UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION (DETROIT)

In re:	Chapter 13
Eula Colcord,	Case No. 15-46941
Debtor.	Hon. Mark A. Randon

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ORDER OVERRULING OCWEN'S OBJECTION TO DEBTOR'S CHAPTER 13 PLAN

I. INTRODUCTION

Eula Colcord owns four duplexes–eight individual units. The rent from seven of the units provide more than 90 percent of her total monthly income; she lives in the remaining unit. In 2015, Colcord filed Chapter 13 bankruptcy. She submitted a plan, which proposes to modify the mortgage terms on the duplex that includes her principal residence. Ocwen Loan Servicing, LLC objects to confirmation of the plan. It argues that because the duplex includes Colcord's principal residence, any modification violates 11 U.S.C. § 1322(b)(2).

The Court heard oral argument. Because Colcord only *uses* an individual unit as her home–as opposed to the entire duplex that secures the mortgage–that unit is her principal residence; the mortgage can be modified. Ocwen's objection is **OVERRULED**.

II. STATEMENT OF FACTS

Colcord's duplex, 7452-7454 Southfield Road, is divided into two individual residential units that share a common wall but otherwise have separate addresses, entrances, and utilities ("the duplex"). Colcord purchased the duplex in 2002 with a $60,000.00 loan from Washtenaw Mortgage Company, secured by a mortgage on the duplex. She has always lived in one unit and rented the other. This intended dual use is reflected in the mortgage, which contains an absolute assignment of all "rents and revenue."

Ocwen is the current holder of the mortgage. The petition-date loan balance is $17,117.00; the loan matures on January 1, 2018.

In 2015, Colcord filed Chapter 13 bankruptcy. Her plan proposes to modify Ocwen's claim to pay only $9,725.48 plus interest.[1] Ocwen objects. It argues that Colcord must pay the entire balance owed on the mortgage plus interest, because the duplex is her principal residence and, therefore, not subject to modification. Colcord says the anti-modification provision of section 1322(b)(2) does not apply to a duplex where only one unit serves as her principal residence.

III. LEGAL ANALYSIS

A bankruptcy court must confirm a plan that complies with the applicable provisions of Chapter 13. 11 U.S.C. § 1325(a)(1). The issue is whether Colcord's

[1]Colcord claims this is the current value of the duplex. *See* 11 U.S.C. § 506(a).

treatment of Ocwen's secured claim violates the anti-modification provision of 11 U.S.C. § 1322(b)(2). Under that section, Colcord cannot modify Ocwen's claim if it is secured "only by a security interest in real property that is the debtor's principal residence." This provision–straightforward though it may appear–has resulted in inconsistent rulings in courts across the country when applied to a multi-unit dwelling that *includes* a debtor's principal residence.

The Court starts with the plain meaning of the statutory text. The anti-modification provision of section 1322(b)(2) has three requirements: (1) the security interest must be in real property; (2) the real property must be the only security for the debt; and (3) the real property must be the debtor's principal residence. *Wages v. J.P. Morgan Chase Bank, N.A. (In re Wages)*, 508 B.R. 161, 165 (B.A.P. 9th Cir. 2014) (interpreting identical language in 11 U.S.C. § 1123(b)(5)). The parties dispute the second and third requirements.

A. The Real Property is the Only Security for the Debt

As security for the $60,000.00 loan, Colcord signed a mortgage; she also assigned all rents to Washtenaw (Ocwen's predecessor-in-interest). Generally, an assignment of rents creates a separate security interest other than real property. *See Lopez v. Credit Union One (In re Lopez)*, 511 B.R. 517, 520 (Bankr. N.D. Ill. 2014) (finding that when a security agreement purports to take a security interest in a debtor's principal residence and some other collateral, such as business inventory, the protections of § 1322(b) do not

apply). But "[a]ssignments of rents are interests in real property and, as such, are created and defined in accordance with the law of the situs of the real property." *In re Madison Heights Grp., LLC*, 506 B.R. 734, 741 (Bankr. E.D. Mich. 2014).

