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Consumer Corner

By Jeffrey Fraser

Broad Scope, or Slippery Slope? Justifications of *Johnson*

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In *Johnson v. Home State Bank*,[1] the U.S. Supreme Court rendered a seemingly benign ruling regarding the impact of a chapter 7 discharge on a mortgage claim, concluding that a chapter 13 reorganization is not categorically foreclosed to a debtor who previously filed for and received a chapter 7 discharge. Thus, the primary and, arguably, sole determination from *Johnson* was the authorization for the so-called "chapter 20": a colloquial bankruptcy term referring to a debtor who first obtains a chapter 7 discharge and eliminates personal liability on a mortgage note, and subsequently files for chapter 13 seeking to cure arrearage in connection with the same mortgage. Through *Johnson*, the Supreme Court emphasized that Congress intended for claims in chapter 13 to be construed broadly.[2] But just how broadly?

Courts have since pushed *Johnson*'s boundaries, leading to an increasingly expansive definition of what constitutes a "claim." Nearly 35 years later, *Johnson*'s ruling has morphed into a decree that claims should not only be construed broadly, but *also* into a declaration that a prior contractual relationship with a creditor is not a prerequisite for a debtor to pay (or "treat") such creditor's claim in a bankruptcy plan. This article explores the apparent merging of personal liability with contractual privity; to what extent as a result of such merger a debtor *not* in contractual privity with a creditor has been permitted to pay such creditor's claims through a bankruptcy plan; and why this has created a slippery slope as it relates to expanding the concept of a "claim."

The Majority Approach: "No Privity, No Problem"

The facts of *Johnson* are straightforward and relatively common. Curtis Johnson entered into a mortgage relationship to secure promissory notes payable to Home State Bank. He defaulted on the notes, Home State initiated foreclosure, and — to halt the process — Johnson filed for chapter 7, eventually receiving a discharge. Thereafter, Home State reinitiated its foreclosure, obtained judgment and scheduled a foreclosure sale. Johnson filed *another* bankruptcy case — this time a chapter 13 proposing to cure the mortgage arrears. *Johnson* firmly established that a debtor could address a surviving mortgage lien in a chapter 13 case, after a chapter 7 discharge. Notwithstanding this narrow holding, courts (old and new) have expanded *Johnson*'s scope, creating the "majority approach," which allows for the inclusion of claims in bankruptcy plans that lack contractual privity.

An early champion of the "broad claim cause" is *Matter of Hutcherson*.[3] In *Hutcherson*, the court concluded that the objecting bank held a "claim" against the debtor's estate, even though no "privity of contract" ever existed between it and the debtor, who inherited interest in the property following her mother's death. The *Hutcherson* court eschewed the bank's argument that *Johnson* should be limited to its unique facts and only govern the resolution of cases involving mortgagors who follow a chapter 7 case with one under chapter 13.[4] Instead, the *Hutcherson* court focused/relied on the Supreme Court's description of "nonrecourse" obligations:

> Insofar as Congress did not expressly limit § 102(2) to nonrecourse loans but rather chose general language broad enough to encompass such obligations, *we understand Congress's intent to be that § 102(2) extends to all interests having the relevant attributes*

1 *Johnson v. Home State Bank*, 501 U.S. 78 (1991).
2 *Id.* at 88.
3 *Matter of Hutcherson*, 186 B.R. 546 (Bankr. N.D. Ga. 1995).
4 *Id.* at 549.

of nonrecourse obligations regardless of how these interests come into existence.[5]

While the *Hutcherson* court conceded that the facts before it and the facts of *Johnson* did not arrive at their common controversy through the same chain of events, the court still determined that it was bound by *Johnson* on the premise that nonrecourse obligations fall within the definition of a claim, and "*[t]hus 'claimholder' status presumptively forms a condition precedent to a creditor's mandatory participation in the Debtor's plan*."[6]

In re Stevenson[7] recently found the existence of a claim whereby the debtor, who inherited real property from a relative, sought to cure the relative's mortgage arrears through a chapter 13 plan, pursuant to § 1322(b)(2). Although the *Stevenson* debtor was not the original mortgagor (similar to the *Hutcherson* debtor), the *Stevenson* court found "no reason to distinguish *Johnson*" and determined that the creditor has a "claim" that might be included in a chapter 13 plan "'if it is enforceable against *either* the debtor *or* his property."[8] As such, even in the absence of personal liability against the debtor, the bank's *in rem* claim against the property is a "claim" for purposes of § 101(5) of the Bankruptcy Code and can be cured through the debtor's plan in accordance with § 1322(b)(2) and (3). As in *Hutcherson*, the *Stevenson* court, over objection, compelled a bank's "mandatory participation" with a party absent its loan documents.[9]

The Minority Approach: "There's a Stranger in My House"

