

This is the seventeenth in my series of newsletters due to your great interest, I plan to continue this quarterly report for my clients.

## **STRIP DOWN OF TOTALLY UNSECURED JUNIOR MORTGAGES NOT PERMITTED**

One of the hottest issues regarding stripping the lien of a totally unsecured mortgage has been resolved in New Jersey.

On October 29, 1997, in an unreported opinion, In Re Robinson, 97-15551, Honorable Judith H. Wizmur ruled that 11 USC 1322 (b)(2) prevents a debtor from stripping a totally unsecured mortgage Id. 15.

Judge Wizmur followed the reasoning in In Re Barnes, 207 B.R. 588 (Bankr. N.D. Ill. 1997)

The Court in Barnes reasoned that "if 11 USC 1322 (b)(2) protection against modification were limited to the security interests with underlying collateral, junior mortgages with a single penny of equity in collateral in the debtor's principal residence would still retain complete protection from a strip down while junior mortgages, who lacked that penny of equity would find their entire claim stripped off. Nobleman did not foster this absurd result because that decision did not delineate that any level of equity protecting the secured creditors is required for Section 1322 (d)(2) protection. Instead, Nobleman flatly held that Section 1322 (b)(2) prohibits a 506 (a) modification where, as here, the lender's claim is secured only by a lien on the debtor's principal residence.

In addition, Judge Stripp followed the analysis in Barnes in In Re Jones, 201 B.R. 371 (Bank DNJ 1996) Judge Stripp recognized in Jones "the existence of a mortgage lien ....determines the application of 1322 (b)(2), and not the value of the collateral subject to that lien." 201 B.R. at 374

The only reported case that allows clients to strip down fully unsecured mortgage is Judge Tuohey's case of In Re Cervelli, 213 B.R. 900 (Bankr. D.NJ 1997).

Unfortunately that case only applies to my clients whose case is in the Newark vicinage.

Judge Ferguson and Judge Burns have followed Judge Wizmur's position and Judge Gindin will only take a position if a junior mortgagee objects.

However, one way around this dilemma is to see if the mortgage company took additional collateral under 11 USC 1322 (b)(2).

This is based on the analysis in In Re Hammond, 27 F. 3d 52 (3<sup>rd</sup> Cir. 1994):

“Section 1322 (b)(2) language plainly states that a mortgagee who has an additional security interest gets no protection for the antimodification clause of Section 1322 (b)(2)..... Creditors who demand additional security interests in personality or escrow accounts and the like pay a price. Their claims become subject to modification. Their recourse, if they wish to avoid modification is to forego the additional security.” Id. at 57

The District of New Jersey in the Camden and Trenton vicinage have been very liberal in allowing strip downs of junior mortgages when an additional interest which is independent of the principal residence is taken. See. In Re Jones, 201 B.R. 371 (Bank D NJ 1996): In Re Cook 97- 12803 (decided by Judge Burns on October 15, 1997).

In In Re Ashford, 97-11053 (decided March 6, 1998), Judge Wizmur held that the Money Store’s interest in the escrow account found under the mortgage did not constitute additional collateral Id. at 12.

In In Re Rosen,208 B.R. 345 (DNJ 1997), the District Court concluded that the funds in the escrow account did not constitute additional collateral. The Rosen Court concluded the “the payment of taxes was simply part of the ownership interest attendant in title to property and should not be considered personalty Id. at 353-54.

Judge Wizmur concluded in Ashford that the funds escrowed were earmarked for taxes and hazard insurance and the mortgagee did not take an interest in the proceeds or returned premiums. Thus, there was no “independent collateral independent of real property” Id. at 11.

However, based on the leading case of In Re Hammond, supra, if a mortgagee takes a security interest in personal property such as doors, windows, appliances, machines or furniture, their claims became subject to modification.

Thus based on the present state of the law, it appears you will only be able to strip down a junior mortgage in the Camden or Trenton vicinage is it the mortgage company took additional collateral besides the debtor’s principal residence as collateral.

If you have any questions on this issue, please contact my office.

### **WHAT’S AHEAD REGARDING BANKRUPTCY REFORM?**

Currently, pending in the US House of Representatives is H.R. 2500 the “Responsible Borrowers Protection Bankruptcy Act” which is a controversial

“needs based” bankruptcy bill to allegedly stop what creditors perceive as the misuse of overbroad bankruptcy protection and relief.

In essence, H.R. 2500 would establish a needs-based bankruptcy system that would on the basis of income, automatically assign individuals to Chapter 7 or Chapter 13 using a non-judicial statutory formula to determine eligibility of relief under Chapter 7.

