

**UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF NEW YORK**

In Re:

**DONALD F. KEAN and
WILMA P. KEAN,**

Debtors.

CASE NO. 94-20396

DECISION & ORDER

BACKGROUND

On March 1, 1994 the Debtors, Donald F. Kean and Wilma P. Kean (the "Debtors"), filed a petition initiating a Chapter 13 case. The schedules filed by the Debtors showed that: (1) the Debtors jointly owned approximately thirty-seven acres of land valued at \$185,000 which was improved by a house, barn and fruit stand (the "Homestead Parcel"); and (2) the Debtor Donald F. Kean also owned approximately sixty acres of vacant land valued at \$242,000 (the "Acreage Parcel"). The schedules further indicated that Alan D. Madden ("Madden") was a secured creditor who was owed approximately \$285,000 which was secured by three different mortgages (sometimes collectively referred to as the "Madden Mortgages"), two covering the Homestead Parcel and one covering the Acreage Parcel, and that the Debtors had commenced an action in New York State Supreme Court against Madden for intentional infliction of emotional distress and other claims (the "Distress Action").

Along with their petition, the Debtors filed a Chapter 13 plan (the "Plan") which proposed to surrender to Madden in full satisfaction of the Madden Mortgages, the Acreage Parcel and all but five acres of the Homestead Parcel which include the house, barn and fruit stand. The Plan further proposed that the Trustee would pursue the Distress Action and distribute the proceeds received first to pay in full the Debtors' unsecured creditors, owed approximately \$11,000, with any balance to be paid over to the Debtors. The Plan also provided for the Debtors to pay to the Trustee \$150.00 per month over the 36-month term of the Plan. Based upon their budget, the \$150.00 per month

payments would essentially be a full use of the Debtors' disposable income.

On January 4, 1994, Madden filed a Motion to Modify the Automatic Stay (the "Madden Stay Motion"), requesting that he be permitted to continue a pending state court mortgage foreclosure proceeding (the "Foreclosure Action"). The Madden Stay Motion indicated that in 1987 Madden, to assist the Debtors and prevent their real property from being sold at a foreclosure sale commenced by the Production Credit Association of the Finger Lakes ("Production Credit"), had paid the amount then due to Production Credit and had taken an Assignment of the Madden Mortgages which it held on the Debtors' real property. These Mortgages were:

- (1) a November 5, 1976 mortgage in the original principal amount of \$32,300 secured by the Homestead Parcel (the "Homestead First Mortgage");
- (2) an April 26, 1982 mortgage in the original principal amount of \$45,000 secured by the Homestead Parcel (the "Homestead Second Mortgage"); and
- (3) a March 24, 1981 mortgage in the original principal amount of \$50,000 secured by the Acreage Parcel (the "Acreage First Mortgage").

The Madden Stay Motion further indicated that: (1) the Foreclosure Action had been commenced by Madden to foreclose the Homestead Second Mortgage and the Acreage First Mortgage; (2) a Judgment of Foreclosure and Sale had been entered in the amount of \$187,579.97 (the "Foreclosure Judgment")¹ on January 19, 1994; and (3) a sale had been scheduled in the Foreclosure Action for March 2, 1994, the day after the Debtors filed their petition.

The Madden Stay Motion also indicated that as of the date of the Motion there was \$191,676.33 due on the Foreclosure Judgment and \$86,509.22 due on the Homestead First Mortgage, bringing the total amount due Madden on the Madden Mortgages to \$278,182.55. The Motion also had attached a copy of a November, 1993 Appraisal (the "Madden Appraisal")

¹ Neither the Madden Stay Motion nor any of the supplemental pleadings filed on behalf of Madden provided a breakdown of the amounts due on the Homestead Second Mortgage and the Acreage First Mortgage.

indicating that the fair market value of the Homestead Parcel was \$117,000 and the fair market value of the Acreage Parcel was also \$117,000.

The Madden Stay Motion asserted that the Debtors had no realizable equity in either the Homestead Parcel or the Acreage Parcel and that neither property was necessary for an effective reorganization, because there could be no effective Chapter 13 reorganization. Madden contended that there could be no effective Chapter 13 reorganization since: (1) the Debtors had insufficient income to cure any arrearages due on the Madden Mortgages over a three to five year permissible term for a Chapter 13 plan or even to make adequate protection payments on the Mortgages; and (2) the Plan could not be confirmed because its proposal to transfer a portion but not all of the Homestead Parcel and the Acreage Parcel to Madden in full satisfaction of his Mortgages would modify Madden's rights as the holder of mortgages secured solely by the Debtor's residence in violation of the provisions of Section 1322(b)(2) as interpreted by the United States Supreme Court in *Nobleman v. American Savings Bank*, --- U.S. ---, 113 S.Ct. 2106, 124 L.Ed.2d 228 (1993).²

The Debtors, Madden and the Chapter 13 Trustee agreed to adjourn the scheduled confirmation hearing on the Plan and anticipated hearings on the value of the Homestead and Acreage Parcels pending a determination by the Court as to whether the Plan was even confirmable in view of the provisions of Section 1322(b)(2).

