

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF RHODE ISLAND

In re: Dennis T. GRIECO,
Christine M. GRIECO,
Debtors

C.A. No. 91-0617L

MEMORANDUM AND ORDER

RONALD R. LAGUEUX, United States District Judge.

Dennis and Christine Grieco, debtors in this case, seek review, pursuant to 28 U.S.C. § 158, of an Order by the United States Bankruptcy Court for the District of Rhode Island granting Eastland Bank ("the Bank") relief from the automatic stay of foreclosure proceedings under 11 U.S.C. § 362(a). For the reasons that follow, the Bankruptcy Court's Order is affirmed in part and the case is remanded for further proceedings.

I. BACKGROUND FACTS

Between 1986 and 1989, the Griecos guaranteed four separate loans with mortgages against their home, located at 86 West River Parkway in North Providence, Rhode Island. On September 25, 1986, the Griecos borrowed \$104,000 (the "first loan") and \$19,000 (the "second loan") from the Bank, both secured by home mortgages. In July 1991, these notes had principal balances of \$97,369.60 and \$8,389.12, respectively. On April 7, 1989, the Griecos borrowed \$50,000 from Old Stone Bank (the "third loan"), secured by a third mortgage. This third loan had a principal balance of \$51,100.00 in July 1991. On February 9, 1990, Dennis Grieco's company, The Lumber Barn, Inc., entered into a revolving credit agreement with the Bank, borrowing a total of \$375,000,

which had an outstanding principal balance of \$275,939.72 in July 1991. The Griecos personally guaranteed this loan with a fourth mortgage (the "fourth mortgage"). The priorities of the mortgages follow the order in which they were secured.

In January 1991, the Griecos defaulted on the first loan. The Griecos have since failed to make any payments toward that debt. In April 1991, the Bank gave the Griecos a Notice of Default, Demand and Possible Acceleration, threatening foreclosure if the full amount due was not paid by May 17, 1991. When the Bank received no payment, it scheduled a foreclosure sale for July 10, 1991.

One day before the scheduled sale, the Griecos filed a petition for bankruptcy relief under Chapter 11 in the Bankruptcy Court for the District of Rhode Island. Bankr. No. 91-11820 (Bankr. D.R.I.). This resulted in the automatic stay of the foreclosure proceedings. The Bank then petitioned the Bankruptcy Court to lift the stay, and after several postponements leading ultimately to a hearing, the Bankruptcy Court granted the Bank's request, subject to a sixty-day stay of execution, which has since expired. The Griecos appealed to this Court, which took the matter under advisement and stayed the foreclosure sale until it could issue this Memorandum and Order.

The Griecos base their appeal on three main contentions. First, they argue that the Bankruptcy Judge should not have considered the fourth mortgage when calculating whether to lift the stay. As will be explained below, given the mathematics of

this particular case, if the fourth mortgage is properly considered in determining whether the Griecos have equity in their home, then the stay should be lifted. If, however, the fourth mortgage cannot be considered, then the stay should not be lifted. The Griecos insist that the fourth mortgage should not count as a lien against their home because the fourth mortgage is the subject of a lender liability lawsuit against the Bank currently pending in Rhode Island Superior Court, and the fourth mortgage is not in foreclosure.

Second, the Griecos complain that the Bankruptcy Court improperly required them to use an attorney at the September 24, 1991, hearing, although the Griecos had fired him earlier and wished to proceed pro se.

Finally, the Griecos assert that they had already agreed to a settlement with the Bank before the September 24 hearing, but their attorney did not raise, and the Bankruptcy Judge did not consider, this issue at the hearing. The Bank denies the existence of a settlement agreement.

II. DISCUSSION

In reviewing the Bankruptcy Court's decision, this Court must accept the Bankruptcy Judge's findings of fact unless they are clearly erroneous. Fed. Bankr. R. 8013; In re Gaudet, 132 B.R. 670, 672 (D.R.I. 1991). This Court gives plenary review, however, to the Bankruptcy Court's conclusions of law. Gaudet, 132 B.R. at 672.

A. Consideration of the Fourth Mortgage

When a debtor files a bankruptcy petition, 11 U.S.C. § 362(a) provides an automatic stay of many kinds of actions, including a secured creditor's foreclosure on the debtors' primary residence. Creditors may then seek relief from the stay. The part of the statute permitting the Bankruptcy Court to lift the stay provides:

(d) On request of a party in interest and after notice and a hearing, the court shall grant relief from the stay provided under subsection (a) of this section, such as by terminating, annulling, modifying, or conditioning such stay--

* * * *

(2) with respect to a stay of an act against property under subsection (a) of this section, if--

(A) the debtor does not have an equity in such property; and

(B) such property is not necessary to an effective reorganization.