Under H.R. 2500, an administrative test for relief under Chapter 7 would be an income based test and would bar individual debtors from obtaining relief under Chapter 7 if the debtors current monthly income is 75% of the national median income for a family of equal size and they can afford to pay 20% of their unsecured non-priority debts over 5 years. The sponsors of H.R. 2500 contend that a needs based system will reduce the volume of Chapter 7 cases filed since presently there is no minimum amount of debt or specific income to debt ratio required to obtain relief under Chapter 7.

The “Consumer Bankruptcy Reform Act of 1997” seeks to combine provisions of H.R. 2500 while preserving the “fresh start” concept under existing bankruptcy laws.

Some proposed changes in S1301 are as follows:

1. Striking the requirement that debtor abuse of Chapter 7 be “substantial” before the Judge may dismiss or convert the Chapter 7 to a Chapter 13.
2. Inserting one’s ability to repay debts under 707(b).
3. Allowing panel Trustee’s and creditors to file 707(b) Motions but stiff penalties for creditors who file with little or no basis. In addition, if the panel Trustee succeeds, they could fine the debtor’s attorney.

Another significant provision of S1301 would require that debtors file account numbers, old tax returns and pay stubs with their petition to deter debtor fraud.

It is the consumer debtor advocates position that H.R. 2500 is an example of radical legislation and consumer debtor advocates are fighting an uphill battle against deep-pocketed pro-creditor groups.

As a result of the proposed legislation, the consumer creditors would have a giant de facto government sponsored federal collection agency at taxpayer expense to defray creditor costs profits for “high risk” lenders.

In addition, other potential bankruptcy bills pending, before Congress are as follows:

S1244, the Religious Liberty and Charitable Donation Protection Act of 1997". This was introduced by Senator Grassley, which would amend Title 11 to protect certain charitable contributions and other purposes.

In addition, H.R. 2611, the "Religious Fairness in Bankruptcy Act of 1997" introduced by Rep Chenoweth (R-ID) would amend Title 11 to declare the donations to a religious group or entity, made by a debtor from a sense of religious obligation such as tithes, shall be considered to have been made in exchange for a reasonably equivalent value.

See What's Ahead? A Review and Update of the Work of the National Review Commission, Presented by Judge David S. Kennedy US BJ (D TN), The Southeastern Bankruptcy Law Institute, March 25-28(1998).

If you have any questions concerning this matter feel free to contact my office or contact your congressman.

## **WHAT EXPENSES ARE REASONABLE FOR A DEBTOR IN BANKRUPTCY?**

Chapter 13 allows debtors to restructure their debts and keep all assets, exempt and non-exempt, in return for paying all or a portion of their debts under repayments plans. Under Section 1325(b) the debtor must use a portion of future income or "disposable income" to fund the plan. Disposable income consists of the debtor's net income minus reasonable living expenses.

Section 1325(b)(2)(a) defines "disposable income" to mean:

"Income which is received by the debtor and which is not reasonably necessary to be expended

- a. For the maintenance or support of the debtor or a dependent of the debtor.

Please note in determining projected disposable income, the debtor's non-filing spouse should be included See In Re Kitchens, 702 F.2d 885 (11<sup>th</sup> Cir 1983); Matter of Belt, 106 B.R. 553 (Bankr N.D.) Ind 1989); Matter of Strong, 84 B.R. 541 (Bankr N.D. Ind. 1988).

Once the Court decides what is the debtor's projected income, the Court must determine what is a reasonable expense.

There are 3 approaches taken by the Court in determining what expenses are reasonably necessary.

1. Some Courts take a "hands off" approach which states that Courts

should not impose their values on the debtor except in cases of obvious luxuries See, In Re Teinneberg, 59 B.R. 634 (Bankr E.D. NY 1986).

2. The second approach or majority approach is the “broad” interpretation. Courts following this approach impose their values on the debtor’s budget to ensure that the debtor’s expenses only provide for life’s necessities. This approach requires that the debtor live a basic lifestyle for maximize disposable income for unsecured creditors.
3. The third approach is a middle of the road position referred as the “Totality of the circumstances test”. Under this approach, Courts look at the debtor’s behavior in proposing the plan, past spending habits and desire to repay creditors See In Re Sutlift, 79 B.R. 151 (Bankr N.D. N. Y. 1987); In Re Narvarro, 83 B.R. 348 (Bankr E.D. PA 1988).

Housing - Housing expenses are usually considered reasonable. However, several cases rejected excessive mortgage payments See, In Re Jones, 55 B.R. 463 (Bankr D Minn 1985) and In Re Kitson, 65 B.R. 615 (Bankr ED N.C. 1986) Courts will either make you pay more to unsecured creditors or find less expensive housing.

