

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

IN RE:)
) Chapter 11
RALPH J. GIVENS,)
) Case No. 09-14401 (BLS)
 Debtor.)
) Docket Ref. Nos. 73, 75, 110, 111
_____)

MEMORANDUM ORDER

Upon consideration of the Letter Brief filed by debtor Ralph J. Givens (“Debtor”) [Docket No. 110]; the Letter Brief filed by American Home Mortgage Servicing, Inc. (“American Home”) [Docket No. 111]; and the statements of counsel on the record at the hearing (the “Hearing”) before this Court on October 7, 2010 relating to the question of whether American Home may be permitted to “credit bid” in connection with the proposed auction and sale of Debtor’s home; and upon due deliberation, and ample cause appearing therefor, the Court hereby FINDS as follows:

1. On March 16, 2005, Debtor executed a residential real estate mortgage (the “Mortgage”) and note (the “Note”). American Home is the servicer for the Note, which is currently held by Deutsche Bank National Trust Company (“Deutsche Bank”), as Trustee in Trust for the Benefit of the Certificateholders for ABFC 2005-AQ1 Trust, Asset-Backed Certificates, Series 2005-AQ1.
2. Deutsche Bank is a first-priority secured creditor of Debtor and the Note is secured by the Mortgage which provides Deutsche Bank with a lien against certain residential real property located at 12081 Chipmans Pond Rd., Laurel, DE 19956 (the “Residence”).
3. American Home asserts that Debtor is in default under the Note and Mortgage and has not made payments on the Note since August 1, 2008.

4. On December 14, 2009, the Debtor filed a voluntary petition for relief pursuant to chapter 11 of title 11 of the United States Code (the “Bankruptcy Code”) in this Court.

5. On July 9, 2010, Debtor filed an Amended Plan of Reorganization (as further amended, the “Plan”) [Docket No. 73], an Amended Disclosure Statement in Respect to Debtor’s Amended Chapter 11 Plan of Reorganization (as further amended, the “Disclosure Statement”) [Docket No. 75], and a motion to approve the Disclosure Statement [Docket No. 77].

6. American Home and several other parties filed objections to the Disclosure Statement. [Docket Nos. 81, 85, 86, 93.] The Debtor subsequently further amended the Plan and Disclosure Statement. [Docket Nos. 87, 88 98, 100.]

7. At the Hearing on October 7, 2010, the Court considered approval of the Disclosure Statement and heard oral argument regarding a number of procedural and substantive issues, including issues related to Debtor’s proposal to auction the Residence to effectuate the Plan. American Home raised a concern regarding provisions in the Plan and Disclosure Statement that purport to restrict American Home’s ability to credit bid at the auction for the Residence. Given the parties’ desire to proceed with the auction in advance of a hearing on confirmation of the Plan, the Court determined at the Hearing that it could not simply treat the credit bid issue as a plan objection to be dealt with at confirmation. As a result, the Court requested additional briefing from the parties regarding whether Debtor may preclude American Home from credit bidding at the auction on the Residence. The Court overruled the remaining objections to the Disclosure Statement and entered an Order approving the Disclosure Statement. [Docket No. 106.] In so doing, the Court noted that the parties’ objections to the Plan were fully reserved.

8. By its letter brief, American Home argues that Debtor may not deprive American Home of its right to credit bid pursuant to Bankruptcy Code Section 1123(b)(5), which restricts an individual debtor's ability to modify the rights of holders of claims secured solely by a security interest in real property that is a debtor's principal residence. American Home further argues that any reliance by Debtor on In re Philadelphia Papers, LLC, 599 F.3d 298 (3d. Cir. 2010) to support the prohibition on credit bidding is misplaced because the facts of that case did not include a security interest on an individual debtor's residential real property so as to implicate Section 1123(b)(5).

9. Debtor argues that Section 1123(b)(5) is not applicable for two reasons. First, Debtor asserts that American Home does not have a substantive right to credit bid that is protected by Section 1123(b)(5). Second, Debtor contends that American Home's security interest is not solely secured by real property that is Debtor's principal residence and thus, Section 1123(b)(5) is inapplicable.

