UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF NEW YORK

In re:

KATHLEEN E. ARNOLD, **BK. NO. 93-20385**

Debtor.

BACKGROUND

On February 23, 1993, the debtor, Kathleen E. Arnold, (the "Debtor") filed a petition initiating a Chapter 13 case. The petition indicated that on March 14, 1990 the Debtor had filed a joint Chapter 7 case with her former spouse and was granted a discharge in that case.

The Debtor scheduled unsecured creditors with total claims of $18,935.49, but did not schedule any unsecured indebtedness to American Credit Services, Inc. ("ACSI").

Along with her petition, the Debtor filed a Chapter 13 plan (the "Plan") which proposed a payment to the Trustee of $75.00 per month over a period of sixty months and provided for allowed unsecured claims to be paid a pro rata distribution after the payment of priority claims and administrative expenses. The distribution to unsecured creditors was estimated to be approximately 19%.

On March 17, 1993, ACSI filed an unsecured claim in the amount of $8,779.37 (the "ACSI Claim"). The Claim indicated that it was for a home improvement loan and attached a copy of an October 27, 1988 mortgage in the original amount of $15,000.00, executed by the Debtor and Michael Arnold and covering property commonly known as 1194 Imperial Drive, Webster, New York ("Imperial Drive").

On May 23, 1993, an Order confirming the Debtor's Plan was entered.

On July 19, 1994, the Debtor filed a motion objecting to the ACSI Claim (the "Claim Objection"). The grounds set forth in the Objection were that the debt represented by the ACSI Claim was scheduled and discharged in the Debtor's prior Chapter 7 case.

On August 10, 1994, ACSI filed a Statement in Support of its Claim (the "ACSI Statement"). Annexed as an exhibit to the ACSI Statement was a copy of an October 27, 1988 Installment Loan Note and Security Agreement (the "Installment Note") indicating that the Note was to be secured by a mortgage on Imperial Drive. The Statement indicated that: (1) in 1991 the Debtor sold Imperial Drive; (2) in connection with the sale, the Debtor requested a release of the ACSI mortgage lien; and (3) ACSI had agreed to release its mortgage lien in consideration of $3,000.00 and an agreement that the Debtor and Michael Arnold would not be discharged from the balance due on the Installment Note and would continue to make payments on the Note. Also attached as an exhibit to the ACSI Statement was a copy of a February 1, 1991 letter agreement (the "Letter Agreement") between the Debtor's attorney and ACSI which evidenced and constituted the agreement of the parties.[1] The ACSI Statement further indicated that after February, 1991 the Debtor made four $150.00 payments to ACSI in furtherance of the obligation provided for in the Letter Agreement.

A Supplemental Response filed by the Debtor on September 9, 1994 (the "Debtor Response")

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[1] The Letter Agreement read:

February 1, 1991

ACSI
Mr. Mark Scmitt
201 East Broad Street
Rochester, New York 14604

RE: KATHLEEN AND MICHAEL ARNOLD
SALE OF 1194 IMPERIAL DRIVE AND
RELEASE OF ACSI LOAN

Dear Mark:

As we have discussed the proposed sale of the above-property for the price indicated will leave the sellers unable to satisfy their home improvement loan with ACSI which my figures indicate has a balance of approximately $13,821. It is my understanding that you are willing to release the lien on the property for approximately $3,000. It is further our understanding that our clients would not be discharged from the balance of the loan but that they are discussing the repayment of that amount with you personally.

I would appreciate your signing the bottom of the letter where indicated, indicating your approval of this arrangement so that I might approve the contract and proceed with the sale. I appreciate very much your cooperation and understanding in this matter. I enclose a copy of the contract for your reference.

Very truly yours,

focused the Court on the provisions of Section 523 and the requirements of Section 524 of the Bankruptcy Code with respect to the discharge and reaffirmation of a debt, and asserted that: (1) the debt owed to ACSI, as evidenced by the Installment Note, was discharged in the prior Chapter 7 case by the Court's June 19, 1990 Order of Discharge entered pursuant to Section 523; (2) the obligation of the Debtor under the Letter Agreement was at best an agreement to reaffirm that debt; (3) the requirements of Section 524 were never complied with; and (4) since the debt evidenced by the Installment Note was never validly reaffirmed, it remained discharged.

On September 21, 1994, after having reviewed the pleadings and proceedings in this case and hearing oral argument by the attorneys for the parties, the Court allowed the ACSI Claim. The Court construed the Letter Agreement to be an Agreement where the Debtor, at its request, obtained a release of the ACSI mortgage lien on Imperial Drive, a valid lien which passed through the Debtor's Chapter 7 bankruptcy case notwithstanding that the Debtor's personal liability on the Installment Note may have been discharged, in consideration of an immediate payment of $3,000.00 and the payment over time of an amount equivalent to the remaining balance on the Installment Note. The Court did not consider the Letter Agreement to be a reaffirmation agreement within the meaning and intent of Section 524 or a waiver of the provisions of Section 523 or the Order of Discharge entered in the prior Chapter 7 case. On September 29, 1994, the Debtor filed a Motion for Rehearing pursuant to Rule 8015 (the "Rehearing Motion") which once again requested that the Court reconsider its allowance of the ACSI Claim pursuant to Section 502(j) and disallow the Claim.

