UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
WESTERN DIVISION

In re: Justin E. Henderson Debtor.	**Case No. 04 B 75363** **Chapter 13**

MEMORANDUM OPINION GRANTING BLACKHAWK STATE BANK'S MOTION TO MODIFY THE AUTOMATIC STAY

This matter comes before the Court on the motion of Blackhawk State Bank (the "Bank") for relief from the automatic stay pursuant to § 362(d) of the United States Bankruptcy Code.[1] The debtor is represented by Attorney John J. Carrozza of Macey & Chern.

FACTS

The debtor, Justin E. Henderson ("Debtor"), filed a Chapter 13 bankruptcy petition on October 28, 2004. Debtor is the owner of real estate located at 7901 Shore Drive, Machesney Park, Illinois, which serves as his principal residence. The property is subject to a mortgage held by Blackhawk State Bank with an approximate remaining principal balance of $55,000. The mortgage was executed by James J. Henderson, the Debtor's father. He subsequently transferred the property to his two sons, Justin and James K. Henderson via a trustee's deed. Debtor's father died on August 29, 1999. Later, Debtor's brother, James K. Henderson, executed a quit claim deed which transferred his interest in the property to Debtor. The property has an estimated value of $79,900 and approximately $25,000 of equity over and above the amount due on the

[1] All references to "the Code" refer to 11 U.S.C. §§ 101 *et. seq*.

mortgage.

Debtor made timely mortgage payments on the property for approximately five years before he began to fall behind. Debtor asserts that he never refinanced the property because the Bank lead him to believe that refinancing was unnecessary as long as he continued to make payments. Debtor also contends that the Bank was aware that the property was transferred to him and attached to his pleadings a handwritten note from the Bank signed by Tom Kostka as support. (Resp. Mem. In Opp. To Mot. Of Blackhawk State Bank to Mod. Stay, Exhibit A.) The note is dated September 23, 2003, just over one year prior to the Debtor's bankruptcy petition.

The Bank filed a mortgage foreclosure action against Debtor in the Circuit Court of Winnebago County and obtained a judgment of foreclosure on July 14, 2004. It is the Bank's contention that Debtor obtained ownership of the subject real estate without knowledge or consent of the Bank. Accordingly, a debtor-creditor relationship does not exist between the Bank and Debtor, and, thus, the Bank has no claim against Debtor. Accordingly, the Bank contends that Debtor has no legal obligation of performance to the Bank since he was not a party to the original loan obligations, and, consequently, Debtor cannot invoke the cure and reinstatement provisions available under § 1322(b)(3) and (5) of the Code. Therefore, the Bank seeks modification of the stay to enforce their rights against the property.

DISCUSSION

The parties acknowledge that Debtor has an ownership interest in the real estate, and, as such, it constitutes property of the estate pursuant to § 541 of the Code. Nevertheless, it is the Bank's position that in the absence of a contractual obligation

between Debtor and the Bank, there is no personal obligation to cure or reinstate as contemplated by § 1322 of the Code. The Bank acknowledges that the U.S. Supreme Court has held that a debtor who discharges his personal obligation of a mortgage through a Chapter 7 bankruptcy could thereafter make use of Chapter 13 to deal with the remaining claim against the property. *Johnson v. Home State Bank,* 501 U.S. 78 (1991). The *Johnson* Court stated: "A fair reading of § 102(2) is that a creditor who, like the Bank in this case, has a claim enforceable only against the debtor's property nonetheless has a 'claim against the debtor' for purposes of the Code." *Id.* at 85. The Court went on to state that the legislative history directly corroborated that inference. "The Committee Reports accompanying § 102(2) explain that this rule of construction contemplates, inter alia, 'nonrecourse loan agreements where the creditor's only rights are against property of the debtor, and not against the debtor personally.'" *Id*. (quoting H.R. REP. NO. 95-595, at 315 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5814).

The Bank argues, however, that the rationale set forth in *Johnson* has no application to situations where there is no privity of contract between the debtor and the mortgagee. The Bank cites the case of *In re Threats*, 159 B.R. 241 (Bankr. N.D. Ill. 1993), for support. The debtors in that case received an ownership interest via a quit claim deed from the original mortgagors. The debtors, however, neither assumed the mortgage nor applied to the Department of Veterans Affairs for an assumption application. The mortgage fell into arrears and become immediately due and payable pursuant to an acceleration clause. Judge Katz held that the creditor's rights are defined in the mortgage instrument, and because there was no mortgagee-mortgagor relationship, there could be no cure. *Id.* at 243. The Court explained:

[T]heir proposed plan would be a *de facto* assumption, enabling them to

> substitute their performance for the Mortgagors' by providing for the de-acceleration of the loan, curing of arrearages and maintenance of current payments. In the absence of a showing that both the assumption and due-on-sale clauses would be unenforceable in Illinois, the Court finds that the proposed plan would impermissibly modify Fleet's rights in violation of Section 1322(b)(2).

