

CONSUMER BANKRUPTCY

Judges Differ with Chapter 7 Cram-Down

By Craig D. Robins

Note: All local decisions cited below can be viewed in their entirety at LongIslandBankruptcy-Blog.com, and then go to The Suffolk Lawyer.



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The December Consumer Bankruptcy *Suffolk Lawyer* article, “Chapter 7 Cram-Down of Second Mortgages” reported that Central Islip Bankruptcy Judge Dorothy T. Eisenberg issued a decision permitting a Chapter 7 debtor to cram-down a second mortgage.

This decision permitted homeowners whose homes were underwater to “strip-off” and remove a wholly-unsecured second mortgage. However, we have since heard from two other Long Island Bankruptcy Court judges.

The decision granting this relief was *In re Lavelle*, No. 09-72389-478, 2009 WL 4043089 (E.D.N.Y. November 25, 2009). In that case, Judge Eisenberg determined that a Chapter 7 debtor may avoid a subordinate mortgage lien if that lien is wholly unsecured. This decision was based on an analysis of Bankruptcy Code section 506.

In her decision Judge Eisenberg also commented on the seminal Supreme Court case of *Dewsnup v. Timm*, 502 U.S. 410 (1992), stating that she found no authority in it that prevents a Chapter 7 debtor from

cramming down a second mortgage in a Chapter 7 case.

Judge Eisenberg focused a large part of her decision on *Dewsnup* which held that a Chapter 7 debtor may not “strip down” a first mortgage to the fair market value of the property. However, she pointed out that there is a difference between “stripping down” a mortgage and “stripping off” a mortgage.

Stripping-down refers to removing that portion of a mortgage that is unsecured, which is done pursuant to § 506. On the other hand, “stripping off” is essentially cramming down a mortgage, which means removing its lien status altogether. She determined that stripping-off was permissible in Chapter 7 cases.

Once Judge Eisenberg released the *Lavelle* decision, the Long Island bankruptcy bar was abuzz about the possibility of being able to cram-down undersecured second mortgages for their Chapter 7 debtor clients. However, there was no guarantee that the other two Long Island bankruptcy judges would follow *Lavelle*.

Just last month, Judge Robert E. Grossman issued a decision in a case involving a somewhat similar set of facts and denied the debtor’s application to cram-down and strip-off the second mortgage – even though the mortgage lender defaulted and failed to file any response whatsoever. *In re Pomilio*, ---B.R.---, No. 09-72389-reg,



Central Islip Bankruptcy Court Judges, from left, Dorothy T. Eisenberg, Robert E. Grossman and Alan S. Trust who have recently reached different conclusions on cramming down mortgages in Chapter 7 cases.

2010 WL 681300 (E.D.N.Y. February 23, 2010).

Judge Grossman discussed Judge Eisenberg’s *Lavelle* decision, stating that she set forth a “well reasoned argument which finds support in a number of scholarly articles.” However, he felt constrained to apply her argument to the facts of his case.

In *Pomilio*, Judge Grossman began his analysis with Bankruptcy Code Sections 506(a) and (d), and the Supreme Court’s holding in *Dewsnup*, that a Chapter 7 debtor cannot bifurcate a secured creditor’s claim into a secured claim to the extent of the fair market value of the subject real property, and an unsecured claim for the remaining balance. He reached a different conclusion

than Judge Eisenberg, determining that the “stripping down” process was simply not available to a Chapter 7 debtor.

Last week, Judge Alan S. Trust issued the *Caliguri* decision in which he expressed his position against Chapter 7 cram-downs. *In re Caliguri*, No. 09-75657-ast, slip op. (E.D.N.Y. March 16, 2010). In that decision, Judge Trust referred to both the *Lavelle* and *Pomilio* decisions and stated, “This Court adopts the analysis in *Pomilio* and concludes that a Chapter 7 debtor may not avoid the lien of a wholly undersecured, consensual mortgage lien holder.”

Judge Trust pointed out that post-*Dewsnup* courts have generally interpreted

(Continued on page 21)

Judges Differ with Chapter 7 Cram-Down

(Continued from page 10)

Dewsnup to prohibit Chapter 7 debtors from avoiding (stripping off) liens which are wholly undersecured for the same reasons that a Chapter 7 debtor may not reduce a secured mortgage claim to the fair market value of the property. He further pointed out that such a reading of *Dewsnup* is a proper and consistent application of Section 506.

A debtor has a one in three chance of having his or her case land in Judge Eisenberg's Court, in which event, the debtor will likely be able to successfully bring a Chapter 7 cram-down proceeding. If the case is pending before Judges Trust or Grossman, their position is clear that the debtor cannot.

However, at some point down the road,

there will certainly be a higher court decision establishing the issue for sure, at which point all of our judges will be obligated to follow it.

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