The principal contention of the Rehearing Motion was that the Letter Agreement was not an agreement for the payment of an amount equivalent to the unpaid balance on the Installment Note in consideration of a release of the ACSI mortgage lien on Imperial Drive, but was an agreement to obtain the release for the payment of $3,000.00 and a reaffirmation of the debt evidenced by the Installment Note. Alternatively, the Rehearing Motion argued that there was no new or sufficient consideration provided by ACSI to support any new promise to pay.

An October 5, 1994 response to the Rehearing Motion by ACSI indicated that there was sufficient consideration for the agreement to repay, which was the agreement by ACSI to release its valid mortgage lien and allow the requested sale by the Debtor to proceed rather than not providing a release and perhaps foreclosing the mortgage lien.

DISCUSSION

Section 502(j) provides that: "A claim that has been allowed or disallowed may be reconsidered for cause. A reconsidered claim may be allowed or disallowed according to the equities of the case." Therefore, such reconsideration and allowance or disallowance is addressed to the sound equitable discretion of the Court.

The Court continues to interpret the Letter Agreement, drawn by the attorneys for the Debtor in connection with the sale of Imperial Drive where those attorneys also represented the buyers of the property, to be an agreement for the payment of a certain amount in consideration for a release of the ACSI mortgage lien on Imperial Drive, and not to be an agreement to reaffirm, in whole or in part, the debt evidenced by the Installment Note or to be a waiver by the Debtor of the provisions of Section 523 or the Order of Discharge entered in the Debtor's prior Chapter 7 case.

The Letter Agreement was entered into on or about February 1, 1991, a date more than seven months after the Debtor and Michael Arnold received their discharge. The date of discharge is also the date after which no valid reaffirmation agreement could be entered into under Section 524(c).[2] If the agreement made by the Debtor to obtain the release of the ACSI mortgage lien was, in whole

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[2] Section 524(c)(1) provides:

> An agreement between a holder of a claim and the debtor, the consideration for which, in whole or in part, is based on a debt that is dischargeable in a case under this title is enforceable only to any extent enforceable under applicable nonbankruptcy law, whether or not discharge of such debt is waived, only if–
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> (1) such agreement was made before the granting of the discharge under section 727, 1141, 1228, or 1328 of this title.

or in part, an agreement to reaffirm the debt evidenced by the Installment Note, what was the intent of the Debtor and her attorneys in making the offer and promise at a time when reaffirmation was no longer possible? Was the offer and promise which the Debtor and her attorneys knew or should have known was impossible of performance, made in bad faith to obtain a release of the ACSI mortgage lien? Would the attorneys for the Debtor, who also represented the buyers, have advised the Debtor to make such an offer and promise if it was impossible of performance and also allow her or the buyers to receive the valuable consideration of a release of the ACSI mortgage lien?

Certainly the Debtor and her attorneys are not contending that the Debtor was acting in bad faith in connection with the Letter Agreement. Is ACSI, which at the time of the Letter Agreement does not appear to have been represented by an attorney, to be prejudiced because it released a valid mortgage lien for a consideration negotiated by the Debtor's attorney which may have included a promise which was known or should have been known to be impossible of performance when made?[3]

As a Court of equity, this Court must balance important policies such as a "fresh start" and the protections of Section 524[4] against other equitable considerations such as prejudice and fundamental fairness and good faith. The only realistic and equitable interpretation of the Letter Agreement which the Court can make is that it was an agreement to obtain a release of the ACSI mortgage lien by the repayment of an amount equivalent to the outstanding balance which otherwise would have been due on the Installment Note, an amount which the parties must have felt was the

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[3] The Court is not aware of any provisions under New York State Law that would have been available to the Debtor to obtain the release of the ACSI mortgage lien on terms and conditions other than agreed to by ACSI in its sole discretion.

[4] The provisions of section 524 arose from a need to protect debtors from post-discharge debt collection efforts and subsequent state court actions pursued by creditors. *See* 3 *Collier on Bankruptcy* ¶524.01[2] (15th ed. 1994). Specifically, subsections (c) and (d) of section 524 set forth the requirements of reaffirmation agreements, "[t]hese provisions grew out of a long history of coercive and deceptive actions by creditors prior to enactment of the Code to secure reaffirmation of discharged debts." *Id.* ¶524.04 at 524-27. The protections of §524 apply to the personal liability of debtors; a creditor's right to foreclose on a lien survives or passes through bankruptcy unaffected by the discharge. We are not presented here with a situation in which a creditor attempted to collect a debt in contravention of the debtor's right to the protections afforded by §524. Rather, the debtor bargained with a lienholder for the release of a valid lien.

fair value of the lien to be released. Further, there was sufficient consideration for such an agreement by the Debtor.

CONCLUSION

The Rehearing Motion by the Debtor to disallow the ACSI claim is in all respects denied.

IT IS SO ORDERED.

/s/
HON. JOHN C. NINFO, II
U.S. BANKRUPTCY COURT JUDGE

Dated: October 19, 1994