With every majority approach, there must exist a minority. *In re Kizelnik*[10] presents the other side to *Johnson*. In *Kizelnik*, the court was confronted with a debtor who sought to deaccelerate a mortgagor's loan and repay arrearages through a chapter 13 plan. Described as a "stranger" to the loan documents, the debtor was the granddaughter of the mortgage creditor's original borrowers, and she resided as a tenant in the property subject to the litigation. After several bankruptcies filed by the borrowers, the granddaughter filed her own case to stop a foreclosure sale. While not mentioned by the parties via the pleadings, the *Kizelnik* court deemed it appropriate to discuss *Johnson* and proclaimed that "[w]hile *Johnson* clearly does not dictate a different result here, cases that claim to follow *Johnson impermissibly extend its holding beyond the same-debtor situation* to chapter 13 cases involving a transfer of property from a mortgagor-parent to a debtor-child."[11]

The *Kizelnik* court stressed that *Johnson* should be limited to its peculiar facts and should therefore only govern the resolution of "chapter 20" cases involving a *single mortgagor* whose chapter 13 is preceded by one under chapter 7.[12] The "single mortgagor" rationale in *Kizelnik* was further underscored by *In re Parks*.[13] Without specifically invoking *Johnson*, the *Parks* court examined why — even if proceeding with respectable intentions — a debtor cannot satisfy the requirements to include payment of a claim under § 1322 without having a preexisting relationship with such creditor.

In *Parks*, the debtor inherited real property following his father's death, and occupied it the same as his primary residence (analogous to the factual circumstances in *Hutcherson* and *Stevenson*). At the time of his father's death, the mortgage on the property was in default. In addressing the bank's motion to lift the automatic stay, the *Parks* court framed the issue as follows: "[W]hat kind or degree of relationship is sufficient to be within the scope of a debtor's privilege of 'cure' under § 1322? Does it suffice that a debtor now has 'title' to the property?"[14] In answering this question, the *Parks* court concluded that the *reach of § 1322(b)(2) cannot extend to include modification of a secured claim already in place when the debtor equitably or legally acquired the property*.[15] Because the mortgage encumbered the property *before* the son/debtor acquired it, and because the debtor lacked privity with the bank, any default under the note and mortgage was neither curable through the son's chapter 13 plan, nor subject to modification.[16]

A public policy or benevolent consideration is that inheritances, heirs or other "family" issues should presumably be viewed to have at least a tangential link to the original creditor. The *Parks* court displays (perhaps unintentionally) how the majority approach's reach might still extend beyond the parent/child transaction by permitting connections between entirely unrelated parties and compelling *de facto* (and nonconsensual) partnerships between strangers with questionable intent/motive:

> [T]his may be an honest Debtor simply trying to save his home, but who may not do so *because any statutory interpretation which would permit him to do so must also permit, for example, a tenant to take title in the eleventh-hour and thwart foreclosure of the landlord's mortgage, even if the tenant is secretly a shill for the landlord*.[17]

Likewise, in *In re Mullin*,[18] the court, confronted with the enforceability of "due-on-sale" clauses, refused to force a new owner (the debtor) on a bank where the original mortgagors deeded the subject property to the debtor without the lender's consent. The *Mullin* court identified the similarities in *Johnson* to the facts before it, but (like *Parks*) cemented its decision on the limitations of the Bankruptcy Code: "[I]t is the case here, as in *Johnson*, that the [bank's] claim is *in rem* as to the Property, not *in personam* with recourse against [the debtor]. However, the fact [that] such 'rights are claims' as defined in § 101(5) ... does not override or nullify the prohibition on modification contained in § 1322(b)(2)."[19]

5 *Id.* at 550 (quoting *Johnson* at 87; emphasis added).
6 Emphasis added.
7 *In re Stevenson*, No. 23-32811-KRH, 2023 WL 7401456.
8 *Id.* (quoting *Johnson* at 85).
9 *See also Matter of Lumpkin*, 144 B.R. 240 (Bankr. D. Conn. 1992). In this case, the court held that *Johnson*'s reasoning clearly governed the present proceeding involving a property transfer to a debtor *where an existing mortgage has not been assumed*. In sum, a chapter 13 plan might deal with a claim where there is no personal liability *no matter what circumstances underlay the lack of personal liability*. Emphasis added.
10 *In re Kizelnik*, 190 B.R. 171 (Bankr. S.D.N.Y. 1995).
11 *Id.* at 178 (emphasis added).
12 *Id.* at 179 (emphasis added).
13 *In re Parks*, 227 B.R. 20 (Bankr. W.D.N.Y. 1998).
14 *Id.* at 23.
15 *Id.* at 25 (emphasis added).
16 *Id.*
17 *Id.* (emphasis added).
18 *In re Mullin*, 433 B.R. 1 (Bankr. S.D. Tex. 2010).
19 *Id.* at 13.

