 227 B.R. 20, 25 (Bankr. W.D.N.Y. 1998); *In re Kizelnik*, 190 B.R. 171, 179 (Bankr. S.D.N.Y. 1995); *In re Mitchell*, 184 B.R. 757, 758 (Bankr. C.D. Ill. 1994); *In re Threats*, 159 B.R. 241, 243 (Bankr. N.D. Ill. 1993).

Kizelnik, *Mitchell* and *Threats* were commenced before the revised Code § 1322(c) was effective and are, therefore, no longer good law, leaving *Parks* and *Allen* as the most pertinent contrary decisions dated after *Johnson* and the revision of Code § 1322(c).

The court in *Parks*, without citing *Johnson*, conceded that "[a] claim only against property of a debtor is nonetheless a 'creditor' claim under the Code." *See Parks*, 227 B.R. at 22. The debtor in that case, as executor of his father's estate, deeded to himself and his sister his father's real property after the mortgagee obtained a judgment of foreclosure but before the foreclosure sale occurred. *See id.* at 21. The court rejected the debtor's attempt to redeem the property, relying on a "common-sense interpretation" of the word "cure," *id.* at 23, and holding that only the original mortgagor could cure a default pursuant to Code § 1322(b)(3) or (b)(5) or modify the mortgagee's rights under Code § 1322(b)(2). *See id.* at 25.

The *Allen* court also held that only the original parties to a mortgage have a right to cure. *See Allen*, 300 B.R. at 119. The debtor in *Allen* attempted to cure a default on her son's mortgage based on her alleged ownership interest in her son's property that resulted from her sporadic informal payments to him. *See id.* The court found that the debtor's filing was an abuse of the bankruptcy process because it appeared that the filing was a gambit devised to save the mortgage after the debtor's son's chapter 13 case was dismissed with prejudice because he failed to make plan payments. *See id.* at 112, 122. The court rejected the debtor's attempt to cure because it construed the term "cure" under Code § 1322(b)(5) to mean the restoration of the original parties' position under the mortgage. *See id.* at 118. The court went on to mention that allowing the debtor to cure would be a modification of the mortgagor's rights in contravention of Code § 1322(b)(2). *See id.* However, the court never analyzed the cure rights provided by Code § 1322(c)(1).

In light of these cases and the right to cure afforded by Code § 1322(c)(1), this Court must disagree with the holdings in *Allen* and *Parks*. The *Allen* court involved a debtor who had no cognizable ownership interest in the subject property and whose filing was found an abuse of the bankruptcy process. This Court must also respectfully decline to follow the *Parks* court, holding as it does a different interpretation of the cure rights permitted under Code § 1322(b)(3), (b)(5) and (c)(1).

Because the Property has yet to be sold at a foreclosure sale, the Court finds that the Debtor may propose to cure any defaults on the note and mortgage secured by the Property in his chapter 13 plan. Hence, Chase's motion to lift the automatic stay is denied.

IT IS SO ORDERED.

Dated at Utica, New York

this 9th day of January 2004

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STEPHEN D. GERLING
Chief U.S. Bankruptcy Judge