BANKRUPTCY CODE § 1322(B)(2)'S NO-MODIFICATION CLAUSE: WHO DOES IT PROTECT?

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INTRODUCTION

It is a matter of common knowledge that debtors file Chapter 13 bankruptcy when they are in danger of losing their homes.[1] That is, the threat of foreclosure of a lien on the debtor's residence is often the final impetus for filing a bankruptcy petition. How the debt secured by that lien will be dealt with in the debtor's reorganization is, therefore, of great importance not only to Chapter 13 debtors, but to the home lending industry. The treatment of such claims is primarily governed by three provisions of the United States Bankruptcy Code.

Section 1325[2] is one of the provisions of the Bankruptcy Code which must be considered in understanding how a claim secured by the debtor's home will be treated. This section contains the requirements which a Chapter 13 plan must meet to be confirmed by the court.[3] Section 1325(a)(5) requires that the plan provide for payment in full of secured claims, either by abandonment of the collateral or by deferred cash payments.[4] If the plan provides for payment

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1. The court in *In re Sauber* noted that "[t]he vast majority of Chapter 13 cases are filed by homeowners, and most plans treat mortgage defaults." 115 Bankr. 197, 199 (Bankr. D. Minn. 1990). Another court noted that "in most cases, the preservation of the residence from foreclosure is the primary reason for the filing of a Chapter 13 case." Cameron Brown Co. v. Bruce (*In re* Bruce), 40 Bankr. 884, 888 (Bankr. W.D. Va. 1984).

2. 11 U.S.C. § 1325 (1988).

3. Under Chapter 13, a debtor submits a plan of reorganization that provides for repayment of creditors over the life of the plan (three years or, in the discretion of the court, up to five years). Unlike Chapter 7, therefore, relief under Chapter 13 is not "quick and final," but takes place over a period of time. Chapter 13, however, allows the debtor to remain in possession of his or her collateral property, which must be surrendered for the satisfaction of secured claims in a Chapter 7 action. *See In re* Vlahakis, 11 Bankr. 751, 754 (Bankr. M.D. Ga. 1981) ("The debtor is required to live under the supervision of the Court for an extended period of time and to make periodic payments toward the elimination of his debts."); *In re* Pittman, 8 Bankr. 299, 301 (D. Colo. 1981) ("A Chapter 13 debtor avoids the loss of his assets by contributing future income to the payment of his debts under a court-approved plan."). The adjustments in creditors' claims and extensions of repayment permitted by Chapter 13 are "subject to provisions that protect the interests of creditors, including ... their secured interests." Eastland Mortgage Co. v. Hart (*In re* Hart), 923 F.2d 1410, 1412 (10th Cir. 1991).

4. With regard to secured claims, 11 U.S.C. § 1325(a)(5) requires that the plan be confirmed if:

(A) the holder of such claim has accepted the plan;

(B)(i) the plan provides that the holder of such claim retain the lien securing such claim; and

of the claim via deferred cash payments, an interest rate must be charged that results in total payments with a present value equal to the amount of the claim.[5] Generally, this rate will be slightly lower than the rate of interest originally agreed upon by the parties.[6] In addition, the term of the loan may be stretched out over a longer period of time, resulting in lower monthly payments. This is subject, however, to the limitation imposed by the maximum five year term of the plan.[7] Therefore, according to § 1325(a)(5) considered in isolation, a claim secured by the debtor's home must be paid back in full. This can, however, be accomplished at a lower interest rate, and possibly over a longer period of time, than originally provided by the loan agreement.

The second Code provision to be considered is § 1322(b)(2).[8] This section deals specifically with claims secured by the debtor's principal residence. It states that a debtor's Chapter 13 plan of reorganization may "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....*"[9] Under this provision the debtor apparently cannot change any of the terms of the agreement governing a loan secured by (and only by) his or her principal

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(ii) the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim; or

(C) the debtor surrenders the property securing such claim to such holder....

11 U.S.C. § 1325(a)(5).

5. *See In re* Mothershed, 62 Bankr. 113, 114 (Bankr. E.D. Ark. 1986); *In re* Paul, 62 Bankr. 269, 270 (Bankr. D. Neb. 1986); *In re* Hugee, 54 Bankr. 676, 678 (Bankr. D.S.C. 1985); *In re* Mitchell, 39 Bankr. 696, 700 (Bankr. D. Or. 1984). The courts generally agree that the proper rate to accomplish this is the prevailing market rate of interest for a loan with a term equal to the contemplated pay-out period, considering the quality of the security and the risk of default. *Mothershed*, 62 Bankr. at 114; *Paul*, 62 Bankr. at 270; *Mitchell*, 39 Bankr. at 701.

6. *See Paul*, 62 Bankr. at 270 (contract rate 15.75%, market rate 10.75%); *Hugee*, 54 Bankr. at 677 (contract rate 24.75%, court approved 14% discount rate). The court in *Hugee* noted that "[i]t is not the purpose of the discount rate to produce a lender's profit." *Id.* at 678.

7. 11 U.S.C. § 1322(c) provides that the Chapter 13 debtor's plan of reorganization "may not provide for payments over a period that is longer than three years, unless the court, for cause, approves a longer period, but the court may not approve a period that is longer than five years." Thus, if the last payment on the debt is not due until after the plan period, the plan cannot provide for the payment of the entire debt. However, the payment period can be stretched out to the extent of the five year plan if the last payment on the debt will come due under the contract prior to the end of the five year period. The plan may also provide for the curing of any defaults and the maintenance of payments while the case is pending on any claim that extends beyond the life of the plan. 11 U.S.C. § 1322(b)(5) (1988).

8. 11 U.S.C. § 1322(b)(2) (1988).

9. *Id.* (emphasis added). 11 U.S.C. §§ 1322(b)(3) and (5) contain a limited exception to the no-modification rule of § 1322(b)(2) by allowing the debtor to cure any pre-petition defaults. The curing of defaults under these provisions is the subject of fairly extensive discussion elsewhere and will not be addressed by this Note. *See* Novellino, *A Serious Case of Metaphysics: When* In re Brown *was Roach'd*, 95 COM. L.J. 97 (1990); Paniello & Johnson, *Chapter 13 Bankruptcy: The Mortgagor's Right to "Deaccelerate" Their Mortgage Under Section 1322(b) Of The Bankruptcy Code*, 39 CONSUMER FIN. L.Q. 9 (1985); Sable, *A Chapter 13 Debtor's Right to Cure Default Under Section 1322(b): A Problem of Interpretation*, 57 AM. BANKR. L.J. 127 (1983); Miller, *Chapter 13 Bankruptcy: When May a Mortgage Debtor Cure the Accelerated Mortgage Debt Using Section 1322(b)(5)?*, 8 U. DAYTON L. REV. 109 (1982).

residence.[10] The debt must be paid back in full as required by § 1325(a)(5), but must also be paid according to the terms of the original loan instrument; that is, at the original rate of interest and over the original term.[11] But what if property values have declined, or the loan has been allowed to negatively amortize pursuant to some special loan program, so that the amount of the debt now exceeds the value of the residence securing it? What if the residence secures several loans, the aggregate amount of which exceeds the value of the residence? Must the debt be paid in full even under these circumstances? Must it, or some portion of it, be paid according to the terms of the original loan agreement?

To determine how an "undersecured" claim secured by a debtor's residence must be treated, a third Code provision, § 506(a), must be consulted.[12] Section 506 is a provision of general application in the Code; it applies to cases under Chapters 7, 11, 12, or 13.[13] Under § 506(a), secured claims are "allowed" in bankruptcy only up to the value of the collateral; the balance of the creditor's claim, in excess of the value of the collateral, is an allowed unsecured claim.[14] The lien securing the portion of the claim allowed only as an unsecured claim is void under section 506(d).[15] Applying this provision to a claim secured by the debtor's residence, the amount of which exceeds the value of that residence, it appears that the claim may be bifurcated into an allowed secured claim and an allowed unsecured claim. As noted above, secured claims

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10. Modification includes any change in the repayment term or interest rate of the loan. *In re* Allen, 75 Bankr. 344, 346 (Bankr. S.D. Ohio 1987); *In re* Coffey, 52 Bankr. 54, 55 (Bankr. D.N.H. 1985).

11. *In re* Rorie, 58 Bankr. 162, 164 (Bankr. S.D. Ohio 1985). Several courts have apparently concluded that a creditor whose claim is secured by a lien on the debtor's principal residence is not entitled to treatment other than that required by § 1325(a)(5)(B), in spite of § 1322(b)(2). *See In re* Bolden, 101 Bankr. 582, 584 (Bankr. E.D. Mo. 1989); *In re* Morphis, 30 Bankr. 589, 593-94 (Bankr. N.D. Ala. 1983); *In re* Neal, 10 Bankr. 535, 540 (Bankr. S.D. Ohio 1981). This, however, is a minority position, and one that makes little sense. The court in *In re Simpkins* explains:

> The special protection of § 1322(b)(2) prevents application of the "cram-down" provision, § 1325(a)(5)(B).... Section 1325(a)(5)(B) allows a plan to be confirmed if it provides for payment of the amount of the secured claim plus an allowance for the time-value of money while the claim is being paid. Section 1322(b)(2) creates an exception to that rule for a claim secured only by a security interest in the debtor's principal residence. The plan cannot provide for any less than maintenance of the regular payments. Worse treatment would "modify" the claimant's rights in violation of § 1322(b)(2).

16 Bankr. 956, 963-64 (Bankr. E.D. Tenn. 1982) (citations and footnotes omitted).

12. 11 U.S.C. § 506 (1988).

13. 11 U.S.C. § 103(a) (1988).

14. 11 U.S.C. § 506(a) states:

> An allowed claim of a creditor secured by a lien on property in which the estate has an interest, ... is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, ... and is an unsecured claim to the extent of such creditor's interest ... is less than the amount of such allowed claim.

15. 11 U.S.C. § 506(d) states: "To the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void...." For a discussion of the application of this provision to liens on real property, see Note, *Can a Debtor Void a Real Property Lien That Exceeds the Value of the Collateral?: An Interpretation of Section 506(d) of the Bankruptcy Code*, 45 WASH. & LEE L. REV. 1393 (1988).

must be paid in full; unsecured claims, in contrast, may receive as little as ten cents, or even five cents, on the dollar.[16]

Although § 506(a) appears to allow bifurcation of the undersecured claim into secured and unsecured portions, § 1322(b)(2) prohibits modification of claims secured by a debtor's principal residence. Is bifurcation of a claim secured by the debtor's residence a "modification" prohibited by § 1322(b)(2)? Or does § 1322(b)(2) merely apply to the "secured" portion of the debt under § 506(a)? Does it make any sense to say that the claim can be cut in two and yet not be "modified?"