10. It is undisputed that a Chapter 11 plan of reorganization must comply with all the requirements of Bankruptcy Code Section 1123. Here, the parties dispute whether Debtor's proposed prohibition on credit bidding during the auction, the result of which would be approved in Debtor's Plan, complies with Section 1123. More specifically, the parties dispute whether the prohibition on credit bidding comports with Section 1123(b)(5), which provides that "a plan may – (5) modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence" 11 U.S.C. § 1123(b)(5). This provision, known as an "anti-modification provision," was added to the Bankruptcy Code by the Bankruptcy Reform Act of 1994 and applies to individual Chapter 11 cases. See id.

11. The same residential mortgage modification restriction is found in Section 1322(b)(2) of Chapter 13 of the Bankruptcy Code and courts construing Section 1123(b)(5) frequently look to cases discussing the parallel Chapter 13 provision. See In re Crystian, 197 B.R. 803, 805 (Bankr. W.D. Pa. 1996); see also 11 U.S.C. § 1322(b)(2). The Third Circuit has stated that the intent of the Bankruptcy Code’s anti-modification provisions is to “encourage the flow of capital into the home lending market.” In re Ferandos, 402 F.3d 147, 151 (3d Cir. 2005). The plain language of Section 1123(b)(5) only restricts an individual debtor’s ability to modify the rights of a holder of a security interest that is (1) a mortgage on the debtor’s principal residence, and (2) that is secured only by the principal residence and not other collateral. See Crystian, 197 B.R. at 804.

12. In the absence of controlling federal law, applicable state law and the terms of the parties’ agreement are the basis for determining what constitutes a right subject to protection by Section 1123(b)(5). See Nobelman v. Am. Sav. Bank, 508 U.S. 324, 329 (1993); In re Watson, 384 B.R. 697, 703 (Bankr. D. Del. 2008) (construing Section 1322(b)(2) and stating that creditors’ rights thereunder “are determined according to state law and the contract terms.”). Neither party cites Delaware law indicating that a substantive right to credit bid does or does not exist; however, Debtor appears to recognize that, at least in practice, credit bidding is commonplace in Delaware. [See Debtor’s Letter Br. at 2-3.] Nevertheless, it is beyond dispute that Delaware adheres to the principle of freedom of contract and Delaware courts generally hold parties to the terms of their agreements. See Abry Partners V, L.P. v. F&W Acquisition LLC, 891 A.2d 1032, 1059-60 (Del. Ch. 2006) (“[T]here is also a strong American tradition of freedom of contract, and that tradition is especially strong in [Delaware] which prides itself on having commercial laws that are efficient.”).

13. Here, the Mortgage provides:

If (a) Borrower fails to perform the covenants and agreements contained in this Security Instrument, (b) there is a legal proceeding that might significantly affect Lender's Interest in the Property and/or rights under this Security Instrument (such as a proceeding in bankruptcy, probate, for condemnation or forfeiture, for enforcement of a lien which may attain priority over this Security Instrument or to enforce laws or regulations), or (c) Borrower has abandoned the Property, then Lender may do and pay for whatever is reasonable or appropriate to protect Lender's Interest in the Property and rights under this Security Interest, including protecting and/or assessing the value of the Property, and securing and/or repairing the Property. Lender's actions can include, but are not limited to: (a) paying any sums secured by a lien which has priority over this Security Instrument; (b) appearing in court; and (c) paying reasonable attorneys' fees to protect its interest in the Property and/or rights under this Security Instrument, including its secured position in a bankruptcy proceeding.

Mortgage § 9. In the present situation where Debtor proposes to open bidding on the Residence securing the Note at an amount substantially less than what is owed on the Note, the secured creditor's ability to credit bid is the quintessential "reasonable or appropriate [act] to protect Lender's Interest in the Property and rights under [the] Security Interest" Id. Accordingly, the Court finds and concludes that the plain language of the Mortgage is sufficient to create a right to credit bid that is protected by Section 1123(b)(5).

14. The Court also finds that the plain language of the Mortgage evidences a single security interest in real property that is the Debtor's principal residence, as required by Section 1123(b)(5). Debtor argues that the Mortgage provides an additional security interest in Debtor's personal property, specified as "Miscellaneous Proceeds" in the Mortgage. American Home argues that the Mortgage contains a single security interest in Debtor's Residence. The Mortgage defines Miscellaneous Proceeds as:

[A]ny compensation, settlement, award of damages, or proceeds paid by any third party (other than insurance proceeds paid under coverages described in Section 5) for (i) damage to, or destruction of, the Property, (ii) condemnation or other taking of all or any part of the Property, (iii) conveyance in lieu of condemnation or (iv) misrepresentations or, or omissions as to, the value and/or condition of the Property.

