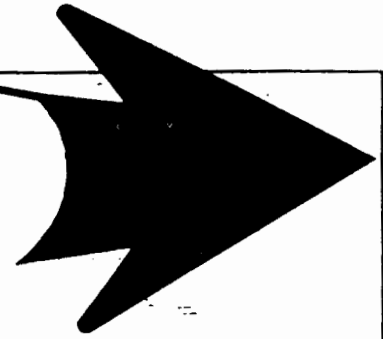


THE ARROW

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SUPREME COURT APPROVES "CHAPTER 20"

The United States Supreme Court seems to be reviewing more bankruptcy issues in recent years. Recently, Justice Thurgood Marshall, the Court's retiring Justice, gave bankruptcy debtors a farewell gift by which to remember him when he wrote the majority Opinion in the case of Johnson v. Home State Bank, 20 BCD 1029. This important decision found the use of "Chapter 20" permissible.

"Chapter 20" is the name given to the procedure whereby a Chapter 7 bankrupt follows his Chapter 7 discharge with a Chapter 13 plan. The initial Chapter 7 discharge eliminates the debtor's personal liability on his debts, and the subsequent Chapter 13 is used by him to cure the mortgage arrearage on his home. Thus, the creditor who holds the mortgage on the debtor's residence first has the debtor's ob-

ligation to it under the mortgage note discharged, then is prevented from foreclosing on its lien by a Chapter 13 Plan which allows the debtor to cure any mortgage arrearage by regular payments to a Chapter 13 Trustee.

In Johnson, a case involving a Kansas debtor, that is exactly what happened. The debtor first filed a Chapter 7 Petition to forestall a foreclosure upon his residence and was discharged from his personal obligation to the bank which held his mortgage. The mortgage holder then obtained termination of the Stay and reactivated its foreclosure to enforce its lien upon the debtor's residence, which lien was unaffected by the discharge. Prior to the foreclosure sale, however, the debtor filed a Chapter 13 petition and scheduled the bank as a partially secured creditor. Eventually, the debtor was successful in

having a Plan confirmed allowing him to pay the obligation to the foreclosing bank over time.

Upon appeal to the District Court, the Bankruptcy Court was reversed upon the reasoning that the debtor's Chapter 13 Plan improperly sought to schedule a discharged debt. The United States Court of Appeals for the 10th Circuit affirmed the District Court, and the debtor appealed to the United States Supreme Court.

Justice Marshall's decision pointed out that 11 U.S.C. §1322 (b) (6) allows a debtor in a Chapter 13 Plan to provide for payment of "all or part of any claim." By interpreting "claim" in the broadest possible sense, including a "claim against property of the debtor" [11 U.S.C. §102(2)] Justice Marshall reasoned that the creditor's mortgage interest on

the real estate was such a "claim." The mortgage holder had both the right to foreclose and the right to payment in the form of a right to the proceeds from the foreclosure sale.

The consequences of this decision are somewhat disconcerting to creditors.

"Chapter 20" allows such a debtor to take a recourse mortgage loan and convert it into a nonrecourse loan over the mortgage holder's protest. Justice Marshall found no prohibitions against such a procedure within the Bankruptcy Code.

Those who finance real estate with the anticipation that they have recourse mortgages should be aware that Justice Marshall's Opinion is now the law of the land. Such creditors must now seek their relief from "Chapter 20" in the hallowed halls of Congress. □

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