

11 U.S.C. § 1322(b)
Modification of secured claim

In re David R. Whitehead

Case No. 695-64334-fra13

3/1/96

FRA

Unpublished

Debtor was seeking an order confirming his Chapter 13 plan and objections to the proposed plan were made. The court denied confirmation of the plan on the grounds that it impermissibly sought under 11 U.S.C. § 1322(b) (2) to modify the rights of a creditor secured solely by the debtor's principal residence, that it impermissibly discriminated in classification, and that it was not feasible.

Modification of rights: Real property was the debtor's principal residence at the time it was purchased, but subsequently, and before the petition date, was vacated by the debtor. The court held, based on the holding of a previous Oregon bankruptcy opinion, that the court must look to the time of the loan transaction rather than the petition date to determine whether property is the debtor's principal residence for purposes of 1322(b) (2).

Discrimination: A second parcel of property owned by the debtor had been rented to a tenant who had been paying her rent for a number of months into her attorney's trust account because of a dispute with the debtor. The tenant was awarded damages in an FED action. In order to settle with the tenant and to induce her to leave the property, the debtor and tenant agreed that the accumulated rent would be "released" to the tenant. The court characterized this "release" of estate assets to the tenant as unfair discrimination under § 1322(b) (1) which benefited one unsecured creditor at the expense of other unsecured creditors.

Feasibility: The debtor based his ability to make plan payments in large part on his receiving unemployment compensation and rent from his rental property. However, the rental property is not currently habitable and the debtor stopped receiving unemployment compensation. He thus does not have the ability to make plan payments.

UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF OREGON

IN RE)
DAVID R. WHITEHEAD,) Case No. 695-64334-fra13
Debtor.) MEMORANDUM OPINION

Debtor seeks an order confirming his proposed plan of reorganization. Objections have been lodged by secured creditors Oma D. Ludwig, and Joseph and May Tam. For the reasons set out in this opinion I find that the plan cannot be confirmed.¹

FACTS

Defendant is a self-employed road construction flagger. His schedules, confirmed by his testimony, show monthly expenses of \$1,290.00, and income of \$1,340.00. Income consists of pay from the construction work, unemployment compensation, and rent. Debtor testified at the hearing that the unemployment compensation had

¹ An objection filed by Lincoln County, Oregon was not received in time to be considered at the confirmation hearing. Given the disposition of the proposed plan the objection is now moot.

been discontinued. As will be discussed below, future rental income is in doubt as well.

Debtor owns two parcels of real property in Lincoln County, Oregon. One parcel situated in Depoe Bay is Debtor's present residence. It is subject to a note and trust deed in favor of Creditors Joseph and Mary Tam. The other property is situated in Otis, Oregon. Debtor purchased this property in 1991 from Creditor Ludwig for use (at that time) as his residence. It is now occupied by Sandra Lucky, a tenant and unsecured creditor. Prior to the commencement of this case Debtor had attempted to evict Ms. Lucky. However, the District Court in Lincoln County apparently found against him in a forcible entry and detainer proceeding. Notwithstanding that, Debtor testified that Ms. Lucky had voluntarily terminated her tenancy, effective February 28, 1996 (the day after the confirmation hearing in this Court). Ms. Lucky, for her part, did not contradict this testimony, but indicated that she needed additional time in which to move from the subject property. She also testified to habitability problems with the property, including a failed septic tank, a toilet that backed up, a bathtub that would not drain, electrical problems, obnoxious odors, and an infestation of ants.

THE PLAN

In his plan the Debtor proposes to make payments to the Trustee of \$50.00 month. \$25.00 of this amount would be applied toward the arrearage in the debt owed to Mr. and Mrs. Tam. Ongoing

payments due to the Tams under their note and trust deed would be made outside the plan. Significantly, no periodic payments would be made to Mrs. Ludwig. Instead, she and the unsecured creditors would be paid from the proceeds of the sale of the Otis property. Debtor acknowledged that sale would probably require extensive repairs, but did not testify as to any source for the funds, other than a potential loan from an unidentified friend.

The plan also proposes to "release" to Ms. Lucky the sum of \$1,350.00 now held in her attorney's client trust account. The source of this fund is rental payments made prior to the hearing. The "release" would be made in order to enable Ms. Lucky to surrender the property within 30 days after confirmation.