Mortgage p. 2 at (L). The Mortgage provides, in its “Uniform Covenants” section, that “[a]ll Miscellaneous Proceeds are hereby assigned to and shall be paid to Lender.” Mortgage § 11. The plain language of this provision does not create a security interest in the Miscellaneous Proceeds, but provides for an assignment upon certain events.

15. As an initial matter, the Court is not convinced that the interests in the Miscellaneous Proceeds created by the Mortgage rise to the level of a security interest. The Bankruptcy Code defines security interest as a “lien created by an agreement” and defines lien as a “charge against or interest in property to secure payment of a debt or performance of an obligation.” 11 U.S.C. §§ 101(37) and (51). The Mortgage provides that the Miscellaneous Proceeds, to the extent they exist at a later date, are assigned outright to the mortgagee without reference to the mortgagor’s underlying repayment obligations. Mortgage § 11. An assignment differs from the grant of a security interest and the assignment here does not remove the Mortgage from the protections of Section 1123(b)(5). See Crystian, 197 B.R. at 805 (determining that “proceeds [that] are the subject of a covenant and are assigned to the [mortgagee] . . . do not purport to grant the [mortgagor] a security interest in the . . . proceeds.”).

16. In addition, the types of interests assigned as Miscellaneous Proceeds are not within the gambit of additional security interests that generally remove the anti-modification protections of Section 1123(b)(5). See In re Mendez, 25 B.R. 143, 147 (Bankr. D.N.J. 2000) (“The condemnation award is considered a substitute for the land as a matter of law. The

inclusion in a mortgage of a reference to such right therefore does not constitute collateral separate from the mortgaged property.”); In re Jackson, 136 B.R. 797, 802 (Bankr. N.D. Ill. 1992) (“[T]he boilerplate language granting the mortgagee the right to receive and use property insurance proceeds in the event of some destruction of the property does not create an additional type of collateral securing the mortgage obligation.”) (internal citations removed); but see In re Thomas, 344 B.R. 386, 392-93 (Bankr. W.D. Pa. 2006) (determining, in dicta, that certain portions of an assignment of miscellaneous proceeds constituted an additional security interest for purposes of Section 1322(b)(2)).

17. Rather, the type of interests that operate to remove mortgages from the Bankruptcy Code’s anti-modification protections are generally security interests in machinery, furniture or equipment. See In re Hammond, 27 F.3d 52 (3d Cir. 1994) (additional security interest in appliances, machinery, furniture, and equipment vitiates anti-modification protections); In re Johns, 37 F.3d 1021 (3d Cir.1994) (same); Wilson v. Commonwealth Mortgage, 895 F.2d 123 (3d Cir.1990) (same); Sapos v. Provident Inst. of Sav. in Town of Boston, 967 F.2d 918 (3d Cir.1992) (additional security interest in appliances and wall-to-wall carpeting vitiates anti-modification protections). These types of additional security interests are readily distinguishable from the prospective or potential assignment provided for in the Mortgage.

18. Accordingly, the Court finds and concludes that the Mortgage falls squarely within the type of interest protected from modification by Section 1123(b)(5) and Debtor cannot modify American Home’s right to credit bid.¹

¹ As should be clear from the foregoing, Philadelphia Newspapers, LLC, 599 F.3d 298 is inapposite to the case at bar, as the applicability of Section 1123(b)(5) was not at issue in that case.

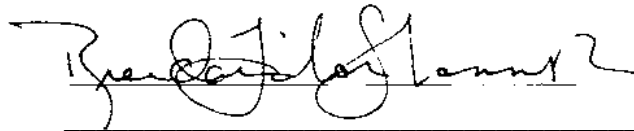
Based on the foregoing, it is hereby

ORDERED, that Debtor shall not preclude American Home from participating at the auction on the Residence in any way; and it is further,

ORDERED, that Debtor shall not preclude American Home from credit bidding at the auction on the Residence; and it is further,

ORDERED, that the Court shall retain jurisdiction to enforce this Order.

Dated: December 7, 2010
Wilmington, Delaware

A handwritten signature in black ink, appearing to read "Brendan Linehan Shannon", written over a horizontal line.

BRENDAN LINEHAN SHANNON
UNITED STATES BANKRUPTCY JUDGE