Ohio Courts Could Change Course for Chapter 13 Bankruptcy

In a Chapter 13 bankruptcy, debtors have the ability to modify their mortgages. A modification is generally called a "cram down" and it occurs when a mortgage claim is bifurcated into a secured portion equal to the current market value of the property and the remainder of the claim is deemed unsecured debt. A cram down usually happens with an investment property or second home because mortgage creditors are protected from modification during a Chapter 13 bankruptcy proceeding if it is a first lien on the primary residence. Even if the property is underwater, that first lien remains fully secured through the Chapter 13 bankruptcy proceeding as long as the debtors resided in the property at the time of filing (11 USC §1322(b)(2)).

However, there is currently a worrisome string of case law that is allowing for a cram down on primary residences, starting with the In Re Stevens, Case 14-41709, in the Northern District of Ohio with Judge Kay Woods (Youngstown). Adversary case 14-41709 styled as Daniel E. Stevens, Jr. v. SunTrust Mortgage, Inc. was filed and SunTrust promptly filed a motion to dismiss the case based on violation of 11 USC §1322(b)(2). In a surprising opinion in response to the motion, Judge Woods indicated that the mortgage took more than just an interest in the property and therefore, the protection of 11 USC §1322(b) (2) did not apply. This additional property was the pledge for escrow funds found in the mortgage. The position caused great alarm among creditors' attorneys as most standard mortgage forms in Ohio contain the escrow provision cited in Judge Woods' opinion. This case was settled rather than litigated, but the Judge's opinion clearly laid out her position and has been discussed aggressively by debtors' attorneys in Ohio as a way to get a Chapter 13 cram down provision on a primary residence.

This opinion traveled south and the next case to explore this issue was In Re Lindsey, Case 15-10255 in the Southern District of Ohio that was assigned to Judge Jeffrey P. Hopkins (Cincinnati). An adversary proceeding was filed, Randall Lindsey v. Beneficial Financial I, Inc. as Case 15-01025, and Beneficial filed a motion to dismiss. Judge Hopkins issued an order denying the motion to dismiss and indicated that he agreed with Judge Woods. Judge Buchanan (Cincinnati) agreed with this same position in the In Re Eldridge, Case 15-13881 in the Southern District of Ohio.

While In Re Lindsey was being decided, a second case came out of the Northern District of Ohio that was extremely favorable to mortgage creditors. In Re Capretta, Case 15-11057 (Judge Arthur I. Harris, Cleveland) was similar in fact to In Re Stevens. Judge Harris denied confirmation of the plan and issued an opinion outlining why a primary cram down was not proper and that Judge Woods was incorrect. Judge Harris states that allowing for primary cram down was against the legislative intent of the code section.

As of this date, every single case with cram down provisions in the plan pending before the court has been settled, usually allowing bifurcation of the claim or coming up with another solution agreeable to parties. At this point, a secured creditor would need to make the decision to allow the case to be confirmed over objection and appeal the case to the higher courts to challenge the issue. Judge Harris laid the groundwork for an excellent issue to appeal in the 6th Circuit so there can be final clarity on this issue, rather than allowing debtors to use these lines of cases as a bargaining tool to get a cram down when it is not warranted.

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