To summarize, if § 1322(b)(2) applies to the entire amount of any claim secured by a lien on the debtor's residence, the debtor must pay such claims in full and according to the original terms, regardless of whether there is any value in the residence supporting the lien. This is a great benefit for the creditor, but may be a rather onerous burden on the harried debtor. On the other hand, if § 1322(b)(2) applies only to the portion of the claim allowed as secured by § 506(a), then some portion of the debt or debts secured by the residence can be "scraped off" and paid along with other unsecured claims. This is an unhappy result for the creditor. While several courts have noted that home loans are rarely undersecured,[17] this may not be the case in areas where property values have recently declined.[18] Creditors in such areas may be extensively affected by decisions disallowing undersecured portions of their claims. Such an interpretation also affects lenders who make home loans that are allowed to negatively amortize pursuant to some special assistance program.[19]

For a number of years after the enactment of the Bankruptcy Code, the bankruptcy and district courts split on the proper application of § 1322(b)(2) in the context of "undersecured" claims secured by liens on the debtor's principal residence. However, three circuit courts of appeals recently addressed this issue. Each resolved it by bifurcating the undersecured claim pursuant to §

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16. After providing for payment of secured and other priority claims, the debtor's "disposable income" is distributed to unsecured creditors in proportion to the amount of their claims. 11 U.S.C. § 1325(b)(1)(B). Depending on how much disposable income the debtor will generate over the life of the plan, the dividend ultimately received by each unsecured debtor may be quite low. *See, e.g., In re* Frost, 96 Bankr. 804, 805 (Bankr. S.D. Ohio 1989), *aff'd*, 123 Bankr. 254 (S.D. Ohio 1990) (court confirmed plan providing for a 5% dividend to be paid unsecured creditors); *In re* Hill, 96 Bankr. 809, 810 (Bankr. S.D. Ohio 1989) (plan provided for a 13% dividend for unsecured creditors). Generally, though the plan must be proposed in good faith, no minimum level of repayment of unsecured claims is required in order for a plan to be confirmed. *See In re* Williams, 42 Bankr. 474 (Bankr. D. Ark. 1984); *In re* Valentine, 29 Bankr. 366 (Bankr. D. Conn. 1983).

17. *See, e.g.*, Hougland v. Lomas & Nettleton Co. (*In re* Hougland), 886 F.2d 1182, 1184 (9th Cir. 1989); Caster v. United States (*In re* Caster), 77 Bankr. 8 (Bankr. E.D. Pa. 1987).

18. *See Frost*, 96 Bankr. at 807 (noting that "very abnormal economic times" may result in a home mortgage being undersecured).

19. For instance, in *Hougland*, the creditor's claim was undersecured due to such a special program. 886 F.2d at 1182.

506(a) and restricting application of § 1322(b)(2)'s "no modification" clause to the portion of the claim allowed as secured.[20]

This Note analyzes the application of § 1322(b)(2) of the Bankruptcy Code in the context of undersecured claims. The Note first examines various methods of statutory interpretation generally employed by the courts. It then explains the alternative court interpretations of § 1322(b)(2) as applied to undersecured claims and analyzes the arguments advanced in support of these interpretations. Finally, this Note critically evaluates the various interpretations of § 1322(b)(2) and concludes that the position taken in the recent courts of appeals decisions, while not unassailable, is the best resolution of the potential conflict between this provision and § 506(a).

METHODS OF STATUTORY INTERPRETATION

An exhaustive discussion of all the methods of statutory construction is beyond the scope of this Note. Nevertheless, a preliminary discussion of some of the most commonly used methods is helpful as a foundation for the later, more detailed discussion of the possible interpretations of § 1322(b)(2).

The Plain Meaning Approach

The United States Supreme Court has stated that courts, in interpreting statutes, must construe the language in a manner that effectuates congressional intent.[21] While this may, indeed, aptly summarize the courts' function, it does not answer the more controversial question concerning which sources the courts should use to decipher that congressional intent.

The Supreme Court often advocates beginning statutory inquiry with an examination of the statutory language itself.[22] This "plain language" or "plain meaning" approach is based on the idea that the statutory language, as ultimately enacted, best indicates Congress' intent.[23] To the extent that this rule is so based, and to the extent that it prohibits a construction clearly at odds with the "plain language" of the statute, it is appropriate and helpful. In its most extreme form, however, it forbids consideration of any other sources of information and is inconsistent with the courts' duty to give effect to congressional intent. "In its name, courts have refused (or purported to refuse) to test the meaning of a particular provision against the broad purpose of a statute, and even refused to look at such 'intrinsic' material as the statute's title or preamble."[24] Nevertheless, the Supreme Court has stated that, at least where

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20. *See Hougland*, 886 F.2d 1182; Wilson v. Commonwealth Mortgage Corp. (*In re* Wilson), 895 F.2d 123 (3d Cir. 1990); *Hart*, 923 F.2d 1410. *See infra* text accompanying notes 83-118.

21. "In the interpretation of statutes, the function of the courts is easily stated. It is to construe the language so as to give effect to the intent of Congress." United States v. American Trucking Ass'ns, Inc., 310 U.S 534, 542 (1940), *reh'g denied*, 311 U.S. 724 (1940).

22. Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 756 (1975) (Powell, J., concurring) ("The starting point in every case involving construction of a statute is the language itself."); Gemsco, Inc. v. Walling, 324 U.S. 244, 260 (1945).

23. *American Trucking*, 310 U.S. at 543.

24. Murphy, *Old Maxims Never Die: The "Plain-Meaning" Rule and Statutory Interpretation in the "Modern" Federal Courts*, 75 COLUM. L. REV. 1299 (1975) (footnotes omitted).

the language is unambiguous, the inquiry should not only begin, but end, with a reading of the statutory language.[25]

Language, however, is rarely if ever truly free of all vagueness and ambiguity. Indeed, one may wonder why, if the "plain language" of the statute at issue furnishes all the answers, the Supreme Court (or any appellate court) would be called upon to interpret it. Commentators have criticized the plain meaning approach,[26] and the Supreme Court itself has appeared at times to disavow it.[27] Nevertheless, it keeps popping up.[28] As the dissent observed in *United States v. Ron Pair Enterprises*, "[t]he notion that because the words of a statute are plain, its meaning is also plain, is merely pernicious oversimplification."[29] In the end, it seems unlikely that the "plain language" approach is enough, by itself, to justify a particular interpretation in all but the simplest cases. Indeed, even when it is espoused, the Court generally considers other factors in addition to the "plain meaning" of the statutory language.[30]

The Context Approach

Another approach used in statutory interpretation is to consider the provision within the context of the statutory scheme as a whole.[31] This

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25. *See* United States v. Ron Pair Enterp., Inc., 489 U.S. 235, 240-41 (1989) ("as long as the statutory scheme is coherent and consistent, there generally is no need for a court to inquire beyond the plain language of the statute"); Davis v. Michigan Dep't of Treasury, 489 U.S. 803, 809 n.3 (1989) ("Legislative history is irrelevant to the interpretation of an unambiguous statute.").

26. Murphy, *supra* note 24, at 1315, advocates abandonment of the plain meaning approach. Klee and Merola criticize the Court for using a plain meaning approach in the interpretation of the Bankruptcy Code and advocate more extensive use of legislative history. Klee & Merola, *Ignoring Congressional Intent: Eight Years of Judicial Legislation*, 62 AM. BANKR. L.J. 1 (1988).

27. *See* Train v. Colorado Pub. Interest Research Group, Inc., 426 U.S. 1, 9-10 (1976) ("To the extent that the Court of Appeals excluded reference to the legislative history of the FWPCA in discerning its meaning, the court was in error."); Watt v. Alaska, 451 U.S. 259, 266 (1981) ("ascertainment of the meaning apparent on the face of a single statute need not end the inquiry.... This is because the plain-meaning rule is 'rather an axiom of experience than a rule of law, and does not preclude consideration of persuasive evidence if it exists.'"); *American Trucking*, 310 U.S. at 543-44 ("When aid to construction of the meaning of words, as used in the statute, is available, there certainly can be no 'rule of law' which forbids its use, however clear the words may appear on 'superficial examination.'") (footnote omitted).

28. *See* Pennsylvania Dep't of Pub. Welfare v. Davenport, 110 S. Ct. 2126, 2134 (1990) (Blackmun, J., dissenting) (characterizing the majority position as an overly simplistic plain-meaning approach); Fisher & Coyne, *The United States Supreme Court Interprets the Bankruptcy Code: Strict Construction*, 42 CONSUMER FIN. L.Q. 181, 183 (1988) (asserting that recent Supreme Court interpretations of the Bankruptcy Code indicate its "willingness to enforce technical provisions" of the Code and "give effect to plain and unambiguous statutory language" rather than consider equity arguments).

29. 489 U.S. at 249 (O'Connor, J., dissenting) (quoting United States v. Monia, 317 U.S. 424, 431 (1943) (Frankfurter, J., dissenting)).

30. *See* Murphy, *supra* note 24, at 1305; *Gemsco*, 324 U.S. at 260-65 (Court uses plain meaning approach but goes on to discuss the legislative history in some detail); *Ron Pair*, 489 U.S. at 242-43 (Court notes that generally "[t]he plain meaning of legislation should be conclusive" but goes on to note that its interpretation "does not contravene the intent of the framers").

31. The Supreme Court, in *United Sav. Ass'n of Tex. v. Timbers of Inwood Forest Ass'n, Ltd.*, stated:

> Statutory construction ... is a holistic endeavor. A provision that may seem ambiguous in isolation is often clarified by the remainder of the statutory scheme

approach is particularly appealing when the issue is the type under consideration here: the interaction of two different sections of an integrated, holistic Code. Several different principles guide the interpretation within this approach.

It is a generally accepted tenet of statutory construction that a Code provision should be interpreted in a manner which avoids a conflict with another provision, if this can be done without resulting in an absurdity.[32] A closely related concept is that one Code provision should not be interpreted in a way which deprives another of all meaning and effect.[33] The obvious idea behind these principles is that the drafters must have intended both provisions to have some effect.

Finally, it is a generally accepted tenet of statutory construction that specific provisions within a statute prevail over other provisions of more general application.[34] This rule need only be applied, however, when the general and specific provisions cannot be read consistently with one another. In other words, this is a rule for deciding which of two irreconcilable provisions applies to a given situation. Under the principal of consistency, the conflict itself should be avoided if possible.[35]

The Legislative Intent Approach

The Supreme Court has occasionally expressed a preference for considering only the statutory language itself in determining the meaning of a statute.[36] At the same time, it has conceded that where statutory language is ambiguous, or its "plain meaning" leads to an absurdity, consideration of legislative intent is appropriate.[37] It has been argued that legislative intent, as

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— because the same terminology is used elsewhere in a context that makes its meaning clear, or because only one of the permissible meanings produces a substantive effect that is compatible with the rest of the law.

484 U.S. 365, 371 (1988) (citations omitted). *See also Davis*, 489 U.S. at 809 ("It is a fundamental canon of statutory construction that the words of a statute must be read in their context and with a view to their place in the overall statutory scheme.") (citation omitted); *Davenport*, 110 S. Ct. at 2129; *American Trucking*, 310 U.S. at 542 ("To take a few words from their context and with them thus isolated to attempt to determine their meaning, certainly would not contribute greatly to the discovery of the purpose of the draftsmen of a statute...."); Kelly v. Robinson, 479 U.S. 36, 43 (1986) ("In expounding a statute, we must not be guided by a single sentence or member of a sentence, but look to the provisions of the whole law, and to its object and policy.") (citations omitted).

32. *See Timbers*, 484 U.S. at 371; Clark v. Uebersee Finanz-Korporation, A.G., 332 U.S. 480, 488 (1947); *Watt*, 451 U.S. at 266; *Ron Pair*, 489 U.S. at 242 n.5.

33. *See Watt*, 451 U.S. at 267 ("We must read the statutes to give effect to each if we can do so while preserving their sense and purpose."); D. Ginsberg & Sons, Inc. v. Popkin, 285 U.S. 204, 208 (1932) (it is a "cardinal rule that, if possible, effect shall be given to every clause and part of a statute."); Rosado v. Wyman, 397 U.S. 397, 415 (1970) (noting that "courts should construe all legislative enactments to give them some meaning").