DISCUSSION

After considering the provisions of Sections 1322(b)(2), 1322(b)(8) and 1325(a)(5), the legislative history for those sections, relevant case law and the submissions of the parties, the Court concludes that the Plan could be confirmed and would not violate the protections afforded by Section

² This argument was asserted only with respect to the Homestead First and Second Mortgages.

1322(b)(2) to the holder of a home mortgage, depending upon the ability of the Court to find in accordance with Section 1325(a)(5)(B)(ii) that the value, as of the effective date of the Plan, of the property proposed to be distributed to Madden was not less than the allowed amount of his secured Mortgage claims. If the Court was able to make the required finding under Section 1325(a)(5)(B)(ii), it would essentially have found that the distribution of property in kind would constitute full payment to Madden of his Mortgages, requiring him to provide appropriate discharges. Therefore, the confirmation of such a plan and its implementation would not modify Madden's rights in violation of Section 1325(b)(2) and the decision of the U.S. Supreme Court in *Nobleman v. American Savings Bank*, --- U.S. ---, 113 S.Ct. 2106, 124 L.Ed.2d 288 (1993), because his rights would terminate upon being paid in full.

Section 1322(b)(2) provides that a Chapter 13 plan may modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence.³

Section 1325 sets forth requirements that the Court must affirmatively find have been complied with in order for it to confirm a Chapter 13 plan. These requirements include Section 1325(a)(5) which provides that:

with respect to each allowed secured claim provided for by the plan—

- (A) the holder of such claim has accepted the plan;
- (B)(i) the plan provides that the holder of such claim retain the lien securing such claim; and

³ Because the Madden Mortgages include boilerplate provisions assigning oil and gas lease rights and the rights to insurance proceeds to the mortgagee, the Debtors have raised and briefed the issue of whether the Homestead First Mortgage and Second Mortgages qualify for the special protection afforded by Section 1322(b)(2) because they are not secured only by a security interest in real property that is the Debtors' principal residence. Because of the Court's decision, it is not necessary for it to determine that issue in this case.

- (ii) the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim; or
- (C) the debtor surrenders the property securing such claim to such holder; . . .

The Debtors' Plan proposes to distribute real property in kind to Madden in full satisfaction of his Mortgages. The property proposed to be distributed in kind is less than all of the property covered by the Madden Mortgages, because the Debtors propose to exclude five acres of land improved by their house, a barn and a fruit stand. Since Madden has not and will not accept the Plan (Section 1325(a)(5)(A)) and the Debtor does not propose to surrender all of the property securing the Madden Mortgages (Section 1325(a)(5)(C)), the Court could only confirm the Plan if it were to find that the requirements of Section 1325(a)(5)(B) had been met. Therefore, in order to confirm the Debtors' Plan, the Court would have to find that the value of the property which the Debtors propose to distribute to Madden is not less than the allowed amount of his secured Mortgage claims.

When Sections 1322(b)(8) and 1325(a)(5)(B)(ii) and their legislative history are read together, they permit a debtor to distribute property in kind and not just cash or cash equivalents. The legislative history and commentary for Chapter 13 indicate that "the secured creditor in a case under Chapter 13 may receive any property of a value as of the effective date of the plan equal to the allowed amount of the creditor's secured claim rather than being restricted to receiving deferred cash payments." *In re Durr*, 78 B.R. 221, 223 (Bankr. D.S.D. 1987). Such property can be property of the estate or exempt or other property of the debtor. To meet the requirements of Section 1325(a)(5)(B)(ii), a debtor, especially when proposing to distribute property in kind as opposed to deferred cash payments or cash equivalents, must clearly demonstrate that the property proposed to be distributed has a value which is not less than the

allowed secured claim. This can be a particularly difficult burden to meet when the property proposed to be distributed in kind is real property which is always difficult to value with certainty in the absence of an existing arms length non-contingent purchase offer.

Although value is not specifically defined in the Bankruptcy Code, Section 506(a), which deals with the determination of secured status, does state that "... value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest." 11 U.S.C.A. §506(a) (1993).

The determination that the Court would be required to make under Section 1325(a)(5)(B)(ii) in connection with the Debtors' Plan would be that the property to be distributed to Madden in kind in fact constitutes full payment of the Madden Mortgages. Courts which have been asked to make similar determinations in Chapter 11 and 12 cases under Sections 1129(b)(2)(A)(iii) and 1225(a)(5)(B) have highly scrutinized the values of the property proposed to be distributed in kind, especially when it is real estate, and have required clear and convincing proof that the secured creditor will be able to realize the full amount of its secured claim from the subsequent commercially reasonable liquidation of the property. *See Durr*, 78 B.R. at 224. These courts have also expressed an additional concern when the property to be distributed is property of the estate and it is not clear that the other creditors will be paid in full, which is that the property may be of a significantly greater value than the secured claim to be satisfied, so that such a distribution may prejudice the other creditors. *See Durr*, 78 B.R. at 225; *In re Elijah*, 41 B.R. 348, 352 (Bankr. W.D.Mo. 1984). This Court does not believe that a distribution in kind of real estate pursuant to Sections 1322(b)(8) and 1325(a)(5)(B)(ii) to effect full payment of a secured claim violates the special treatment afforded to holders of home mortgages by Section 1322(b)(2) when the burden to show that the provisions of Section