Id. That case appears to rest largely on the debtors violation of the due-on-sale clause contained in the mortgage, which the Court held was an impermissible modification of the creditor's rights under §§ 1322(b)(3) and (5). The Bank and Debtor agree that the due-on-sale clause cannot be invoked in this case because the Garn-Saint Germain Depository Institutions Act of 1982 (hereinafter the "Act") prohibits the enforcement of a due-on-sale clause when property is transferred to a spouse or a child who will occupy the property. 12 U.S.C.A. § 1701j-3(d)(6).

The *Threats* decision, however, goes on to state that the reason behind the Code provisions which allow debtors to cure defaults and maintain current payments is to allow "the parties to return to their respective pre-default positions under the relevant agreement." 159 B.R. at 243. "Cure means to restore matters to the way they were before the default." *Id.* (quoting *In re Clark*, 738 F.2d 869, 872 (7th Cir. 1984) and *In re Roach*, 824 F.2d 1370, 1375 (3rd Cir. 1987)). The Court concluded that the Code "allows debtors to regain certain previously held interests in property–it does not allow them to create new ones." *Id.*

While it is clear that a creditor's right to enforce the due-on-sale clause cannot be modified by § 1322(b)(2), it is unclear whether the Act's exemption of this debtor from that limitation implies the existence of other rights. If the Act exempts the transferee from the due-on-sale provision, does it necessarily follow that the transferee has

essentially assumed the contract by operation of law? This court concludes that such is not the intent nor effect of the Act.

The Legislative Committee report notes a concern with state restrictions on the enforcement of due-on-sale clauses. Thus, the Act preempts the states and allows some exemptions, such as the one applicable to Debtor. Among the enumerated concerns Congress sought to address are: 1) due-on-sale clauses favor existing home owners over new ones; 2) assumable loans pose risks for lenders requiring higher prices for mortgages; and 3) restrictions on such clauses may bring about the disappearance of "the traditional mainstay" of home owners, the long term fixed mortgage. S. REP. NO. 97-536, at 21 (1982) *reprinted in* 1982 U.S.C.C.A.N. 3054. Thus, the Act was intended to protect banks against an individual state's ability to restrict the contractual right to enforce due-on-sale clauses and to protect the ability of debtors similarly situated to Mr. Henderson to continue making mortgage payments and enjoy the benefit of the transfer. It operates as a shield for children of transferors to wield in order to maintain possession of the property that constitutes their principal residence.

While much of the case law and argument in this matter concerns the due-on-sale clause, the mortgage also provides for acceleration upon default. The right of the lender to accelerate the loan is the modification allowed by § 1322(b)(5). The Act does not shield Debtor from the Bank's right to accelerate the loan. It is one thing to provide a shield against the enforcement of a due-on-sale clause and quite another to say that the Act also provides a sword with which the transferee can modify the contractual rights of a creditor by allowing a person who is otherwise not a party to the contract to cure a pre-petition default. The cases that have so allowed have done so on the basis

of some extrapolation from the *Johnson* case wherein the broad definition of claim was used to justify treatment of *in rem* liability in a chapter 13 plan. *See In re Lumpkin,* 144 B.R. 240 (Bankr. D. Conn. 1992) and *In re Rutledge*, 208 B.R. 624, (Bankr. E.D.N.Y. 1997). Those cases focused on the definition of "claim." However, § 1322(b)(5) refers to the "curing of any default." As stated by Judge Katz, "the creditor's rights are defined in the mortgage instrument, and because there was no mortgagee-mortgagor relationship, there could be no cure." 159 B.R. at 243.

The application of the Supreme Court's decision in *Johnson* should be limited. The *Johnson* case did not involve a transfer, a third party or the absence of privity of contract. Thus, any extension of the *Johnson* rationale to the present facts requires a reading which stretches its holding to encompass cases in which no privity of contract exists. Such a stretch is untenable given the purpose § 1322 to provide for the cure or reinstatement of contractual rights. As the court in *Threats* noted, one cannot cure or reinstate that which one never had. *See id.*

The Debtor also raises the doctrine of waiver as to the Bank's alleged acquiescence to the "assumption' of the loan by Debtor. This Court granted Debtor leave to supply any authority for the proposition that a waiver theory could be applied to find a *de facto* assumption which would bind the Bank. The Debtor acknowledged that no authority exists for that proposition. In addition, the exhibit attached to Debtor's memorandum in opposition to the motion to modify stay merely states: "Please call me immediately." (Exhibit A.) This, without more, does not establish an acquiescence to Debtor's assumption of the mortgage. Thus, this Court finds no support for the proposition that the Bank acquiesced to the assumption of the mortgage.

CONCLUSION

The right to cure a pre-petition mortgage pursuant to § 1322(b) does not grant a debtor rights which the debtor did not have pre-petition. The Garn-St. Germain Act's prohibition of enforcement of a due-on-sale clause does not operate as a means to modify the rights of a creditor with respect to a debtor who was not a party to the mortgage. The Supreme Court's holding in *Johnson* should not be extended to third parties attempting to cure mortgage defaults. Thus, § 1322 cannot be implemented to cure defaults of a mortgage to which the debtor was not a party. Therefore, cause exists to modify the automatic stay.

Dated: May 17, 2005

Manuel Barbosa
U.S. Bankruptcy Judge