Food – Most Courts use the broad interpretation of “disposable income” and scrutinize the debtor’s food budget based on the size of the family and age of dependents. Food expenses were held to be reasonable in the following cases: In Re Killough, 900 F.2d G (5<sup>th</sup> Cir. 1990) (\$225 per month for family of two); In Re Easley, 72 B.R. 948 (Bankr M.D. Tenn 1987) (\$200 per month for a single debtor)

Finally, Courts carefully scrutinize dining out expenses and have criticized expenditures for non-grocery items such as cigarettes.

Transportation: Even though transportation is considered a reasonable expense, there is an issue involving what type of transportation expenses are reasonable.

For example, In Re Rogers, 65 B.R.. 1018 (Bankr E.D. Mich 1986) held that \$440 payment per month on a red corvette were not reasonable and a luxury. In addition, in In Re Reyes, 106 B.R. 155 (Bankr N.D. I11 1989) the debtor purchased a new Chevrolet Blazer for \$472 per month and then filed Chapter 13. The Court held that this was improper when there were nominal payments to unsecured creditors.

4. Education: There is also a question concerning private education when you are trying to discharge debts to unsecured creditors. The Courts in New Jersey hold it is improper to in essence have your

creditors finance your children's private school education. See In Re Jones, 55 B.R. 462 (Bankr D. Minn. 1989) (\$500 per month for private college tuition and \$500 per month for parochial high school tuition was not reasonably necessary in light of high quality of public education available at college and secondary school levels. See also In Re Gyurci, 95 B.R. 639 (Bankr. D. Minn 1989) (held that 395 per month for a private high school may not be reasonably necessary).

5. Recreation: Courts are very reluctant to allow large recreation expenses especially when one proposes to pay a very small percentage of unsecured debt.

Courts have generally found the following expenses unnecessary or excessive.

- a. Cable TV: Most Courts have disfavored high cable expenses as excessive. Cf. In Re Killough, 900 F.2d 1011 (5<sup>th</sup> Cir. 1990) (The Court affirmed the bankruptcy court's decision that \$27 per month for cable was a reasonable recreational expense).
- b. Dining Out: Courts have criticized eating out as unreasonable. See, In Re Waites, 910 B.R. 211 (ED VA 1990); In Re Ploegert, 93 B.R. 641 (Bankr. W.D. Ark 1988).
- c. Health Club Membership: See, In Re Kitson, 65 B.R. 615 (Bankr E.D. N.C. 1986) (debtor's recreational expense of \$275 for a family of four which included \$48 for health club membership was excessive).
6. Charitable Contributions: There has been a major issue regarding tithing. Most Courts hold that a charitable or religious contribution is not reasonably necessary. In Re Curry, 77 B.R. 969 (Bankr S.D. FLA 1989) (to allow the expense would "permit the debtor to require his creditors to contribute to his chosen charity; In Re Tucker, 102 B.R. 219 (Bankr. D.N.M. 1989) (a tithe of \$100 per month was not a reasonably necessary expense). See How Fresh is the Debtor's Fresh Start? Standard of Living Issues For The Post Petition Debtor; Presented by Judge David S. Kennedy, U.S. B.J. (D TN), The Southeastern Bankruptcy Law Institute, March 25-28 (1998).

The reason for this analysis is to determine what the Court considers a good faith payment to unsecured creditors in a Chapter 13 Plan. Contrary to a lot of my clients' beliefs that you can wipe out all unsecured debt, this is based on the Court's analysis of good faith and my clients' budget. If you have no money left over after you pay reasonable expenses, it is likely you can get away with minimal payments to unsecured creditors: however, if you have too many luxuries in your budget for "unreasonable" expenses, a Court will raise your Trustee payments so unsecured creditors will get a higher payment.

If you have any questions on these lifestyle issues always feel free to call.

### **LET ME ANSWER ALL YOUR LEGAL QUESTIONS**

As my law practice continues to grow, I hope to help you in all areas of the law where I have helped my other clients. Remember, even if I am not familiar with a specific area of the law, I work with other lawyers who are well qualified to handle these matters. Therefore, if you have any question on any legal matter whatsoever, please ask me about it.

### **IF YOU LIKE MY WORK, SPREAD THE WORD**

I appreciate the confidence my clients show by referring new business to me. Such referrals are my largest and best source of new clients. Please let me know if you have a friend or relative who needs legal assistance or who would like to receive one of my quarterly news letters.

I sincerely appreciate all the referrals from so many of you over the past several years. Thank you for your continued confidence and good will.

If you would like me to speak at your organization or place of worship, feel free to contact me.