11 U.S.C. § 362(d) (1988) (emphasis added). The word "shall" leaves the Bankruptcy Court no choice but to grant the requested relief if it concludes after a hearing that the debtors have no equity in the property and the property is not necessary to an effective reorganization.

The Bankruptcy Judge lifted the Griecos' automatic stay. According to an unofficial transcript of the hearing, which the debtors have provided, the Bankruptcy Judge concluded:

It's impossible to make this case fly on the numbers that we have. And the evidence that's been presented by the debtors is not very persuasive [T]he bottom line is that the motion for relief of stay has to be granted

Unofficial Transcript of Bankruptcy Hearing on Sept. 24, 1991, P.M. session, p.27. Although he never explicitly said so, the

Bankruptcy Judge evidently concluded both that the debtors had no equity in their home and that the house was not necessary to an effective reorganization.

In calculating whether a debtor has equity in a property, the Bankruptcy Judge measures the difference between the property's value and the total amount of liens against it. In re Liona Corp., N.V., 68 B.R. 761, 766 (Bankr. E.D. Pa. 1987). According to the Griecos, the highest estimated value of the property is \$270,000. Unofficial Transcript, P.M. session, p.1. The three undisputed liens against the property totaled \$156,858.72 at the time of the hearing. If only these three liens are included in the equation, then the Griecos clearly possessed equity in their home. If, however, the disputed fourth mortgage lien of \$275,939.72 is added to the others, then the sum of the liens against the property exceeds \$432,000, and no equity remains.

In finding that the debtors had no equity, the Bankruptcy Judge properly included the disputed fourth mortgage in his calculations. Under federal law, even if a debtor's defenses and counterclaims against a secured creditor are valid and will eventually prevail, the disputed lien may be included in calculations of the debtor's equity in the property. See In re High Sky, Inc., 15 B.R. 332, 337 (Bankr. M.D. Pa. 1981) (citing In re Born, 10 B.R. 43 (Bankr. S.D. Tex. 1981)). Two strong reasons support this rule. First, the federal bankruptcy system cannot permit debtors to tie up foreclosure proceedings simply by

filing lender liability lawsuits in state courts. Many lender liability claims are justifiable. But if a debtor's lender liability complaint could prevent creditors from showing that the debtor has no equity in his property, so that a stay of foreclosure could not be lifted, then such suits would become a common delaying tactic among debtors. Second, if the Griecos ultimately prevail on their state claim, then an appropriate award of damages can make them whole again. The best policy, therefore, is to allow the stay to be lifted despite the dispute over the fourth mortgage.

The Griecos' objection that the fourth mortgage was not in foreclosure carries no weight. The controlling statute requires only that the debtors have no equity in the property. It does not matter that some of the liens against the property may not be in foreclosure. The statute requires a lack of equity, not of liquidity. The debtors' lack of equity in the security implies that at least one creditor is at least partially unprotected. Under the bankruptcy code, this justifies lifting the stay.

The Bankruptcy Judge made no error in finding that the Griecos have no equity in their home.

The Bankruptcy Judge was also well within his discretion in determining that the Griecos' primary residence was not essential to their effective reorganization. The debtors, of course, need a place to live. In their view, keeping their home may be "necessary." But unless they use their primary residence as a necessary part of their income generation, the property is not

"necessary to an effective reorganization." For example, the primary residence of farmers who grow crops on their land is necessary to an effective reorganization. In re Deeter, 53 B.R. 623, 625 (Bankr. N.D. Ind. 1985). The Griecos, however, do not use their home as a necessary part of their business, and so the property does not receive the statute's protection.

The decisions of other federal courts support this conclusion. The Federal District Court of Utah explained that the provisions of 11 U.S.C. § 362(d)(2):

were designed to allow creditors to strip off any property from the debtor's estate that will not be needed in an effective reorganization. For example, a creditor should be allowed to foreclose on the home of a self-employed engineer, since his home is not necessary to reorganizing his business of engineering.

In re Sunstone Ridge Assoc., 51 B.R. 560, 562 (D. Utah 1985). A bankruptcy court in Tennessee explained further:

Although there are unusual cases where a wage-earning debtor uses his home in the production of income, and every non-business debtor can argue that his home enables him to function in society and thereby relates to income production, the better course is to recognize that "necessary" does not require a finding of income production where the element of an effective reorganization at issue is the debtors' living quarters.