34. The Supreme Court stated, in *Ginsberg*: "General language of a statutory provision, although broad enough to include it, will not be held to apply to a matter specifically dealt with in another part of the same enactment. Specific terms prevail over the general in the same or another statute which otherwise might be controlling." 285 U.S. at 208 (citations omitted).

35. *See supra* discussion in text accompanying note 32.

36. *See supra* discussion in text accompanying notes 21-30.

37. *See Davenport*, 110 S. Ct. at 2134 (Blackmun, J., dissenting); *Ron Pair*, 489 U.S. at 242; *Gemsco*, 324 U.S. at 260.

embodied in the legislative history of a statute, should be routinely considered in interpreting the statute's meaning — not just when other methods of interpretation fail.[38] There is a danger, of course, that courts will use an ambiguous and inconclusive history to support a conclusion at odds with the language of the statute. The danger does not, however, justify banning the use of whatever helpful information is available to the courts.[39] Of course, certain sources of legislative intent, such as committee reports, are more reliable than others.[40]

An analysis of legislative intent may be particularly important when the statute appears to require a break from previous judicial interpretation. The Supreme Court, in *Midlantic National Bank v. New Jersey Department of Environmental Protection*[41] and *Kelly v. Robinson*[42] appeared to adopt the rule that the Bankruptcy Code will not be deemed to have changed pre-Code bankruptcy law absent some explicit indication that Congress so intended. However, the majority in *Ron Pair* severely limited the scope of this "rule," noting that a consideration of pre-Code practice is appropriate only when it implicates important policy considerations or when the statutory language under consideration is "at least to some degree, ... open to interpretation."[43] The dissent in *Ron Pair* rejected this limitation, arguing that the rule expressed in *Midlantic* and *Kelly* mandates a preference for continuity with pre-Code practice even where the statutory language is "absolute in its terms" so long as no explicit expression of congressional intent to change pre-Code law appears.[44] Subsequently, the majority opinion in *Pennsylvania Department of Public Welfare v. Davenport* seemed to reaffirm the *Midlantic* rule,[45] though the dissent criticized the majority as ultimately adopting a plain meaning approach.[46] It is thus unclear to what extent a consideration of pre-Code practice should influence the interpretation of the Bankruptcy Code.

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38. *See* Murphy, *supra* note 24, at 1316; Klee & Merola, *supra* note 26, at 3. *See also Watt*, 451 U.S. at 266 ("The circumstances of the enactment of particular legislation may persuade a court that Congress did not intend words of common meaning to have their literal effect."); *Train*, 426 U.S. at 10-11; *American Trucking*, 310 U.S. at 544.

39. As the Supreme Court stated in *American Trucking*:

> Obviously there is danger that the courts' conclusion as to legislative purpose will be unconsciously influenced by the judges' own views or by factors not considered by the enacting body. A lively appreciation of the danger is the best assurance of escape from its threat but hardly justifies an acceptance of a literal interpretation dogma which withholds from the courts available information for reaching a correct conclusion.

310 U.S. at 544.

40. *See* Klee & Merola, *supra* note 26, at 4; Murphy, *supra* note 24, at 1314.

41. 474 U.S. 494, *reh'g denied*, 475 U.S. 1090 (1986).

42. 479 U.S. 36 (1986).

43. 489 U.S. at 245.

44. *Id.* at 252 (O'Connor, J., dissenting).

45. The majority stated that "[w]e will not read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such a departure." *Davenport*, 110 S. Ct. at 2133. The dissent added that "[t]o determine the drafter's intent the Court presumes that Congress intended to keep continuity between pre-Code judicial practice and the enactment of the Bankruptcy Code in 1978." *Id.* at 2134 (Blackmun, J., dissenting).

46. *Id.* at 2134 (Blackmun, J., dissenting).

THE THREE INTERPRETATIONS

The courts have developed three distinct interpretations of the application of § 1322(b)(2) in the context of undersecured claims secured by liens on the debtor's principal residence. This section describes these interpretations and analyzes the arguments advanced by the courts to support them. Applying these different interpretations to the same fact pattern helps in understanding each of the three positions and the differences among them. Therefore, as the different positions are discussed, reference will be made to the following hypothetical situation.

Mr. and Ms. Jones, husband and wife, file a Chapter 13 petition in bankruptcy court. In addition to various unsecured debts, the Jones have three mortgages on their home, which has a fair market value of $80,000. The unpaid balance of the debt (a purchase-money loan) secured by the first lien on their home is $70,000. The unpaid balance on the debt (a home improvement loan) secured by the second position lien is $15,000. The third lien secures a debt (a business loan) with an unpaid balance of $5000. All three creditors file claims in the full amount of their unpaid balances.

Section 1322(b)(2) Applies to all "Claims" Secured by the Debtor's Residence

A number of courts have concluded that the no-modification provision of § 1322(b)(2) applies to the entire "claim" secured by the debtor's principal residence, whether or not there is any actual value in the residence to support it.[47] The undersecured claim cannot be bifurcated into secured and unsecured portions via application of § 506(a); instead, the entire claim must be paid back in full and according to the terms of the loan agreement. In *In re Hynson*,[48] a case often cited to support this position, the Bankruptcy Court for the District of New Jersey addressed many of the arguments advanced in favor of this interpretation.

The debtor's plan in *Hynson* modified the rights of a holder of a second mortgage secured by a lien on the debtor's residence.[49] The balance due on the first mortgage exceeded the value of the residence and the debtor sought to have the second mortgagee's claim allowed as unsecured under § 506(a) and the lien avoided under § 506(d).[50] The court refused to confirm the plan, finding that it impermissibly modified the mortgagee's rights under § 1322(b)(2).[51]

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47. *See Sauber*, 115 Bankr. 197; *In re* Hemsing, 75 Bankr. 689 (Bankr. D. Mont. 1987); *In re* Russell, 93 Bankr. 703 (D.N.D. 1988); *In re* Schum 112 Bankr. 159 (Bankr. N.D. Tex. 1990); *In re* Kaczmarczyk, 107 Bankr. 200 (Bankr. D. Neb. 1989); *Simpkins*, 16 Bankr. 956. *See also In re* Brown, 91 Bankr. 19 (Bankr. E.D. Va. 1988); *In re* Catlin, 81 Bankr. 522 (Bankr. D. Minn. 1987). Although the main issue in *Brown* and *Catlin* was whether a creditor, whose claim is secured only by a lien on the debtor's principal residence, is entitled to interest on arrearages when the debtor cures a default, the bifurcation issue was addressed in dicta.

48. 66 Bankr. 246 (Bankr. D.N.J. 1986). Although the position of this court was reversed by *In re* Harris, 94 Bankr. 832 (D.N.J. 1989), its reasoning is representative of the interpretation under discussion and is still employed by a number of courts.

49. 66 Bankr. at 247. Throughout this Note, when claims are discussed, it should be assumed that, unless explicitly noted otherwise, they are secured by, and only by, real estate which is the debtor's principal residence.

50. *Id.* at 248.

51. *Id.* at 247.

The Plain Meaning Approach

In support of its conclusion, the *Hynson* court argued that the plain language of § 1322(b)(2), which allows modification of secured claims "other than a *claim* secured only by a security interest in real property that is the debtor's residence,"[52] protects not only "secured" claims as defined by § 506(a), but any "claim"[53] secured only by the debtor's residence.[54] This argument has been criticized as arbitrarily isolating the above-quoted phrase from the "secured claims" language preceding it.[55]

The *Hynson* court also argued that, had Congress intended to limit the protection of § 1322(b)(2) to secured claims, it could have drafted the provision more precisely to allow modification of "secured claims, other than secured claims secured only by ...."[56] The Ninth Circuit Court of Appeals rejected this argument in *Hougland v. Lomas & Nettleton Co. (In re Hougland)*, as proposing an awkward sentence structure.[57] Given the fact that within the Bankruptcy Code the terms "claim" and "secured claim" have special meanings, however, it is not unreasonable to expect Congress to use them precisely.

The Context Approach

The *Hynson* court also argued that because § 506(a) is a general provision in conflict with § 1322(b)(2), a specific provision, it must yield to that specific provision.[58] The general principle relied upon by proponents of this argument is sound.[59] However, in order for the "specific over general" rule to apply to § 1322(b)(2) and § 506(a), the two provisions must be in actual conflict with one another. Therefore, if § 1322(b)(2) is first interpreted as applying only to "secured" claims as defined by § 506(a), there is no conflict and no choice need be made as to which provision "prevails" over the other.[60]

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52. 11 U.S.C. § 1322(b)(2) (emphasis added).

53. "Claim" is defined very broadly by the Code; it includes any "right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured...." 11 U.S.C. § 101(5)(A) (1990).

54. 66 Bankr. at 253 ("The language of 11 U.S.C. § 1322(b)(2) does not specifically limit its protection to a *secured* claim secured only by a security interest in such real property."). *See also Russell*, 93 Bankr. at 705; *Schum*, 112 Bankr. at 162 ("the plain language of § 1322(b)(2) ... control[s] to prohibit a modification of the secured status of a claimant whose claim is secured only by the principal residence of the debtor."); *Sauber*, 115 Bankr. at 199 (insisting that a "straight-forward, common-sense reading of § 1322(b)(2) ... both standing alone and in the overall context of the Code" supports the conclusion that § 506(a) does not apply where § 1322(b)(2) does).

55. *See Hougland*, 886 F.2d at 1184.

56. 66 Bankr. at 253.

57. 886 F.2d at 1184.

58. 66 Bankr. at 249. *See also Catlin*, 81 Bankr. at 524; *Sauber*, 115 Bankr. at 199; *Hemsing*, 75 Bankr. at 691-92; *Russell*, 93 Bankr. at 705; *In re* Smith, 63 Bankr. 15, 17 (Bankr. D.N.J. 1986); *Schum*, 112 Bankr. at 160-61; *In re* Mahaner, 34 Bankr. 308, 309 (Bankr. W.D. N.Y. 1983).

59. *See supra* text accompanying notes 34-35.

60. *See Hougland*, 886 F.2d at 1184; *In re* Hougland, 93 Bankr. 718, 722 (D. Or. 1988), *aff'd*, 886 F.2d 1182 (9th Cir. 1989); *Caster*, 77 Bankr. at 13; *In re* Demoff, 109 Bankr. 902, 919 (Bankr. N.D. Ind. 1989) (court concluded that it need not apply the "specific over general" rule because § 506(a) and § 1322(b)(2) "do not conflict and when read in the context of the entire Bankruptcy Code they are harmonious and internally consistent").

In other words, the argument essentially begs the question. It is only valid if it is first concluded that § 1322(b)(2) applies to all claims secured only by a security interest in the debtor's principal residence.[61] This conclusion may be reached by an analysis of the "plain language" of the provision or by an analysis of other factors, such as general policy considerations or legislative intent.[62]

The *Hynson* court further maintained that limiting the application of § 1322(b)(2) to claims that are "secured" under § 506(a) is invalid because such a limitation would "in large part vitiate" the protection offered by that section.[63] Other courts have rejected this argument, noting that even if § 506(a) is applied to bifurcate the creditor's claim, § 1322(b)(2) continues to require that the original terms of the loan be preserved as to the secured portion of the claim.[64] Recall that in the absence of § 1322(b)(2), the interest rate and payment term of a secured claim may be altered under § 1325(a)(5).[65]

The Legislative Intent Approach

The *Hynson* court also argued that limiting the application of § 1322(b)(2) to claims allowed as secured under § 506(a) is contrary to the clear congressional intent to protect certain lenders.[66] It is indeed clear that § 1322(b)(2), as ultimately enacted, represents Congress' intent to protect home mortgage lenders. The extent of the intended protection, however, remains unclear.[67] Even if the protection of § 1322(b)(2) is limited to the portion of the claim allowed as "secured" under § 506(a), it affords more protection than is available under the general requirements of § 1325(a)(5). Congress may have

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61. Many of the courts which advance this argument formulate the issue as which of two conflicting provisions applies. *See, e.g., Russell*, 93 Bankr. at 704 (court defines issue as "which section of 11 U.S.C., § 506 or § 1322 [,] is controlling in the case at bar"); *Smith*, 63 Bankr. at 17.