In Michigan, only rents on commercial or industrial property (including apartment buildings with *more* than six apartments) may be lawfully assigned. MICH. COMP. LAWS § 554.231:

> Hereafter, *in or in connection with any mortgage on commercial or industrial property other than an apartment building with less than 6 apartments* or any family residence to secure notes, bonds or other fixed obligations, *it shall be lawful to assign the rents*, or any portion thereof, under any oral or written leases upon the mortgaged property to the mortgagee, *as security in addition to the property described in such mortgage*.

(Emphasis added). Because the duplex has less than six apartments (units), the assignment of rents provision in the mortgage violates Michigan law; therefore, Ocwen's claim is secured only by a security in real property. *See In re Madison Heights Grp., LLC*, 506 B.R. at 741 ("a federal court in bankruptcy is not allowed to upend the property law of the state in which it sits, for to do so would encourage forum shopping and allow a party to receive 'a windfall merely by reason of the happenstance of bankruptcy'") (quoting *Butner v. United States*, 440 U.S. 48, 55 (1979)).

B. The Real Property is not Colcord's Principal Residence

The Court must next determine whether the duplex is Colcord's principal residence. Although neither the Supreme Court nor the Sixth Circuit has ruled on this issue, the Third Circuit and the Bankruptcy Appellate Panel for the Ninth Circuit provide

examples of courts that have weighed-in but reached opposite conclusions: *Scarborough v. Chase Manhattan Mortg. Corp. (In re Scarborough)*, 461 F.3d 406 (3rd Cir. 2006) and *Wages v. J.P. Morgan Chase Bank, N.A. (In re Wages*), 508 B.R. 161 (B.A.P. 9th Cir. 2014).

In *Scarborough*, debtor owned a two-story, semi-detached residence that was converted to a multi-dwelling unit prior to her purchase. The debtor lived on the first floor and rented out the second floor unit. Chase Manhattan Mortgage Corporation held the mortgage lien. During the bankruptcy proceedings, debtor sought to bifurcate Chase's claim into a secured and unsecured claim. Chase argued that its claim was protected from modification under section 1322(b)(2). *In re Scarborough*, 461 F.3d at 409.

The Third Circuit framed the issue as "whether a claim secured by an interest in real property that includes the debtor's principal residence *as well as* other income-producing rental property is 'a claim secured only by a security interest in real property that is the debtor's principal residence.'" *Id.* at 410 (emphasis in original). It held that section 1322(b)(2) did not apply–and debtor could modify Chase's claim–because the real property that secured the mortgage was not *solely* the debtor's principal residence. *Id.* at 411. "A claim secured by real property that is, even in part, *not* the debtor's principal residence does not fall under the terms of §1322(b)(2)." *Id.* (Emphasis in original).

The Bankruptcy Appellate Panel for the Ninth Circuit reached the opposite conclusion. In *Wages*, part of debtors' residence was used as a home office, and they

parked trucks and trailers used in their business on the property. The court adopted a bright-line approach and held that the anti-modification provision applies to any property that is used as a debtor's principal residence–even if part of it has a commercial use. *In re Wages*, 508 B.R. at 166-67.

The Bankruptcy Code's definition of "debtor's principal residence" supports the outcome in *Scarborough*. Under section 101(13A), the term:

> (A) means a residential structure *if used* as the principal residence by the debtor . . . and
>
> (B) includes an individual condominium or cooperative unit, . . . *if used* as the principal residence by the debtor.

(Emphasis added). Although the code's definition of principal residence is circular–it includes the term being defined as part of the definition–its focus on *use* cannot be ignored. Here, the residential structure is the duplex, but Colcord has never used the entire duplex as her principal residence–only the individual unit. Subsection 101(13A)(B) clarifies that an individual unit, such as a condominium or cooperative, within a larger residential structure, can be Colcord's principal residence.

