

# THE LEGAL WAY TO DEFEAT OPTIMUS SUB-PRIME

## INTRODUCTION

Everyday, Americans turn on their televisions or open their newspapers and cannot escape the endless media coverage of the subprime mortgage crisis. The subprime mortgage crisis, characterized by a sharp rise in home foreclosures, serves as a gloomy reminder of the repercussions of the “mortgage lending spree that fed the real estate boom during the first half of this decade.”<sup>1</sup> As the number of foreclosures continues accelerating at a remarkable rate,<sup>2</sup> the shattering of the American Dream becomes a stark reality for many. The American Dream is grounded in the idea of homeownership, and the purchase of a home is usually the greatest investment, in terms of both equity and personal attachment, that a person will make in his lifetime.<sup>3</sup> During the housing boom earlier this decade, when interest rates were considerably lower and loans were consequently easier to obtain, home ownership became a deceptive economic status symbol. Today, many Americans’ opportunities to live the American Dream slowly dwindle into oblivion as subprime mortgage interest rates commence their hike.

The illusion that anyone can own a home was driven by subprime mortgage lenders who employed creative financing mechanisms to enable people with poor credit history or high debt-to-income ratios to obtain home mortgages.<sup>4</sup> The borrowers could afford the initial low monthly payments, but once the payments associated with the subprime credit increased, these borrowers were only one unfortunate situation away from filing for bankruptcy.<sup>5</sup>

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<sup>1</sup> *Will Subprime Mess Ripple Through Economy?*, Mar. 13, 2007, <http://www.msnbc.msn.com/id/17584725/>.

<sup>2</sup> See Bob Ivry, *U.S. Foreclosures Double as House Prices Decline*, July 25, 2008, <http://www.bloomberg.com/apps/news?pid=20601087&refer=home&sid=aomtw8.Pro2E>.

<sup>3</sup> See *Allied Credit Corp. v. Davis (In re Davis)*, 989 F.2d 208, 210 (6th Cir. 1993) (citing *Fed. Land Bank of Louisville v. Glenn (In re Glenn)*, 760 F.2d 1428, 1434 (6th Cir 1985)).

<sup>4</sup> See Faten Sabry & Thomas Schopflocher, *The Subprime Mortgage Meltdown: Who, What, Where and Why . . . Investigations & Litigation*, PRACTISING L. INST. CORP. L. & PRAC. COURSE HANDBOOK SERIES, PLI Order No. 15783 at 91–92 (Sept. 12, 2007).

<sup>5</sup> R. Stephen Painter, Jr., *Subprime Lending, Suboptimal Bankruptcy: A Proposal to Amend §§ 522(f)(1)(B) and 548(a)(1)(B) of the Bankruptcy Code to Protect Subprime Mortgage Borrowers and Their Unsecured Creditors*, 38 LOY. U. CHI. L.J. 81, 82 (2006).

The suspect actions and lending strategies of the subprime mortgage lenders raise many fascinating questions. This Comment leaves the issues of predatory lending to other scholars<sup>6</sup> and instead focuses on how the subprime mortgage industry has affected the area of bankruptcy law and what should be done to curtail this problem.

When an individual files for bankruptcy, he generally has the choice of liquidation under chapter 7 or rehabilitation under chapter 13.<sup>7</sup> Rehabilitation promotes the restructuring of debt and preservation of the estate,<sup>8</sup> and as a result, homeowners facing possible foreclosure can use this as a last resort to save their homes.<sup>9</sup> The Bankruptcy Code allows homeowners who have defaulted on their mortgage to cure within a reasonable time, thus undoing acceleration and preventing foreclosures.<sup>10</sup> Although in the past this simple provision in the Bankruptcy Code averted many foreclosures, the recent surge of the subprime mortgage in the mortgage lending industry carried borrowers too far past the possibility of curing defaults, rendering this provision useless in many instances.