62. *See supra* text accompanying notes 21-30 & 36-46.

63. 66 Bankr. at 252. *See also Sauber*, 115 Bankr. at 199 ("By focusing on the terms 'secured claim' and 'unsecured claim,' and by using § 506(a) definitions, *Hougland* judicially removes most of the protection that the statute provides."); *Hart*, 923 F.2d at 1417 (Brorby, J., dissenting) (noting that the problem with the majority's approach "is that it renders § 1322(b)(2) essentially meaningless").

64. *See, e.g.*, Brouse v. CSB Mortgage Corp. (*In re* Brouse), 110 Bankr. 539, 543 & 544 n.7 (Bankr. D. Colo. 1990); *Caster*, 77 Bankr. at 13 ("we believe that § 1322(b)(2) serves a purpose even if it is read, as we believe that the principles of statutory construction require, ... not as in conflict with, but as *consistently* with, § 506(a) as possible. It prevents debtors from changing the payment terms of claims based on mortgages which actually are fully secured."); *Frost*, 96 Bankr. at 807 ("This interpretation of § 1322(b)(2) does not unacceptably undercut the Congressional policy of protecting long-term mortgage-backed obligations.... The creditor's allowed secured claim ... must be paid in full with the contract rate of interest unless the claimant agrees to a different treatment. Such treatment satisfies the requirements of 11 U.S.C. § 1325(a)(5).").

65. *See* discussion of § 1325(a)(5), *supra* in text accompanying notes 4-6.

66. 66 Bankr. at 252 (applying § 506(a) "would be at odds with the clear intent of Congress to protect a lender's security when a lender is secured only by a security interest in a Chapter 13 debtor's home."). *See also Brown*, 91 Bankr. at 22 ("we conclude ... that subsections (b)(2) and (b)(5) of section 1322 of the Code provide for the unique treatment of claims held by residential mortgage lenders."); *Russell*, 93 Bankr. at 706; *Schum*, 112 Bankr. at 162 ("It is clear that Congress intended special treatment for a creditor whose claim is secured only by a security interest in the debtor's principal residence.").

67. *See Harris*, 94 Bankr. at 836.

intended no more.[68] On the other hand, the repayment period of most home loans extends beyond the life of a Chapter 13 plan. In such cases, the claim secured by the debtor's residence is already immune from the "cramdown" provisions of § 1325(a)(5) and the debtor must simply cure any defaults and maintain payments during the plan period. If § 1322(b)(2) does not prevent bifurcation under § 506(a), it really does fail to offer creditors any special protection in such cases.

The Bankruptcy Court for the District of Nebraska, in *In re Kaczmarczyk*, analyzed pre-Code practice and concluded that § 1322(b)(2) prohibits bifurcation of an undersecured claim, secured by the debtor's principal residence, into a secured and an unsecured claim.[69] Because the Supreme Court has at times relied on pre-Code practice in interpreting the Bankruptcy Code, this argument is worthy of consideration, despite the paucity of courts raising it.[70]

Under the Bankruptcy Act of 1898, a Chapter XII plan could not deal with a claim secured by an interest in real estate, though the court could enjoin foreclosure of the mortgage.[71] While the plan could deal with other secured claims, the holders of these claims had to consent to the plan in order for it to be confirmed.[72] Each secured creditor affected by the plan could essentially "veto" it. The *Kaczmarczyk* court concluded that the Bankruptcy Code did not change the basic pre-Code rule of leaving alone claims secured by real property, except to the extent that § 1322(b)(2) limits the rule to claims secured by the debtor's residence, rather than any real estate.[73]

The issue is whether or not Congress, in fact, explicitly changed pre-Code practice. The Commission on the Bankruptcy Laws of the United States, which compiled a lengthy report for Congress in preparation for drafting the Code, recommended that various changes be made in the way that secured claims could be dealt with in a Chapter 13 plan. It noted that, as a general rule,

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68. The legislative history of § 1322(b)(2) will be discussed more extensively, *infra*, in connection with the third interpretation of § 1322(b)(2) advanced by the courts. This third interpretation relies extensively on an analysis of legislative intent but concludes that the class Congress intended to protect is that of residential purchase-money lenders *only*, rather than all lenders who take a security interest in the debtor's principal residence.

69. 107 Bankr. at 202-03. *See also Simpkins*, which though not raising the continuity argument specifically, does an excellent job of placing § 1322(b)(2) within its historical context. 16 Bankr. at 961-63.

70. *See supra* text accompanying notes 41-46.

71. REPORT OF THE COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES 165 (1973) [hereinafter REPORT].

72. *Id.*

73. The court stated:

> I conclude that § 1322(b)(2) continued the prohibition on modifying the rights of holders of claims secured by real estate, but only with respect to real estate that constitutes the debtor's principal residence. If Congress had intended to change the manner in which a claim secured by a debtor's residence would be treated under the Code it would have specifically limited § 1322(b)(2) to claims secured pursuant to § 506(a). However, as Congress did not explicitly change the treatment of claims secured by a mortgage on a debtor's residence, I conclude that a continuity of treatment of such claims was intended.

107 Bankr. at 203.

a secured creditor should not be able to veto the debtor's plan so long as the creditor is protected to the extent of the value of its collateral.[74]

The Commission did not, however, recommend doing away with all distinctions between claims secured by real estate and those secured by personal property.[75] With regard to the former type of claim, the Commission simply recommended allowing the debtor to provide for the curing of defaults and the maintenance of payments during the life of the plan, apparently on the assumption that any claim secured by the debtor's residence would be long-term, and hence beyond the life of the plan.[76] This recommendation was incorporated into § 1322(b)(5).[77] The Commission further recommended that *short-term debts secured by personal property* be allowed as secured claims only up to the value of the property, with the remainder allowed only as an unsecured claim.[78] This recommendation developed into § 506(a). The recommendation did not, however, necessarily extend to claims secured by the debtor's residence.[79] Assuming that Congress intended to follow the Commission's recommendations, this is some support for the argument that Congress did not intend to break with pre-Code practice but instead intended that claims secured by the Chapter 13 debtor's residence be preserved.

The beauty of the argument based on a consideration of pre-Code practice is that it furnishes a presumption in favor of continuity, which is extremely helpful in dealing with ambiguities of the type presented here. When arguments seem balanced, the presumption resolves the "tie" in favor of the interpretation that preserves continuity. The weakness in applying such an argument here, however, is that we are dealing not with judicially created common law that the legislature can be presumed to endorse absent a legislative override, but

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74. REPORT, *supra* note 71, at 166.
75. *Id.*
76. *Id.*
77. *See supra* notes 7 and 9.
78. REPORT, *supra* note 71, at 166.
79. *Id.* The Commission's discussion of claims secured by personal property is jumbled together with its discussion of claims secured by the debtor's residence. However, if its recommendations are read carefully, it becomes apparent that certain recommendations were meant to apply only to certain types of claims. In regard to claims secured by the debtor's residence, the Commission stated that:

> there is no reason for continuing the exclusion of a debt secured by real property used as a residence from the relief available to a debtor who proposes to pay his debts out of future income. Accordingly, the Commission recommends that the new Act authorize inclusion in any plan proposed under [Chapter 13], *provisions for the curing of defaults within a reasonable time and the maintenance of payments while the case is pending* on claims secured by a lien on the debtor's residence....

Id. (emphasis added). The commission then went on to address other secured claims:

> *With respect to short-term debts secured by personal property*, the Commission recommends that the plan be permitted to include provisions dealing with such claims severally rather than generally as a member of a class of creditors. The proposal does not contemplate that the creditor *so secured* should be entitled to insist that the plan strictly preserve all of the terms of his original contract if the value of his claim against the property of the debtor is preserved. Insofar as there is a deficiency of the collateral to cover the claim of the secured creditor, he may be and should be treated as a member of the class of unsecured creditors.

Id. (emphasis added). This recommendation, which was made only in regard to claims secured by personal property, developed into § 506(a).

with a change from one statutory provision to another. Whether such a presumption is appropriate in this latter circumstance is open to debate.[80]

Hypothetical

According to the position exemplified in *Hynson*, all three claims in the hypothetical situation described earlier[81] are protected by § 1322(b)(2). The plan, to be confirmed, must provide for full repayment of the outstanding balance on all three loans, and repayment must be according to the terms of the original loan contract.[82]

Section 1322(b)(2) Applies Only to Claims Allowed as Secured Pursuant to § 506(a)

The second interpretation advanced by the courts is that § 1322(b)(2) operates only on the portion of the claim that is secured after application of § 506(a). Three circuit courts of appeal have squarely addressed the interpretation of § 1322(b)(2) in the context of undersecured claims.[83] The Ninth Circuit Court of Appeals, in *Hougland v. Lomas & Nettleton Co. (In re Hougland)*,[84] the Third Circuit Court of Appeals, in *Wilson v. Commonwealth Mortgage Corp. (In re Wilson)*,[85] and the Tenth Circuit, in *Eastland Mortgage Co. v. Hart (In re Hart)*,[86] concluded that § 1322(b)(2) does not prevent bifurcation of an undersecured claim via application of § 506(a).

In *Hougland*, the debtors obtained a loan from the creditor pursuant to a government program designed to assist United States veterans in purchasing homes.[87] The loan was secured by a deed of trust on the residence purchased with the loan funds.[88] Under the terms of the loan program, the loan was

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80. The Supreme Court has at times referred to continuity with pre-Code judicially created concepts (*see Midlantic*, 474 U.S. at 501; *Ron Pair*, 489 U.S. at 245) and at other times, more generally, to pre-Code practice or pre-Code law (*see Ron Pair*, 489 U.S. at 244).

81. The hypothetical is described, *supra*, at the beginning of this section.

82. If the creditors *consented* to less favorable treatment, the plan would be confirmable. *See* 11 U.S.C. § 1325(a)(5)(A). We assume, however, that the creditors will object to treatment any less favorable than that to which they are legally entitled under the "cramdown" provisions of the Code.

83. Although Justice v. Valley Nat'l Bank, 849 F.2d 1078 (8th Cir. 1988), was relied upon (to some extent) by the court in *Sauber* as an indication that the Eighth Circuit would prohibit application of § 506(a) to claims secured only by a security interest in a debtor's principal residence, *Justice* in fact concerned a Chapter 12 plan; § 1322(b)(2) was mentioned only by way of analogy and was not discussed in any detail.

84. 886 F.2d 1182. While *Hougland* was the first Ninth Circuit case to directly address this issue, an earlier case, *Seidel v. Larson (In re Seidel)*, contained dicta to the effect that "[w]hen a creditor is secured only by the debtor's principal residence, a chapter 13 plan is barred from 'modifying' the rights of the secured creditor." 752 F.2d 1382, 1383 (9th Cir. 1985). The fact that the court referred to the *creditor* as being secured, rather than as having a secured claim, would seem to be in line with an interpretation of § 1322(b)(2) as prohibiting bifurcation of such a creditor's claim under § 506(a). The fact that the court, when faced with the issue, decided otherwise, highlights the hazards of relying on dicta. *See supra* note 83.

