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Legal Briefs from the Attorneys of
Mackall, Crouse & Moore, PLC

Creditors' Corner

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8TH CIRCUIT BANKRUPTCY APPELLATE PANEL RULES THAT COMPLETELY UNSECURED JUNIOR LIENS CAN BE STRIPPED IN CHAPTER 13 PLAN

The Eighth Circuit Bankruptcy Appellate Panel recently joined the majority of other courts nationally in holding that a Chapter 13 debtor can strip a wholly-unsecured junior mortgage on its principal residence in a plan. As has been previously noted in this publication, the federal bankruptcy judges in Minnesota have long ruled that mortgages on a debtor's principal residence cannot be modified, even if there is no equity for the junior mortgage. *In re Fisette*, 11-6012, (8th Cir. BAP, 2011) the BAP sought to overrule a recent Minnesota decision which required the debtor to pay wholly-unsecured junior mortgages in his plan.

The general rule for a Chapter 13 plan is that the Debtor can modify payment of secured debt. Where the debt exceeds the value of the collateral, the Debtor can further bifurcate the claim into secured and unsecured portions, with the secured portion equaling the value of the collateral. While the plan must provide for payment of the secured claim, or surrender of the collateral, it need only pay disposable income to the unsecured portion along with the other general creditors, which will likely result in payment of only a small fraction of the undersecured amount.

Congress enacted additional protections for home lenders in Chapter 13. Section 1322(b)(2) of the code provides that the Debtor may not modify the rights of a holder of a claim secured by the debtor's principal residence. The United States Supreme Court held in *In re Nobelman* that Section 1322(b)(2) prevents the modification or bifurcation of undersecured mortgages, including junior liens. *Nobelman* did not address the circumstance where the value of the property was less than the amount due on the first mortgage, in which case there would be no equity for the junior mortgage holder.

Fisette held that where the value of the property is less than the amount due of the first mortgage, there is no value for the second mortgage and that the second mortgage does not have a secured claim. A secured claim is specifically provided for in the code only to the extent of the value of the property. If the value is zero, there is no secured claim, and Section 1322(b)(2)'s protection does not come into play.

Practice Pointer: As noted above, the BAP adopted the rule which most courts in the country have adopted, which is a bad rule for consumer junior mortgage holders. The decision may be appealed further. Also, the BAP technically does not provide binding precedent to the bankruptcy court but it is influential, and it would be unusual for the bankruptcy court to disagree with the BAP. The attorneys at MCM

routinely handle Chapter 13 matters, including representation of second mortgages. Because the debtor could not modify a claim if it is established there is \$1 of equity, it appears that valuation fights may re-emerge in the Chapter 13 cases for residential mortgages.

A NATIONAL BANK IS A CITIZEN OF THE STATE WHERE ITS ARTICLES OF ASSOCIATION PROVIDE ITS MAIN OFFICE IS LOCATED

U.S. Bank, N.A. v. Polyphase Electric Co., et al. No. 10-CV-4881 (D. Minn. 2011) involved a dispute over a revolving bank loan. The defendants brought a motion to dismiss the case for lack of subject matter jurisdiction. The jurisdiction of the federal court was based upon diversity of citizenship, which required that no defendant was a citizen of the same state as the plaintiff. U.S. Bank alleged that it was a citizen of Ohio. The defendants, some of who were citizens of Minnesota, asserted that U.S. Bank should be considered a citizen of Ohio, where its main office was located, and also Minnesota, its principal place of business. The defendants noted that U.S. Bank had asserted in at least sixty prior cases that it was a citizen of Minnesota. The federal district court held that under a diversity analysis, a national bank is a citizen of the state where its articles of association provide its main office is located, and held that it had subject matter jurisdiction over the case. The court noted the unique nature of national banks. It found that U.S. Bank's prior assertions that it was a citizen of Minnesota were irrelevant.

Practice Pointer: Jurisdiction disputes can be an expensive and seemingly wasteful disputes because they generally only incur fees and get the parties no closer to the merits. On the citizenship issue in this case, the rule for national banks is relatively clear because the articles of association control. Other situations are less clear but generally with any party the state of incorporation and principal place of business may establish citizenship, but on the latter point, facts may be in issue. The attorneys at MCM have extensive experience in procedure and jurisdiction issues in state, federal and bankruptcy courts.

ARE YOU MEDIATING IN GOOD FAITH?

A recent decision of the U.S. District Court in the Southern District of New York, *In re A.T. Reynolds, Inc. d/b/a Leisure Time Spring Water*, establishes an important standard for what constitutes good faith participation in court-ordered mediation. The ruling vindicated the lender's "no pay" position taken at mediation. In *A.T. Reynolds*, the court ordered the lender, the borrower/debtor and the purchaser to mediate the lender's potential liability for unpaid wages when sale proceeds of collateral failed to cover all of the debtor's operating liabilities and the debt due the lender. At mediation the lender refused to pay anything. The mediator said that because the lender did not do a "risk analysis," the lender did not mediate in good faith. The bankruptcy court held the lender and its counsel in contempt and the lender took immediate appeal.

The District Court held that the lender could adopt a "no pay" position finding that courts cannot coerce parties into settlements since it is proper for a party to conclude that it has no liability. The decision also

states that confidentiality concerns in mediation prevent a court from inquiring into the level of a party's participation in mediation.

Practice Pointer: The court set out a good faith standard which requires a party to attend mediation, provide pre-mediation memoranda and, in some cases, produce a representative with sufficient settlement authority. Choosing to not make a dollar offer is not a measure of authority. Mediation has become a standard practice in most legal disputes, and there is always pressure from the mediator against parties to settle, even if they have "airtight" claims. This decision confirms that parties can "stick to their guns" when they are in the right and do not need to be bullied into making a deal. MCM attorneys regularly represent parties in court ordered and other mediation and aggressively advocate to obtain attractive settlements for their clients.

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