

## U.S. District Court Reverses Bankruptcy Court in Important Victory for Condominium Associations

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On February 16, 2016, the U.S. District Court for the District of New Jersey handed down an important victory for condominium associations in the matter of *Whispering Woods Condo. Ass'n v. Rones (In re Rones)*, reversing a published U.S. Bankruptcy Court for the District of New Jersey decision which would have enabled delinquent condominium owners to "strip or cram down" their entire association debt in a Chapter 13 bankruptcy with the exception of six months of maintenance fees. The impact of the ruling is that condominium debtors must now pay back the entirety of a validly-filed condominium lien as a secured debt in order to have a Chapter 13 plan confirmed.

In an appeal filed by the Whispering Woods Condominium Association and supported by the Community Associations Institute briefing as amicus curiae, the Court held that liens filed by condominium associations are protected from modification because of the Bankruptcy Code provision known as the Anti-Modification Clause, settling the matter of how to treat condominium liens in Chapter 13 plans in favor of condominium associations.

In *Rones*, the debtors became delinquent in paying their condominium maintenance fees. In January 2014, the association recorded an amended lien against the debtors' property. The debtors subsequently filed for bankruptcy under Chapter 13 of the Bankruptcy Code. In their proposed plan, the debtors sought to pay only that portion of the lien which represented six months of unpaid fees as secured debts (those that are paid in full through the plan), with the remainder of the association's lien being "stripped off" as unsecured debts (paid off at cents on the dollar). The debtors argued that the New Jersey Condominium Act only provides protection to six months of the lien, with the remainder eligible to be

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stripped. The association argued that because of the six-month priority afforded in the Condominium Act, the lien was protected from modification due to the Anti-Modification Clause of the Bankruptcy Code.

In June 2015, the Bankruptcy Court ruled that the association was not protected by the Anti-Modification Act because the Condominium Act provided only a "method for payment" rather than a true priority which would protect the lien pursuant to the Anti-Modification Clause. The ruling held that the debtors should further prevail because the Condominium Act served as a second form of "security" for the association's lien, a fact that would disqualify it from protection.

In its decision reversing the Bankruptcy Court ruling, the District Court stated: "In short, the Condominium Act does not merely provide for the *payment* of six months of a condominium association's unpaid assessments prior to the payment of other liens. Instead, it ensures that result by *elevating* the collateral position of a portion of a duly-recorded lien on those unpaid assessments over certain other senior claims, such as the Mortgage in this case. Once recorded, the Lien created by the Master Deed became a single lien with dual priority. . . Therefore, the Bankruptcy Court's holding that N.J.S.A. 46:8B-21 did not change the priority of a portion of the Association's Lien was in error." The Court concluded, "The Bankruptcy Court erred in treating the Association's Lien as a "wholly unsecured" claim which could be stripped off (either in whole or in part); instead this Court finds that the Lien was partially secured by a security interest in the debtor's principal residence." The case has been remanded to the Bankruptcy Court for further proceedings.

The author of this Alert, **Steven G. Mlenak**, played a significant role in representing the condominium association in its appeal, and in coordinating the Community Associations Institute's amicus brief, during his tenure at a prior firm. Please contact Mr. Mlenak for additional information on this case or with other questions related to community association law.