85. 895 F.2d 123.

86. 923 F.2d 1410, 1413 (10th Cir. 1991) ("We join the Third and Ninth Circuits in holding that an undersecured mortgage is, for the purposes of the bankruptcy code, two *claims*, and only the secured *claim* is protected by section 1322(b)(2).") (emphasis in original).

87. 886 F.2d at 1182.

88. *Id.*

allowed to negatively amortize so that at the time of the debtors' default the loan was undersecured.[89]

The debtors sought to avoid the lien on the portion of the debt in excess of the fair market value of the residence and treat the excess under the plan as an unsecured claim.[90] The bankruptcy court denied confirmation of the debtors' plan, accepting the creditor's contention that the plan impermissibly modified the creditor's claim in violation of § 1322(b)(2).[91] The district court reversed, concluding that § 1322(b)(2) does not prohibit bifurcation of the creditor's claim into secured and unsecured portions.[92] The creditor appealed to the Ninth Circuit Court of Appeals, which affirmed the district court's ruling.[93]

In *Wilson*, the claim in question arose from a loan used by the debtors to purchase their home.[94] The claim was secured by a deed of trust on the debtors' principal residence, appliances, machinery, furniture, and equipment.[95] At the time the debtors filed bankruptcy, the debt was undersecured.[96] The creditor filed a claim in the full amount of the unpaid balance and the debtors sought to have the creditor's allowed secured claim limited to the value of the collateral pursuant to § 506(a).[97] The creditor objected, contending that this violated § 1322(b)(2)'s prohibition against modification of a claim secured only by the debtors' principal residence.[98] The bankruptcy court did not reach the issue of whether bifurcation of an undersecured claim violates § 1322(b)(2); instead, it concluded that § 1322(b)(2) was simply inapplicable.[99] Because the creditor had a security interest in the debtor's furniture and appliances, its claim was not "secured *only* by a security interest in real property that is the debtor's principal residence" as required by the statute.[100]

The creditor appealed and the district court affirmed on two grounds. It held that bifurcating an undersecured claim, secured only by a debtor's principal residence, into a secured and an unsecured claim, does not violate § 1322(b)(2).[101] It also agreed with the bankruptcy court, however, that in this case, due to the additional collateral for the claim, § 1322(b)(2) was inapplicable.[102]

The Third Circuit Court of Appeals affirmed on both grounds.[103]

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89. *Id.*
90. *Hougland*, 93 Bankr. at 719.
91. *Id.* at 719-20.
92. *Id.* at 722 ("[The Creditor's] security interest in Debtors' residence can only be protected by the no-modification clause of section 1322(b)(2) to the extent that the claim is actually secured.").
93. 886 F.2d at 1182.
94. 895 F.2d at 124.
95. *Id.*
96. *Id.*
97. *Id.*
98. *Id.*
99. *Id.* at 125.
100. *Id.* (emphasis added).
101. *Id.* at 126.
102. *Id.*
103. *Id.* at 124.

Following the reasoning of the *Hougland* court, it concluded that § 1322(b)(2) does not preclude the bifurcation of an undersecured claim pursuant to § 506(a).[104] However, because the court also concluded that § 1322(b)(2) did not apply in this case, it is unclear why it, or the district court below, even reached the bifurcation issue. Presumably, since § 1322(b)(2) did not apply, the debtors could not only bifurcate the claim into a secured and an unsecured claim, but were free to "modify" the secured portion, within the limits of § 1325(a)(5), as well.[105]

In *Hart*, the claim in question arose from a loan secured by real property to which the debtors' mobile home was attached, along with any rents, royalties, profits and fixtures.[106] At the time the debtors filed their Chapter 13 petition, the balance on the loan far exceeded the fair market value of the realty securing it.[107] When the debtors sought to bifurcate the creditor's claim and limit the secured claim to the value of the collateral, the creditor objected.[108] The bankruptcy court approved the debtors' plan, finding § 1322(b)(2) inapplicable because of the additional collateral.[109] On appeal, the district court concluded that the additional collateral was illusory, and therefore § 1322(b)(2) applied to the claim.[110] It further held that § 1322(b)(2) protected the creditor's entire claim and prohibited bifurcation pursuant to § 506(a).[111] The Tenth Circuit reversed, finding that § 1322(b)(2) applies only to the portion of a claim allowed as secured after application of § 506(a).[112] The court also held that the district court erred in making additional findings of fact, unsupported by the record, concerning the additional collateral.[113]

A leading bankruptcy treatise also maintains that bifurcation of an undersecured claim secured by an interest in the debtor's residence under § 506(a) does not violate § 1322(b)(2), but little discussion is devoted to any

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104. *Id.* at 127. Because the Third Circuit previously took this position in dicta in *Gaglia v. First Fed. Sav. & Loan Ass'n*, its conclusion in *Wilson* was no surprise. 889 F.2d 1304, 1311 (3d Cir. 1989).

105. *See* discussion of § 1325(a)(5), *supra*, in text accompanying notes 4-6.

106. 923 F.2d at 1411.

107. *Id.*

108. *Id.*

109. *Id.* at 1413 ("the bankruptcy court ... found that rents, royalties, profits and stock were 'collateral other than the debtor's principal residence, and thus the claim was not protected by section 1322(b)(2)'").

110. *Id.* at 1416.

111. *Id.* at 1411.

112. *Id.* at 1415.

113. *Id.* at 1416. In spite of this latter holding, it is apparent that the court properly reached the bifurcation issue (in contrast with the *Wilson* case). If on remand the bankruptcy court makes the additional finding of fact, erroneously made for the first time by the district court and concludes that § 1322(b)(2) applies, it will be guided in its application of that provision by the circuit court's holding.

potential conflict between the two provisions.[114] In addition, a number of bankruptcy and district courts have adopted this view.[115]

Under the *Hougland*-type interpretation, the § 1322(b)(2) no-modification clause applies only to that portion of the creditor's claim actually "secured" by the debtor's principal residence, as defined by § 506(a). One may wonder, however, what this means. As noted earlier, in the absence of § 1322(b)(2), payments to a secured creditor may, in some cases, be "stretched out" for a longer period of time, and the claim paid at a lower rate of interest, than was originally contemplated.[116] When § 1322(b)(2) applies, it prevents the debtor from changing the interest rate on the secured portion of the claim.[117] The next question is whether the debtor must continue to make the same monthly payments for a shorter period of time, or make smaller payments for the same period of time. In either case, some term of the contract is arguably "modified." The general view appears to be that the debtor must continue to make the same monthly payments; the claim will simply be paid off sooner than if the entire amount of the debt remained to be paid.[118]

The Plain Meaning Approach

In support of its holding in *Hougland*, the Ninth Circuit analyzed the language of § 1322(b)(2)[119] and concluded that: (1) there is no reason to assume that the phrases "secured claim" and "unsecured claim" are used differently in § 1322(b)(2) than elsewhere in the Code;[120] and (2) grammatically, the "other

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114. *Collier on Bankruptcy* states that "an undersecured claim secured only by a security interest in the debtor's principal residence may still be divided into an allowed secured claim and an allowed unsecured claim, with the lien declared void to the extent it secures a claim in excess of the allowed secured claim." 5 W. COLLIER, COLLIER ON BANKRUPTCY ¶ 1322.06[1][a] (15th ed. 1979).

115. *See, e.g., Brouse*, 110 Bankr. at 541; *In re* Ross, 107 Bankr. 759, 762 (Bankr. W.D. Okl. 1989) (holding that an earlier decision "that § 1322(b)(2) prohibited a determination under 506(a) as to the extent to which a claim is secured and unsecured" was error); *In re* Jablonski, 88 Bankr. 652, 657 (E.D. Pa. 1988); *Caster*, 77 Bankr. at 10 ("11 U.S.C. § 1322(b)(2) ... would not preclude the bifurcation of the Defendant's claim into secured and unsecured portions, per 11 U.S.C. § 506(a)."); *Harris*, 94 Bankr. at 833 ("this court holds that the protection afforded under § 1322(b)(2) does not apply to unsecured and undersecured loans"); *Hill*, 96 Bankr. at 814 ("bifurcation pursuant to § 506(a) of a claim secured only by a security interest in a debtor's principal residence is not violative of § 1322(b)(2)'s proscription against modification"); Kehm v. Citicorp Homeowners Service, Inc. (*In re* Kehm), 90 Bankr. 117, 119 (Bankr. E.D. Pa. 1988); *Demoff*, 109 Bankr. at 919.

116. *See* discussion of § 1325(a)(5), *supra*, at text accompanying notes 4-6.

117. *See Brouse*, 110 Bankr. at 544, n.7; *Ross*, 107 Bankr. at 762; *Demoff*, 109 Bankr. at 920.

118. *In re* Hyden, 112 Bankr. 431, 433 (Bankr. W.D. Okla. 1990); *Ross*, 107 Bankr. at 762; *Demoff*, 109 Bankr. at 920 ("The size and timing of the installment payments will not be altered and thus the scheduled amount of the monthly contract payment will remain the same, as will the interest rate."). *But see* In re Diquinzio, 110 Bankr. 628, 629 (Bankr. D.R.I. 1990) (held, debtors "free to modify their Chapter 13 payments to [the secured creditor] at least to the extent of the unsecured portion of its claim," implying that smaller payments could be made for the same length of time).

119. For other cases following this "plain language" approach to the same conclusion, see *Hart*, 923 F.2d at 1415; *Wilson*, 895 F.2d at 127; *Harris*, 94 Bankr. at 836; *In re* Simmons, 78 Bankr. 300, 303 (Bankr. D. Kan. 1987); *Hill*, 96 Bankr. at 813-814; *Frost*, 96 Bankr. at 807; *Kehm*, 90 Bankr. at 120; *Demoff*, 109 Bankr. at 919.

120. *Hougland*, 886 F.2d at 1183 ("it is clear that section 506(a) applies to Chapter 13 proceedings.... There is, therefore, no reason to believe that the phrases 'secured claim' and

than" clause in § 1322(b)(2) must refer to the "secured claim" language immediately preceding it, which "strongly indicates that only the 'secured claim' portion is protected."[121] Therefore, the no-modification provision does not apply to the unsecured portion of the creditor's claim.[122] This analysis has been rejected by one court as an "overly technocratic approach" that misses the meaning of § 1322(b)(2) "as clearly ... as the proverbial forest might be missed in examining the trees."[123] Indeed, the meaning of a provision that has resulted in so much controversy can hardly be said to be "plain," and the grammatical analysis, though persuasive, may assume that the provision was drafted more carefully than it was. In addition, if this interpretation is accepted as the plain meaning of the statute's language, the analysis does not necessarily end there. Such a "plain meaning" should not be applied if it is at odds with the intention of the drafters or otherwise results in an absurdity.[124]

The Context Approach

The *Hougland* court also noted that its interpretation results in a reading of § 1322(b)(2) which is consistent with § 506(a), a result to be preferred if it can be reached without absurdity.[125] Because § 1322(b)(2) continues to apply to the portion of the claim allowed as secured after application of § 506(a), there is no reason to "choose" between the two provisions.[126] Of course, some courts have argued that the provisions are truly irreconcilable. These courts contend that because the two provisions cannot be read consistently with one another, § 1322(b)(2) must take precedence over § 506(a).[127]

The Legislative Intent Approach

Several cases advocating the *Hougland*-type interpretation of § 1322(b)(2) cited the "fresh start" policy of Chapter 13 bankruptcy to support their position.[128] One of bankruptcy's primary goals is a fresh start for the debtor. Chapter 13 advances this goal by offering the debtor a way to reorganize and regroup, thus allowing him/her to bring under control an otherwise

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'unsecured claim' in section 1322(b)(2) have any meaning other than those given to them by section 506(a)."). The legislative history of § 506(a) states that "[t]hroughout the bill, references to secured claims are only to the claim determined to be secured under this section, and are not to the full amount of the creditor's claim." H.R. REP. NO. 595, 95th Cong., 1st Sess. 356 (1977) [hereinafter H.R. REP. NO. 595].