DISCUSSION

The plan fails to comply with three separate requirements of the Bankruptcy Code: (1) it impermissibly modifies the rights of a creditor secured by the Debtor's residence; (2) it unfairly discriminates between classes of unsecured creditors; and (3) it is not feasible.

Modification of Secured Claim: By withholding current installments, the plan modifies the rights of Creditor Ludwig under her mortgage and trust deed with Debtor. Debtor concedes as much, but argues that, for the purposes of Code § 1322(b) the Otis property is not Debtor's residence because he did not reside there at the time his petition for relief was filed. Ludwig argues that

1 the Debtor purchased the property for use as his residence, and
2 that this date should control.

3 The Creditor is correct. In determining whether a secured
4 claim is not subject to modification under § 1322(b) the Court must
5 review the facts surrounding the creation of the secured claim. In
6 re Hildebrand, 54 B.R. 585 (Bankr. D. Or. 1985). Here it appears
7 that the Debtor purchased the property, together with his former
8 wife, in order to live there. It follows that the secured claim
9 arising out of the transaction is not subject to modification in
10 Chapter 13.

11 Discrimination: A plan may not discriminate unfairly against
12 a class of unsecured creditors. Code § 1322(b)(1). The proposed
13 "release" to Ms. Lucky is in fact a partial payment on a claim
14 stipulated to by the parties. The original claim arises out of the
15 FED proceeding. The money paid into Ms. Lucky's attorney's trust
16 account is, whatever her claim against it may be, rental proceeds
17 from estate property, and therefore itself property of the estate.
18 What the plan in effect proposes to do is place Ms. Lucky in a
19 separate class of unsecured creditors, and provide her with an
20 advance payment of at least part of the debt owed to her. Other
21 unsecured creditors will receive nothing until and unless the
22 Debtor succeeds in liquidating assets.

23 I believe this to be discriminatory, and unfair to other
24 unsecured creditors. It is particularly unfair in light of the
25 fact that the payment appears to be necessitated by Ms. Lucky's

1 refusal to relinquish property of the estate. The results of the
2 FED notwithstanding, the tenancy may be terminated by a plan, and
3 the property subject to turnover to the Trustee or Debtor.

4 Feasibility: As noted, Debtor's expenses are \$1,290.00 per
5 month. While Schedule I lists income of \$1,340.00, it was
6 established at the hearing that the Debtor was no longer receiving
7 unemployment benefits (\$640.00 per month) or rent from the Otis
8 property (\$450.00 per month). This leaves only \$250.00 per month
9 which is clearly insufficient. Debtor presents no evidence to
10 suggest that he can make up the shortfall.
11

12 Ms. Lucky's testimony establishes that the Otis property is
13 not habitable, as that term is used in O.R.S. 90.320. That statute
14 requires a person renting residential property to maintain certain
15 standards of habitability. It would be unlawful to rent the
16 property in its present condition, and Debtor did not present
17 persuasive evidence to the effect that he can afford the repairs
18 necessary to make the property suitable for tenants. This, in
19 turn, casts some doubt on whether the property can be sold by
20 October of 1996 as the plan proposes.
21

22 I conclude that the Debtor is not presently able to make the
23 payments called for under the plan.
24

CONCLUSION

25 The proposed plan does not satisfy the provisions of 11 U.S.C.
26 §§ 1332 and 1335, and confirmation will be denied.
27

The schedules show that the Debtor has \$1,925.00 worth of personal property, nearly all of which is subject to exemption, and \$1,261.07 in unsecured debt, excluding the claim of Ms. Lucky. The schedules show real property valued at \$75,000.00, although I understand the Debtor to have testified that the combined value of the two to be over \$170,000. The plan simply proposes to liquidate one piece of property, and retain the other piece, making \$25.00 per month payments against a modest arrearage. For the reasons discussed above, I find little reason to believe that the Debtor's goals can be accomplished in a reorganization. However, the Debtor may determine that his interests are better served by conversion to Chapter 7 than an outright dismissal.

14 Debtor may, within 14 days, file a motion to convert his case
15 to one under Chapter 7. If no such motion is filed the case will
16 be dismissed.

FRANK R. ALLEY, III
Bankruptcy Judge