The *Mullin* court was persuaded by a line of cases that held "that a debtor who obtained residential property from the mortgagor without adhering to a due-on-sale clause is not permitted to cure the mortgage defaults through the chapter 13 plan over the objection of the mortgageholder."[20] In so finding, the court proclaimed that forcing a new owner on the bank would disregard Texas law that due-on-sale clauses are enforceable.[21] While the *Mullin* court linked its decision directly to the existence and enforceability of a due-on-sale clause, the analysis is informative, as the due-on-sale clause (if waived by lender) resolves the privity issue by effectively *creating* (or accepting) privity between the creditor and the new title owner.

"Privity of Contract" and "Personal Liability": Similar, but Not Synonymous

Ultimately, the divide between the majority and minority centers around the distinction, relationship and comparison between "privity of contract" and "personal liability." The interplay — and in many cases, the *merging* — of these two distinct and separate realities has created an informal bankruptcy policy, birthed by *Johnson*, that *any* ownership interest (regardless of origin) is enough for a debtor to include such interest as a claim in a bankruptcy plan.

As previously mentioned, the core link of *Johnson*'s text that opened the claim floodgates is the Supreme Court's directive that "nonrecourse obligations" fall within the definition of a "claim." In *Johnson*, the Court framed the issue narrowly: "The issue in this case is whether a mortgage lien that secures an obligation for which a debtor's personal liability has been discharged in a Chapter 7 liquidation is a 'claim' subject to inclusion in an approved Chapter 13 reorganization plan."[22]

The *Kizelnik* court's contention that the majority's perspective is an impermissible extension beyond the "same-debtor situation" (and that *Johnson* should only govern cases involving a "single mortgagor") is instructive. Perhaps instead of focusing solely on the term "nonrecourse," due attention should *also* be given to the terms "enforceable," "obligation" and (most importantly) "*survive*." Dissecting the Supreme Court's rationale, the "single mortgagor" perspective harmonizes and supports *Johnson*'s ruling:

> [T]he conclusion that a *surviving* mortgage interest is a "claim" under § 101(5) is consistent with other parts of the Code.... In other words, the court must allow the claim if it is *enforceable* against either the debtor or his property. Thus, § 502(b)(1), *through* a Chapter 7 proceeding, may consist of nothing more than an *obligation enforceable* against the debtor's property.[23]

This brings us back to the flawed connection between personal liability and privity of contract: While the *survival* of "personal liability" is discussed extensively in *Johnson*, the phrase "privity of contract" is entirely absent from the Supreme Court's opinion. Nevertheless, the majority's interpretation connects privity of contract to the *Johnson* creditor's nonrecourse *obligation*. However, in *Johnson*, "nonrecourse obligation" is not related to contractual privity, but rather defined as the bank's *in rem* rights that *survived* the debtor's chapter 7 discharge. The Court explicitly stated that "there can be no doubt that the *surviving mortgage* interest corresponds to an '*enforceable obligation*' of the debtor ... and is a 'claim' under § 101(5)."[24]

Thus, implicit in *Johnson* is the notion that in order for a creditor to have a "nonrecourse obligation" against property of a debtor, actual privity of contract must have existed between the parties at some point in time. This marks the precise point where personal liability and privity of contract dramatically diverge. At inception, a mortgage simultaneously creates personal liability against an individual and an *in rem* right against a piece of collateral (collectively, the "mortgage rights"). A chapter 7 discharge, as in *Johnson*, removes one of those mortgage rights (personal liability), but the other (*in rem* right to collateral) *survives*.

Conclusion

While the majority approach offers a more "inclusive" standard for what constitutes a "claim," the *only* nonrecourse obligation (after a chapter 7 discharge) available for bankruptcy plan treatment (pursuant to *Johnson*) is the original bank's *in rem* right to foreclose on the collateral — nothing more, nothing less. The term "obligation" inherently requires both an "obligor" (the party responsible for fulfilling the obligation) and an "obligee" (the party or entity to enforce the obligation). An individual (a debtor) with no prior connection to an entity (an alleged creditor) cannot legitimately owe an obligation to such entity.

As stated in *Parks*,[25] a "common sense interpretation" is that "only a right or status lost by the debtor may be cured," meaning that a "debtor may not 'cure' *someone else's default*." Such an interpretation complements the "single mortgagor" principle proffered by *Kizelnik* and further emphasizes the fact that *Johnson* exclusively dealt with one individual, one creditor and the dynamics of what rights remained (or could be "revived") between those two entities that were connected pre-petition.

The majority approach's synonymous use of privity of contract and personal liability has created a broader definition for the phrase "nonrecourse obligation," which is a slippery slope. In short, *Johnson* was a case about the survival of rights, not the expansion of them. **abi**

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20 *Id.* (citing *In re Tewell*, 355 B.R. at 682).
21 *Id.*
22 *Johnson* at 82.
23 *Id.* at 85 (emphasis added).
24 *Id.*
25 *Parks* at 23.