121. *Hougland*, 886 F.2d at 1184.

122. *Id.*

123. *Sauber*, 115 Bankr. at 199.

124. *See supra* text accompanying note 37. For a discussion of the legislative history and congressional intent behind § 1322(b)(2), see *infra* text accompanying notes 163-67.

125. 886 F.2d at 1184.

126. *Id. See also Jablonski*, 88 Bankr. at 657 ("Whether a plan impermissibly modifies the rights of the holder of a claim secured only by a mortgage on a debtor's principal residence must necessarily follow the determination of how much of its claim is, in fact, secured."); *Frost*, 96 Bankr. at 807 ("The Court ... agrees with those opinions which hold that § 506(a) and § 1322(b)(2) must be interpreted in a complementary manner."); *Demoff*, 109 Bankr. at 920; *Caster*, 77 Bankr. at 13.

127. This position is discussed, *supra*, in text accompanying notes 58-62.

128. *See, e.g., Hougland*, 93 Bankr. at 723 ("The Bankruptcy Code must be equitably interpreted to accomplish its purposes, one of which is to provide the Debtors with a fresh start."); *Simmons*, 78 Bankr. at 304; *Harris*, 94 Bankr. at 836 ("allowing creditors to avoid

unmanageable mass of debt.[129] Permitting bifurcation of an undersecured claim into a secured and an unsecured claim promotes this policy in two ways. First, it prevents the creditor from benefitting from a security interest that does not in reality exist.[130] Second, it insures that the creditor is not entitled to receive more on its claim, simply because the debtor filed a Chapter 13 petition, than it would be if left to its usual state law remedies, such as foreclosure.[131]

For instance, in *Hougland*, the district court noted that the creditor, if forced to foreclose on its claim, would have been unable to collect more than the value of the collateral, due to Oregon's anti-deficiency statute.[132] It reasoned that the creditor should not be able to obtain more simply because the debtor chose to file a bankruptcy petition.[133] It should be noted, however, that certain secured creditors are given "extra" protection by the Bankruptcy Code, suggesting that the "fresh start" policy behind bankruptcy reorganization is not without exceptions.[134] It is also true that, while a fresh start for the debtor is one policy behind bankruptcy, equitable repayment of creditors is another,[135] and it is up to Congress to decide what type of treatment is "equitable."

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modification of their claims by taking 'marginally-secured junior mortgages' on residential real estate" runs afoul of the fresh start policy of the code).

129. For instance, the *Simmons* court stated that:

> This Court reaches its decision being ever mindful that the bankruptcy Code is to be equitably interpreted to accomplish its purposes; and that one of the primary purposes of bankruptcy law is to give the honest debtor "a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt." My ruling certainly promotes this fresh start purpose by not strapping the debtor with preexisting unsecured debt.

78 Bankr. at 304 (citations omitted).

130. *Id.*

131. *See Hougland*, 93 Bankr. at 723; *Demoff*, 109 Bankr. at 921. Note, however that because payments must continue at the contract amount until the secured claim is paid in full, the debtor does not immediately experience much relief.

132. 93 Bankr. at 722-23. Note, however, that the creditor in that case *did* receive more than it would have by foreclosing, insofar as it was allowed an unsecured claim in the amount of the debt in excess of the value of the collateral. Presumably, it realized something on this unsecured claim. *See* discussion, *infra*, at note 137 and accompanying text.

133. 93 Bankr. at 722-23.

134. For example, an undersecured creditor in Chapter 11 may make an election under 11 U.S.C. § 1111(b)(2) to have its entire claim treated as secured. The legislative history explains that a creditor who makes such an election retains its lien to the full extent of its claim (escaping application of § 506(d)) and must receive, under the debtor's plan, payments with a present value not less than the value of its collateral and a face amount not less than the total amount of its claim. 124 CONG. REC. H11,103-11,105 (daily ed. Sept. 28, 1978). One may look at this provision as support for the proposition that what a creditor receives pursuant to a plan of reorganization is not always limited to what it would receive outside bankruptcy. On the other hand, one may look upon it as an example of how Congress may *explicitly* provide for special treatment when it so intends. The question remains whether it so intended in enacting § 1322(b)(2).

135. "Chapter 13 is designed to serve as a flexible vehicle for the repayment of part or all of the allowed claims of the debtor." S. REP. NO. 989, 95th Cong., 2d Sess. 141 (1978) [hereinafter S. REP. NO. 989]. *See also* Crouch v. Lomas & Nettleton Co. (*In re* Crouch), 76 Bankr. 91, 94 (Bankr. W.D. Va. 1987) (noting both fresh start and repayment policies); *Mahaner*, 34 Bankr. at 309 (policy favoring repayment plans); *Vlahakis*, 11 Bankr. at 755 (noting both fresh start and repayment policies behind Chapter 13).

Hypothetical

Under the *Hougland*-type interpretation of § 1322(b)(2), the creditor holding the first position lien in our hypothetical problem will be paid back in full. The Jones must cure any arrearages within a reasonable time, and continue payments in the contract amount.[136] The claim of the second creditor will be bifurcated under § 506(a) into a secured claim of $10,000 and an unsecured claim of $5000. The Jones must cure the default on this claim as well and continue to make payments in the contract amount until the $10,000 secured claim is paid. This creditor's $5000 unsecured claim, as well as the third creditor's $5000 unsecured claim, will receive the same dividend as other unsecured claims under the plan.[137]

Section 1322(b)(2) Protects Long-Term Purchase Money Mortgages Only

The third interpretation of § 1322(b)(2) focuses primarily on what is perceived as the congressional intent to protect long-term home mortgages.[138]

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136. Payments will be of both interest and principal; the interest charged will be at the contract rate.

One might speculate that if the debtor's arrearages at the time of filing do not exceed the unsecured portion of the claim, and the debtor is allowed to bifurcate the claim, no "cure" of the default would be necessary, given that the arrearages could be characterized as the unsecured claim. This argument was advanced by the debtors in *Sauber* and *In re Hyden*. The *Hyden* court stated, however, that "[e]ven when the claim is bifurcated under § 506(a) ... the provisions of § 1322(b)(5) protect the creditor at least to the extent that they require that the default, i.e., the arrearages, be cured in a reasonable time and that regular payments be maintained, albeit for a shorter period of time." 110 Bankr. at 50.

137. One may question whether, under this interpretation, the creditor should necessarily be entitled to receive anything on the unsecured claim. In *In re* Marshall, 111 Bankr. 325 (Bankr. D. Mont. 1990), the debtor sought to bifurcate the creditor's undersecured claim and avoid the unsecured portion altogether, claiming that the *Hougland* decision authorizes a total "strip-down" of the creditor's unsecured claim in a state, such as Montana, with an anti-deficiency statute. The court disagreed, stating that:

> The Ninth Circuit Court did not hold that the unsecured portion could be "stripped down" or alleviated by lien avoidance. Avoidance of the lien under § 506(d) to the unsecured portion of the claim means only that the unsecured portion of the claim is treated along with the other unsecured debts....

111 Bankr. at 326.

Despite the court's summary disposal of the debtor's arguments in *Marshall*, there is some support for such an argument. 11 U.S.C. § 502(b)(1) states that the court shall allow a claim in the amount it determines to be allowable "except to the extent that — [] such claim is unenforceable against the debtor and property of the debtor, under any agreement or applicable law for a reason other than because such claim is contingent or unmatured...." In a state with an anti-deficiency statute, this would seem to be the case for a claim exceeding the value of the residence securing it. An amendment to § 506(a) was proposed as part of the Omnibus Bankruptcy Improvements Act of 1983 to make it "clear that a nonrecourse secured creditor does not have an allowed unsecured claim to the extent that his claim is more than the value of this collateral." W. COLLIER, *supra* note 114, ¶ 506.03 at 506-12. The amendment, however, was not adopted.

138. *See, e.g., United Companies Fin. Corp. v. Brantley*, in which the court concluded that:

> the plain intent of [§ 1322(b)(2)] is to provide stability in the residential long-term home financing industry and market. It is to specifically protect institutional lenders engaged only in providing long-term home mortgage financing and not lenders primarily engaged in consumer or other areas of financing but who take security interests in a residence or homestead to secure non-home financing debts.

6 Bankr. 178, 189 (Bankr. N.D. Fla. 1980).

Not all the cases classified together in this section necessarily reach identical results. Some cases reach the same result as that reached by the *Hougland*-type analysis. All of the cases classified here, however, focus on the type of loan rather than its § 506(a) "secured" or "unsecured" status. Generally, if the creditor's claim arises from a loan used by the debtor to purchase a residence, it is protected in its entirety by § 1322(b)(2), regardless of whether it is fully secured under § 506(a). Conversely, any other claim secured by the debtor's residence is not protected by § 1322(b)(2), even if it is fully secured under § 506(a). The difference, therefore, between this and the *Hougland*-type interpretation is that the latter focuses on the claim's § 506(a) status in determining whether § 1322(b)(2) applies, rather than the type of loan from which the claim arises.[139] The overlap between the two approaches occurs when the claims occupying the junior lien positions are unsecured pursuant to § 506(a), in which case § 1322(b)(2) would not apply under either interpretation.

In *In re Simmons*, the objecting creditor held an undersecured second mortgage on the debtors' home, securing a "home improvement loan."[140] The debtors sought to bifurcate the claim into an allowed secured claim and an allowed unsecured claim, and avoid the lien on the unsecured claim.[141] The creditor objected, claiming that such treatment violated § 1322(b)(2).[142] After a discussion of the legislative history of § 1322(b)(2) and the conflicting case law, the bankruptcy court concluded that § 1322(b)(2) does not prevent bifurcation of an undersecured second mortgage.[143] Because the court was dealing with a second mortgage, and apparently limited its holding as such, it is unclear whether an undersecured first mortgage would also be bifurcated.[144]

Perhaps the purest statement of this interpretation is found in a line of cases from the Bankruptcy Court for the Western District of Virginia. In *Bank of Virginia v. Lindamood (In re Lindamood)*, the debtor defaulted on payments to an undersecured creditor during the term of the reorganization plan.[145] The

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139. However, the Ninth Circuit, in *Hougland*, stated that "[w]e need not and do not decide whether section 1322(b)(2) covers lenders" other than true residential real estate lenders who take a security interest in a debtor's home. 886 F.2d at 1184. The court went on to "note that our reading of the statute would certainly put a crimp in their schemes." *Id.* at 1184-85. This suggestive remark is rather peculiar given the court's reliance on a "plain meaning" analysis of the statute (*id.* at 1183) and its rejection of the legislative history as a source of interpretation (*id.* at 1185). The court might simply have been referring to the fact that many of these lenders are either partially or totally unsecured since they would generally occupy a junior lien position.

140. 78 Bankr. 300 (Bankr. D. Kan. 1987).