Michigan's treatment of duplexes for property tax purposes further supports the proposition that a duplex is not the principal residence of an individual who lives in one of the units. In Michigan, an individual who owns and occupies her principal residence may claim an exemption from a portion of her local school operating taxes. For a "multiple-unit dwelling," the exemption may be claimed only on the portion of the

dwelling "that is owned and occupied by an owner of the dwelling or unit." MICH. COMP. LAWS § 211.7dd(c). Simply put, for purposes of the tax exemption, a duplex cannot be used as a principal residence–only the unit occupied by the owner.[2]

The third requirement of section 1322(b)(2)'s anti-modification provision is that the real property is the debtor's principal residence. That is not the case here: the real property is the duplex–that includes a rental unit. Colcord's principal residence is the other unit within the duplex. Therefore, Ocwen's mortgage can be modified.

A majority of courts that have considered the issue have reached the same conclusion. *See, e.g., Ford Consumer Fin. Co., Inc. v. Maddaloni (In re Maddaloni)*, 225 B.R. 277, 278-80 (D.Conn. 1998) ("the [anti-modification] provision is inapplicable when

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[2]In its interpretive guidelines, the Michigan Department of Treasury provides further clarification on duplexes:

> A duplex is assessed as a multiple unit dwelling. An owner may occupy part or the entire dwelling but is only entitled to an exemption on one unit. A duplex, or any other multiple unit dwelling, is assumed to have additional units for the purpose of renting or leasing them out. It is a business property. Because one unit of the duplex, or one or more units in a multiple unit dwelling is unoccupied, does not change the essential nature of the dwelling. If an owner is using both units of a duplex as a personal principal residence, then the owner needs to get the dwelling reclassified as a single family dwelling in order to be eligible for a 100% principal residence exemption.

Guidelines for the Michigan Principal Exemption Program, Michigan Department of Treasury 2856 (Rev. 09-14), pp. 7-8, *available at* https://www.michigan.gov/documents/2856_11014_7.pdf (last visited September 16, 2015).

the creditor's security interest extends to other income-producing units in addition to the debtor's principal residence"); *In re Del Valle*, 186 B.R. 347, 349 (Bankr. D. Conn. 1995) (allowing strip down of a lien secured by a duplex although the debtor lived in one side and rented the other); *In re McGregor*, 172 B.R. 718, 720 (Bankr. D. Mass. 1994) ("If [Congress intended to extend §1322(b)(2) to multi-unit buildings,] the statute should refer to real property that 'includes' the residence. Instead, the word 'is' appears, which more aptly describes an equivalence between the real estate and the residence."); *Lomas Mortgage, Inc. v. Louis*, 82 F.3d 1, 7 (1st Cir. 1996) (the anti-modification provision of section 1322(b)(2) does not bar modification of a secured claim on a multi-unit property in which one of the units is the debtor's principal residence and the security interest extends to the other income-producing units); *In re Abrego*, 506 B.R. 509, 512 (Bankr. N.D. Ill. 2014) (section 1322(b)(2) protects claims secured only by a security interest in real property that is the debtor's principal residence, not real property *that includes or contains the debtor's principal residence*, and not real property on which the debtor resides) (emphasis added); *Pawtucket Credit Union v. Picchi (In re Picchi*), 448 B.R. 870, 875 (B.A.P. 1st Cir. 2011) (section 1322(b)(2) does not bar bifurcation of a claim secured by a multi-unit dwelling); *In re Lopez)*, 511 B.R. at 522 (the anti-modification provision of section 1322(b)(2) protects only claims secured by a security interest in real property that is, "in its entirety, the debtor's principal residence").

IV. CONCLUSION

The anti-modification provision applies to claims secured only by a security interest in real property that is a debtor's principal residence. Because Ocwen took an interest in the duplex–not Colcord's principal residence–section 1322(b)(2) does not apply. Ocwen's claim can be modified as proposed in Colcord's Chapter 13 plan.

IT IS ORDERED.

Signed on September 16, 2015

/s/ Mark A. Randon
Mark A. Randon
United States Bankruptcy Judge