The main problem arises when debtors in bankruptcy get so far behind on their mortgage payments that they are financially unable to cure the default. When this situation occurs, the debtor has no way of salvaging his house because the Bankruptcy Code does not permit borrowers to modify the mortgage on their principal place of residence.<sup>11</sup> Despite the multitude of issues raised by § 1322(b)(2), the Supreme Court has only decided one case regarding the interpretation of the antimodification provision: *Nobelman v.*

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<sup>6</sup> See Meghan Stringer Musselman, *Talent Amendment: Limitations on Military Lending*, 40-DEC Md. B.J. 38, 40 (2007) (examining the susceptibility of military personnel to predatory lending practices); David Adam Friedman, *Reinventing Consumer Protection*, 57 DEPAUL L. REV. 45, 56-57 (2007) (arguing for consumer protection from predatory lenders); Andrew L. Sandler, Benjamin B. Klubes, Anand S. Raman & Jonice Gray Tucker, *The Expansion of Liability for Predatory and Discriminatory Lending to Secondary Mortgage Market Participants*, PRACTISING L. INST. CORP. L. & PRAC. COURSE HANDBOOK SERIES, PLI Order No. 11451 at 823 (Dec. 5, 2007) (examining the liability of predatory lenders in the secondary mortgage market).

<sup>7</sup> *In re Ross*, 95 B.R. 509, 510 (Bankr. S.D. Ohio 1988). Individuals can also file under chapter 11 but a chapter 11 is not an attractive option for individual debtors. *Toibb v. Radloff*, 501 U.S. 157, 161 (1991); *Bell v. Bell (In re Bell)*, 225 F.3d 203, 220 (2d Cir. 2000) (noting that individual debtors filing under chapter 11 likely constitute a small and shrinking class).

<sup>8</sup> *Ross*, 95 B.R. at 510.

<sup>9</sup> See *infra* notes 60-61.

<sup>10</sup> Gordon Bermant & Jean Braucher, *Making Post-Petition Mortgage Payments Inside Chapter 13 Plans: Facts, Law, Policy*, 80 AM. BANKR. L.J. 261, 263 (2006).

<sup>11</sup> See 11 U.S.C. § 1322(b)(2) (2006). The provision relating to precluding debtors from modifying their home mortgages is often called the home mortgage antimodification provision.

*American Savings Bank*.<sup>12</sup> Even more problematic, the Supreme Court's decision failed to resolve ambiguities created by the antimodification provision.<sup>13</sup> Ultimately, lower courts bear the burden of attempting to clear up the ambiguous interpretations associated with the antimodification provision. As a result, lower courts have taken one of two approaches: a strict interpretation of the provision or a liberal interpretation.<sup>14</sup>

Although the antimodification provision in the Bankruptcy Code has always played a significant role in bankruptcy because of the limitation it places on the borrower,<sup>15</sup> it has not received much attention until recently. The recent attention is due to the implosion in the subprime mortgage lending market.<sup>16</sup> This market implosion demands that the current deficiency in bankruptcy policy concerning the effects of the subprime mortgage be resolved quickly. The best method of resolving any inadequacy is by attacking it directly.

In 2008, Congress passed a housing rescue bill designed to stabilize the housing market and keep homeowners out of foreclosure.<sup>17</sup> The major problem with the bill is that it is unlikely to make a substantial difference, and it fails to account for the number of foreclosures expected over the next five years. Enacting a bill to alleviate some problems of the subprime mess is crucial to a rebound in the housing market, but Congress must address an issue closely associated with many foreclosures: bankruptcy.

To achieve this end, Congress must amend the Bankruptcy Code to provide chapter 13 debtors with the opportunity to modify existing home mortgages when they are on the brink of foreclosure. Congress proposed legislation in an attempt to end the subprime lending crisis.<sup>18</sup> In addition to the recently enacted bill, there were multiple bills in both the Senate and the House of Representatives. One of the bills would have provided emergency funding to raise the portfolio caps of government-sponsored enterprises that operate to

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<sup>12</sup> See *Nobelman v. Am. Sav. Bank*, 508 U.S. 324 (1993).

<sup>13</sup> R. Douglass Hanson II, *Bankruptcy Law—Nobelman v. American Savings Bank: Permissibility of Bifurcating and Modifying Homestead Mortgages*, 24 MEM. ST. U. L. REV. 805, 820 (1994).

<sup>14</sup> See discussion *infra* Part III.B–C.

<sup>15</sup> See *Hammond v. Commonwealth Mortgage Corp. of Am. (In re Hammond)*, 27 F.3d 52, 55 (3d Cir. 1994) (stating that the antimodification provision “limits a party’s ability to modify the rights of a lien on real property that is a debtor’s principal place of residence”).