141. *Id.*

142. *Id.*

143. The court stated: "The special no-modification proviso of section 1322(b)(2) does NOT protect an under-collateralized residential second mortgage from a reduction that results from bifurcating its allowable claim into an allowed 100% secured claim and an allowed 100% unsecured claim under section 506(a) and avoiding the unsecured claim under § 506(d)." *Id.* at 303 (capitalization in original). Note that the court spoke of avoiding the unsecured *claim* rather than the unsecured *lien*. It is unclear whether the court meant that the unsecured claim itself would not have to be paid, or simply that the lien would be avoided as to the unsecured claim pursuant to § 506(d).

144. *Id.*

145. 34 Bankr. 330, 331 (Bankr. W.D. Va. 1983). The factual and procedural setting of the case is somewhat unclear. The plaintiff and other creditors moved to dismiss the case after the debtor defaulted on payments under the plan. The court, however, addressed itself to the issue of adequate protection for the plaintiff creditor and ultimately revalued its claim and changed the plan's treatment of its claim.

creditor's claim arose from a business loan made to the debtor that was secured by a second deed of trust on his residence.[146] In re-evaluating the rights of this creditor, the court held that § 1322(b)(2) did not prevent bifurcation of the claim into a secured and an unsecured claim.[147] It further held that § 1322(b)(2) did not apply even to the secured portion of the debt.[148] The court based its conclusion on the theory that extending the protection of § 1322(b)(2) to this type of business debt would violate the intent of Congress to protect only long-term home loans.[149]

The second of this line of cases is *In re Bruce*.[150] In *Bruce*, the claim secured by the first mortgage on the debtors' residence approximately equaled the value of the collateral; the second mortgage was therefore completely "unsecured" under § 506(a).[151] After discussing both the workings of § 506(a) and the supposed intent of Congress to protect first mortgages,[152] the court concluded that "the first mortgage ... is secured and entitled to treatment pursuant to § 1322(b)(2); ... the [second mortgage] is an unsecured claim to be paid with unsecured creditors...."[153] It is not entirely clear whether the court relied primarily upon the claim's § 506(a) status or its second lien position in reaching this conclusion.[154]

The position of the Bankruptcy Court for the Western District of Virginia was made quite clear, however, in *In re Schaffer*, the third in this line of cases.[155] As in *Lindamood* and *Bruce*, there were two mortgages on the debtor's principal residence.[156] Although not explicitly stated, it appears that both claims may have been fully secured within the meaning of § 506(a).[157] The debtor's plan proposed paying the first mortgage according to the terms of the contract, but stretched out repayment of the second claim and changed the interest rate.[158] The court approved this treatment, stating that the protection

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146. *Id.* at 330.
147. *Id.* at 331. Note that thus far the *Lindamood* court's position parallels that of the *Hougland* court.
148. *Id.*
149. *Id.* at 332.
150. 40 Bankr. 884 (Bankr. W.D. Va. 1984).
151. *Id.* at 885.
152. The court stated:

> The review of the legislative history ... of § 1322(b)(2) demonstrates a desire on the part of Congress to retain first mortgage secured claims without material modification....
>
> A review of § 506 further shows a desire on the part of Congress to make certain that creditors claiming to be secured, which, in fact, are not secured, should not enjoy a priority payment status over other unsecured creditors....

Id. at 887.
153. *Id.* at 888.
154. Note that the result reached in this case is the same as would result from an application of the *Hougland*-type interpretation discussed, *supra*, in text accompanying notes 83-118.
155. 84 Bankr. 63 (Bankr. W.D. Va. 1988), *aff'd in part, remanded in part sub nom.* Capital Credit Plan of Tenn., Inc. v. Shaffer, 116 Bankr. 60 (W.D. Va. 1988).
156. *Id.* at 64.
157. *Id.* at 67 ("the value of the real estate may be high enough to make the debt fully secured").
158. *Id.* at 64. Such treatment would comply with the requirements of § 1325(a)(5) as to the treatment of secured claims generally, but would be a modification within the meaning of § 1322(b)(2), if applicable.

of § 1322(b)(2) does not apply to junior liens, even when fully secured within the meaning of § 506(a).[159]

Note that although this interpretation denies junior liens the protection of § 1322(b)(2), the requirements of § 1325(a)(5) still apply.[160] That is, those claims with junior liens that are secured under § 506(a) must be paid in full, either by surrender of the collateral or deferred cash payments discounted to present value.[161]

The Legislative Intent Approach

Courts holding that the protection of § 1322(b)(2) is limited to long-term, residential, purchase-money mortgages only, do so based primarily on a legislative intent argument. These courts conclude, based on an analysis of the legislative history, that this is the group Congress intended to protect via § 1322(b)(2).[162] However, the legislative history of this provision is, in fact, very scarce; several courts have even concluded that it is of no assistance in understanding the proper interaction of § 506(a) and § 1322(b)(2).[163]

The House draft of § 1322(b)(2) simply stated that a Chapter 13 reorganization plan could "modify the rights of holders of secured claims or holders of unsecured claims."[164] The Senate's version of § 1322(b)(2) stated that such a plan could "modify the rights of holders of secured claims (other than claims wholly secured by mortgages on real property) or holders of unsecured claims."[165] The final version was the result of a compromise between the

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159. The court stated:

> It is hardly conceivable that Congress could have intended that Section 1322 protect subordinate fourth of fifth or sixth liens which in fact may totally lack equity security in the property. As the *Simpkins* Court noted, *supra*, the obvious purpose of Section 1322(b)(2) is "to protect long-term home mortgages...." That plain intent is thwarted if the section is applied to second, third, fourth, fifth, sixth or more mortgages, whose burdens probably brought the debtor into this court in the first place. It could not be reasonably said that such unsecured creditors could occupy a favored position over other unsecured creditors in a Chapter 13 case. This analysis should not change even assuming, however remote the possibility, that the junior lien *is* fully secured.

Id. at 66.

160. *See Lindamood*, 34 Bankr. at 332 (referring to application of "cramdown" provision, meaning § 1325(a)(5)); *Shaffer*, 84 Bankr. at 67 (court implies that claim will be treated as required by § 1325(a)(5)).

161. 11 U.S.C. § 1325(a)(5). *See supra* text accompanying notes 4-6.

162. *See Brantley*, 6 Bankr. at 189; *Neal*, 10 Bankr. at 538; *Morphis*, 30 Bankr. at 593 (concluding that § 1322(b)(2) "is intended to specifically apply to actual, long-term home financing loans"); *Lindamood*, 34 Bankr. at 331 ("§ 1322(b)(2) contemplates the personal residential mortgage financing traditional in that industry"); *Bruce*, 40 Bankr. at 887 ("review of the legislative history ... demonstrates a desire on the part of the Congress to retain first mortgage secured claims without material modification"); *Shaffer*, 84 Bankr. at 66.

163. *See, e.g., Hougland*, 886 F.2d at 1185; *Wilson*, 895 F.2d at 127. It is interesting to note that, although the Ninth Circuit found the legislative history unhelpful in *Hougland*, it had, in an earlier case, found that the legislative history demonstrates a strong congressional intent to protect home mortgage lenders. *See Seidel*, 752 F.2d at 1383.

164. H.R. REP. NO. 595, *supra* note 120, at 429.

165. S. REP. NO. 989, *supra* note 135. This version, apparently, limited its protection to "wholly" (100%) secured claims, though it is not clear whether a claim "wholly" secured by operation of § 506(a) (i.e., part of a larger claim held by an undersecured creditor) would qualify, or if the protection was limited to claims secured up to the full amount of the debt. *See Neal*, 10 Bankr. at 539; *Morphis*, 30 Bankr. at 594.

House and the Senate.[166] Indeed, it is clear that the protection provided by the section as enacted is more than that included in the House version, which did not contain a no-modification clause. In addition, by restricting the application of the no-modification clause to claims secured by the debtor's principal residence, rather than claims secured by any real property, the final version is less expansive than the Senate version.[167] Beyond this, it is difficult to conclude just how far Congress intended the protection of § 1322(b)(2) to extend. The words of the statute do not themselves make any distinction based on the type of loan giving rise to the creditor's claim.[168]

Hypothetical

Under the *Shaffer*-type interpretation of § 1322(b)(2), the Jones must repay the first creditor in full and according to the terms of their loan contract. The claim of the second creditor is bifurcated under § 506(a) into a secured and an unsecured portion, but neither portion is protected by § 1322(b)(2)'s no-modification clause. Instead they are treated according to the general requirements of § 1325. The secured claim must be paid back in full, though not necessarily according to the terms of the loan agreement, while the unsecured claim will receive the same dividend as other unsecured creditors. The third claim is also unsecured, and outside the protection of § 1322(b)(2).

ANALYSIS

Recent circuit court decisions appear to have turned the judicial tide in favor of an interpretation limiting the protection of § 1322(b)(2) to claims that are "secured" under § 506(a). This is a plus for debtors who may have been prompted to file bankruptcy by the threat of foreclosure on their homes. It is also a plus for the holders of unsecured claims who will receive a larger dividend if less of the debtor's funds are being used to pay secured creditors. It may well be a shock, however, to the home mortgage industry, which no doubt lobbied strenuously for the protection of § 1322(b)(2).

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166. 124 CONG. REC. H11,106 (daily ed. Sept. 28, 1978).

167. It is not at all clear what was intended by the substitution of the phrase "secured only by" for the word "wholly." If the change was intended to be substantive, it lends some support to those who interpret § 1322(b)(2) as applying to all "claims" rather than only "secured" claims, which are secured by the debtor's principal residence.

168. As the *Harris* court stated:

> While a number of courts have recognized that the Congressional intent of the special protection of § 1322(b)(2) was to protect holders of long-term home mortgages and not junior liens, the plain language of the statute is not so limited. In addition, as previously stated, the legislative history surrounding the enactment of § 1322(b)(2) is sparse. This court will not override the plain language of the statute, which does not limit its application to long-term money purchase mortgages.

94 Bankr. at 837 (citations omitted). *See also Hart*, 923 F.2d at 1415 ("[u]sing a literal reading of 11 U.S.C. § 1322(b)(2) is less speculative and less quasi-legislative than attempting to ferret its meaning from its legislative history, which ... is not clear enough with respect to this issue to show a 'demonstrably' different congressional intent than that indicated by the plain meaning of the statute itself"); *In re* Marrero, 111 Bankr. 384, 387 (Bankr. D.P.R. 1990); *Simpkins*, 16 Bankr. at 966 ("The special protection of § 1322(b)(2) was meant to protect holders of long-term home mortgages, rather than holders of short-term notes.... Nevertheless, the provision of § 1322(b)(2) is not so limited. The legislative history cannot amend the plain language of the statute.").

Is application of § 1322(b)(2) to only those claims which are secured pursuant to § 506(a) the correct interpretation of § 1322(b)(2)? Does it accurately "give effect to the intent of Congress?" The Supreme Court has suggested that, in interpreting the Bankruptcy Code, courts should presume that Congress intended to maintain continuity with pre-Code practice.[169] That is, absent a clear indication that Congress intended to break with pre-Code bankruptcy law, an interpretation of the Code consistent with pre-Code interpretations is to be preferred. Regardless of the scope of this "rule," which remains unclear, an analysis of pre-Code practice is helpful in understanding § 1322(b)(2).