This court believes that a debtor's home is necessary to an effective reorganization only if the property is not fungible with other living arrangements meeting the debtor's minimum living requirements.

In re Gregory, 39 B.R. 405, 411 (Bankr. M.D. Tenn. 1984). Like the debtors in those other cases, the Griecos can show no special need for their house instead of another place of shelter.

B. The Attorney Withdrawal Question

The Bankruptcy Judge committed no error in refusing to

approve the withdrawal of Attorney Patronio as the Griecos' lawyer at the September 24 hearing. The Bankruptcy Court's rules do not address the withdrawal of attorneys, but the local rules of the Federal District Court for the District of Rhode Island provide,

[a]n attorney may withdraw from a case by serving notice of his withdrawal on his client and all other parties and filing the notice, provided that (1) such notice is accompanied by notice of the appearance of other counsel, (2) there are no motions pending before the court, and (3) no trial date has been set. Unless these conditions are met, an attorney may withdraw from a case only by leave of the court.

Local Rule 6(d).

The decision to grant or deny an attorney's motion to withdraw from a civil case is committed to the discretion of the trial judge, who is familiar with the unique circumstances and timetable of the case. Washington v. Sherwin Real Estate, Inc., 694 F.2d 1081, 1087 (7th Cir. 1982); In re Edsall, 89 B.R. 772, 774 (Bankr. N.D. Ind. 1988). The trial court's decision will be reversed on appeal only when no reasonable person could agree with the decision. Washington, 694 F.2d at 1087.

Under the circumstances, this Court cannot find fault with the Bankruptcy Judge's decision not to allow Attorney Patronio to withdraw before the September 24 hearing. The Griecos did not have another lawyer with whom to replace Attorney Patronio, and a motion was pending before the court. The Bankruptcy Judge balanced the Griecos' desire for new representation (pro se representation) against the need to avoid further delays and to protect the Griecos' rights in a complicated hearing. There was

ample justification for keeping Attorney Patronio on board. See Ohntrup v. Firearms Ctr., Inc., 802 F.2d 676, 679 (3d Cir. 1986); Akers v. Bonifasi, 629 F. Supp. 1212, 1215 (M.D. Tenn. 1984).

C. The Alleged Settlement Agreement

A real controversy exists over whether the Griecos and the Bank agreed to settle their disputes. The Griecos insist that they accepted a settlement offer made by the Bank before the bankruptcy hearing on September 24. The Bank asserts that its offer was very different from what the Griecos now claim to have accepted. The Griecos' pretrial statement informed the Bankruptcy Court that the Griecos believed they had agreed to a settlement, but neither the Griecos' attorney nor the Bankruptcy Judge pursued this issue at the September 24 hearing. The Bankruptcy Court apparently never ruled on the issue.

This Court believes that if the Griecos' allegations are indeed true, the Grieco's attorney should have raised the settlement issue at the September 24 hearing, and his failure to do so may have greatly harmed his clients' interests. If, on the other hand, their claims are not true, then no harm resulted from the Bankruptcy Court's ignorance of this issue.

This Court cannot resolve whether the parties ever agreed to settle their differences before September 24. Under normal circumstances, the failure of the Grieco's attorney to raise this issue at the hearing might be reason to preclude its consideration by this Court. But because of the unusual, involuntary relationship between the Griecos and their attorney

at the time of the hearing, this Court believes that to hold the Griecos accountable for their attorney's possible oversight would be unjust. Accordingly, the best solution is to remand the settlement question to the Bankruptcy Court for a full hearing on this issue. If, as the Bank asserts, the Griecos's conception of the Bank's settlement offer is fantasy, then this should be readily apparent to the Bankruptcy Court, and the removal of the stay can be reordered. If, on the other hand, the Bank actually made the settlement offer that the Griecos purport to have accepted, then the Bankruptcy Judge can confirm the settlement agreement and issue any appropriate new orders.

III. CONCLUSION

For the reasons stated above, the Order of the Bankruptcy Court dated October 3, 1991, is affirmed in part, and the matter is remanded to the Bankruptcy Court for further proceedings solely on the question of whether the Griecos and the Bank had agreed to a settlement sometime before September 24, 1991. This Court's temporary stay of the foreclosure sale will remain in effect until the Bankruptcy Court has acted.

It is so ordered.


Ronald R. Lagueux
United States District Judge
January 21, 1992