Prior to the enactment of the Bankruptcy Code, a debtor could not deal with a claim secured by real estate in his or her plan.[170] The court could, however, enjoin foreclosure on the debtor's home, and this stay would generally be continued if the debtor cured defaults and maintained payments under the loan contract.[171] Under pre-Code law, therefore, the debtor could not alter the terms of a loan secured by his residence. Congress, in enacting the Code, obviously intended to allow the debtor to deal with such claims in the Chapter 13 plan itself, rather than through the adversary process as under pre-Code law.[172] Hence, § 1322(b)(5) was enacted providing for the curing of defaults and maintenance of payments on claims which extend beyond the term of the plan. The legislative history indicates that Congress expected most claims secured by the debtor's residence to be dealt with under this provision.[173] Congress apparently assumed that most home mortgages (Congress' primary concern) were long-term and would, therefore, come due after the term of the plan. There is no indication that Congress was primarily concerned with the debtor's ability to limit the amount of the claim under § 506(a) to the value of the collateral. Congress may have assumed that most, if not all, home loans are fully secured. To this extent, the Code simply codifies pre-Code practice.

The debtor could now deal with claims secured by his or her residence via the Chapter 13 plan. Therefore, Congress also had to provide for claims that would mature within the term of the plan. Without some protective provision, such claims could be treated like any other secured claim. Apparently, Congress did not wish this to be the case; hence, it enacted § 1322(b)(2), providing that these claims must also receive payments in the contract amount.

If this is an accurate reconstruction of the legislative thought process, it supports the proposition that Congress had two things in mind when enacting §§ 1322(b)(2) and (b)(5).[174] First, Congress wanted to allow Chapter 13 debtors to protect their homes by providing for claims secured by their homes in their

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169. *See* discussion, *supra*, in text accompanying notes 41-46.
170. *See Simpkins*, 16 Bankr. at 961.
171. *Id.*
172. *See id.* at 962.
173. The legislative history states that "the plan may modify the rights of holders of secured claims other than a claim secured by a security interest in real property that is the debtor's principal residence. *It is intended that a claim secured by the debtor's principal residence may be treated with under § 1322(b)(5)....*" 124 CONG. REC. H11,106 (daily ed. Sept. 28, 1978); S17,423 (daily ed. Oct. 6, 1978) (emphasis added).
174. *See Simpkins*, 16 Bankr. at 963.

Chapter 13 plans. Second, Congress wished to protect long-term home mortgagees by requiring that such claims be paid in full and pursuant to the terms of the loan contract, as had been the practice prior to the enactment of the Bankruptcy Code. This analysis supports the third interpretation of § 1322(b)(2) as applicable to long-term, purchase-money mortgages regardless of their § 506(a) status, and as not applicable to other types of loans.[175]

The words of the statute do not, however, make any distinction based on the type of loan from which the claim arises.[176] In addition, the legislative history behind § 1322(b)(2) is simply too inconclusive to serve as a basis for an interpretation so contrary to the language of the statute. Therefore, an interpretation of § 1322(b)(2) that makes such a distinction by prohibiting modification of claims arising from purchase-money loans and permitting modification of claims based on other types of loans, without regard to their § 506(a) status, cannot stand.[177] The provision either applies to all claims secured by a debtor's personal residence, or only those claims allowed as secured by operation of § 506(a).

Given its concern with long-term, first position mortgages, it is unlikely that Congress intended any and all claims secured by the debtor's residence to partake of § 1322(b)(2)'s protection, regardless of whether there is any value in the residence to support it. As one court noted "[i]t is hardly conceivable that Congress could have intended that Section 1322(b)(2) protect subordinate fourth or fifth or sixth liens which in fact totally lack equity in the property."[178] Such a result, it is argued, would be clearly contrary to the equitable policies underlying the Bankruptcy Code — both the fresh start policy and the equitable repayment policy.[179] One might question, however, whether many debtors in fact have "fourth, fifth, or sixth" liens on their homes which are totally lacking in equity and which would qualify for protection under § 1322(b)(2). A claim, to be within this section, must be secured *only* by a security interest in the debtor's residence. It is unlikely that many lenders would take, as their only security, a junior lien on an already over-encumbered piece of property. Therefore, the interpretation of § 1322(b)(2) as applicable

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175. *See* discussion, *supra*, in text accompanying notes 138-61.

176. The *Coffey* court, for instance, refused to "read out of the statute the word 'only' and read into the statute a limitation referring to 'purchase-money' mortgages" in spite of Congress' primary focus on long term mortgage debt. 52 Bankr. at 55. The *Allen* court also felt compelled to conclude that § 1322(b)(2) is not limited to long-term purchase-money debts, though it argued that Congress should have so limited it. 75 Bankr. at 345-46.

177. The Supreme Court has noted that "[t]he plain words and meaning of a statute cannot be overcome by a legislative history which, through strained processes of deduction from events of wholly ambiguous significance, may furnish dubious bases for inference in every direction." *Gemsco*, 324 U.S. at 260. The author of this Note freely admits that her reconstruction of the legislative intent behind § 1322(b)(2) of the Bankruptcy Code is largely speculative, based primarily on a "between the lines" reading of the legislative history.

178. *Shaffer*, 84 Bankr. at 66.

179. Requiring the debtor to pay back, in full and at the contract rate of interest, all loans purportedly secured by the debtor's residence, regardless of any actual security, would certainly do little to furnish the debtor with a "fresh start," unhampered by pre-existing debt. In addition, such a requirement would substantially lessen the dividend received by unsecured creditors. Indeed, the *Allen* court argued that even the *Hougland*-type approach (which it felt compelled to adopt), in extending the protection of § 1322(b)(2) beyond purchase-money mortgages only to any claim that is secured via § 506(a), results in an "inequitable distribution unrelated to the implementation of any affirmatively considered and adopted policy." 75 Bankr. at 346.

to any and all "claims" supported by, and only by, a security interest in the debtor's residence, may not be quite as "absurd" as it first appears. In addition, however, such an interpretation would entitle creditors, in some circumstances, to more favorable treatment under the Bankruptcy Code than if left to their state law remedies — a result that is somewhat suspect.[180] Therefore, this interpretation of § 1322(b)(2) fails.

This leaves the *Hougland* interpretation, which applies § 1322(b)(2) only to those claims that are allowed as secured pursuant to § 506(a). Allowing the "unsecured" portion of a home mortgage claim to be "scraped off" seems to run contrary to Congress' intent to protect home-mortgage lenders. The alternative, however, is to give more protection than was probably intended. The reality is that Congress may never have considered the undersecured home lender. Had Congress considered such a situation, it might have made § 1322(b)(2) applicable to the entire claim arising from a purchase-money loan. On the other hand, operating on the assumption that the undersecured claim is too rare an exception to provide for, Congress might have concluded that § 1322(b)(2), if applied only to claims allowed as secured under § 506(a), would offer the right amount of protection in the majority of cases. At any rate, this interpretation seems preferable to the other two, and arguably results in a more natural reading of the statutory language.[181]

The effects of this interpretation on the home mortgage industry, however, should not be lightly dismissed. Several cases adopting a *Hougland*-type interpretation of § 1322(b)(2) assert that virtually all home mortgages are fully secured.[182] This may be the case. However, there is evidence that the general down-turn in the economy is "taking its toll on many housing markets, with prices flat or falling."[183] The 1980's have been characterized as a decade in which the country was on a "credit binge." From 1980 to 1989, the volume of real-estate loans at the nation's banks rose from $268 billion to $750 billion.[184] At least $130 billion of those loans are now in default.[185] Delinquency rates are rising and foreclosures are up.[186] Although these figures include both residential and commercial real estate loans, they are suggestive. Throughout much of the eighties home financing was available with low down payments and large mortgages.[187] Falling prices in many areas may result in the fair market value of those homes falling below the outstanding balance of the loans they

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180. *See Hougland*, 93 Bankr. at 723; *Demoff*, 109 Bankr. at 921. This is based on the notion that the creditor outside of bankruptcy can recover no more than the value of the collateral. Of course, in states which do not have an anti-deficiency statute applicable to the creditor, the creditor could foreclose and sue for a deficiency. In addition, a junior lienholder outside bankruptcy can forego a foreclosure action and simply sue on the debt. If the debtor is in financial straits, however, this would in reality do the creditor little good. In any event, it is difficult to see why the existence of the creditor's lien, which would be of little use outside bankruptcy, should protect it within a bankruptcy proceeding.

181. *See* discussion *supra* at text accompanying notes 119-24.

182. *See Hougland*, 886 F.2d at 1184; *Hougland*, 93 Bankr. at 722; *Caster*, 77 Bankr. at 13; *Demoff*, 109 Bankr. at 921; *Bruce*, 40 Bankr. at 887.

183. *See* Dentzer, *Staying Afloat*, 109 U.S. NEWS & WORLD REPORT, No. 19, at 62 (1989).

184. *Id.* at 64.

185. *Id.* at 62.

186. *Id.* at 66.

187. *Id.*

secure. Allowing Chapter 13 debtors to "scrape off" the amount of the loan that exceeds the value of the residence could have a profound financial impact on already troubled lenders.[188]

In addition, some loans are allowed to negatively amortize pursuant to special assistance programs; the claim at issue in *Hougland* arose from such a program. It appears likely that a *Hougland*-type interpretation of § 1322(b)(2) will negatively impact the availability of such loans. After all, if the debtor is not required to repay them, United States taxpayers may not want to be responsible for unpaid loans that are not covered by the collateral.

CONCLUSION

Section 1322(b)(2) of the bankruptcy code prohibits the modification of claims secured by, and only by, a security interest in the debtor's principal residence. There are three possible ways of interpreting this provision: (1) § 1322(b)(2) prohibits the modification of any claim secured by the debtor's principal residence, regardless of the relative value of the collateral and the amount of the claim(s); (2) § 1322(b)(2) applies only to claims allowed as secured pursuant to § 506(a), which limits secured claims to the value of the collateral, and allows the remainder as an unsecured claim; (3) § 1322(b)(2) applies to — and only to — claims arising from purchase-money mortgages, regardless of the relative value of the collateral and the amount of the claim(s).

The legislative history behind § 1322(b)(2), considered in the context of pre-Code bankruptcy practice, suggests that Congress was primarily concerned with protecting long-term, purchase-money mortgagees. Interpreting § 1322(b)(2) to protect these loans is, however, contrary to the plain language of the statute, which makes no distinction based on the type of loan from which a claim arises. The third interpretation, therefore, fails. In addition, the first interpretation fails because it can lead, in some cases, to an arguably absurd result. By protecting any and all claims secured by the debtor's residence, even if there is no corresponding equity in the collateral, this interpretation runs counter to the intent of Congress and the equitable policies underlying the Code. It allows the undersecured claim to fare better through bankruptcy proceedings than it would via its normal state law remedies, while placing a heavy burden on the debtor.

The second interpretation is therefore the best. While it fails to fully protect the undersecured purchase-money mortgagee, and thus arguably fails to effectuate the congressional intent behind § 1322(b)(2), it does not result in either an absurdity or a strained reading of the statutory language. For these reasons, three circuit courts of appeals — the only circuit courts addressing the issue thus far — have adopted this interpretation. Nevertheless, the negative effects of allowing debtors to "scrape-off" claims that exceed the value of their residences should not be ignored in this age of falling property values and troubled financial institutions.

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188. Another effect of this interpretation is that it puts home lenders in a "double-bind." If undersecured claims are not protected by § 1322(b)(2), many lenders may wish to have an equity cushion for their loans. If, however, security in addition to the debtor's principal residence is taken, the lender will be *completely* outside the protection of § 1322(b)(2) should the debtor declare bankruptcy.