<sup>16</sup> Painter, *supra* note 5, at 82–83.

<sup>17</sup> See Housing and Economic Recovery Act of 2008, Pub. L. No. 110-289, 122 Stat. 2654 (2008).

<sup>18</sup> See *infra* Part VI.A.

fund the development of the secondary mortgage market.<sup>19</sup> The proposed bills would all amend the Bankruptcy Code to allow modification of mortgages on the debtor's principal residence.<sup>20</sup>

This Comment explains the different bills proposed in Congress and analyzes their positive and negative aspects. All of these pieces of legislation propose additions or changes to specific provisions of the Bankruptcy Code. This Comment grapples with the various proposed bills and urges the adoption of a more lenient statutory provision for chapter 13 debtors, while offering flexible solutions for those borrowers specifically affected by subprime mortgage lending. This Comment makes it apparent that an amendment must be made to the antimodification provision as currently written in § 1322(b)(2).

Part I of this Comment provides background information about the subprime mortgage market, the interplay between foreclosure law and bankruptcy law, and the chapter 13 plan confirmation process. Part II discusses the adverse effects that the subprime mortgage crisis has had on other sectors of American society. Part III addresses the legislative history and Congressional intent behind § 1322(b)(2) and the antimodification provision located therein. Part IV examines the Supreme Court's only decision interpreting § 1322(b)(2), as well as the lower courts' varying interpretations of § 1322(b)(2) that the Supreme Court's decision failed to clear up. Further, Part V explains how Congress implemented chapter 12 of the Bankruptcy Code to alleviate the burden placed on family farmers in the midst of the farm crisis in the 1980s and the corollaries to § 1322(b)(2) in chapters 11 and 12. Finally, Part VI introduces and analyzes the various bills proposed in the House and Senate regarding attempts to mitigate the crippling effect of the subprime mortgage crisis on chapter 13 home mortgagors, and urges that Congress pass a flexible but limiting resolution.

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<sup>19</sup> The two main government-sponsored enterprises which comprise the secondary mortgage market are Fannie Mae and Freddie Mac. See *infra* notes 231–32. Fannie Mae is a shareholder owned company that operates in the secondary mortgage market to ensure that mortgage lenders have enough funds to offer home buyers low interest rates. About Fannie Mae, <http://www.fanniemae.com> (follow “About Fannie Mae” hyperlink) (last visited Nov. 24, 2008). Freddie Mac's purpose is essentially the same as Fannie Mae's with a mission striving “to provide liquidity, stability and affordability to the housing market.” Our Mission, <http://www.freddiemac.com> (follow “Company Profile” hyperlink, then follow “Our Mission” hyperlink) (last visited Nov. 24, 2008).

<sup>20</sup> See *infra* Part VI.A.2.

## I. BACKGROUND

### A. *Subprime Mortgage Market*

Since the enactment of the Bankruptcy Code, the types of mortgages that lenders offer continue to change and evolve.<sup>21</sup> In the early to mid-1990s, many lending institutions adopted a type of lending scheme known as the subprime mortgage.<sup>22</sup> This new loan product divided the lending market into prime and subprime mortgages.<sup>23</sup> Prime market rate mortgages tend to be delivered only to the “most creditworthy borrowers.”<sup>24</sup> Subprime mortgages are loans to those individuals who do not qualify for prime mortgages because of their risky credit ratings or to those who are unable to show that they can make necessary payments on a prime mortgage.<sup>25</sup> As the subprime mortgage market emerged in the mid-1990s, so did several types of subprime mortgages.<sup>26</sup> The most popular included the adjustable rate mortgage (“ARM”), interest-only mortgage, and Alternative-A (“Alt-A”) mortgage.<sup>27</sup>

An ARM is a loan that “provide[s] short term benefits to encourage borrowing by offering initially low rates of interest which eventually reset to significantly higher levels.”<sup>28</sup> Among the types of ARMs saturating the subprime mortgage market are the hybrid ARM and payment-option ARM.<sup>29</sup> Hybrid ARMs contain a combination of a fixed-rate term and an adjustable-rate term and are appropriately coined 2/28, 3/27, etc.<sup>30</sup> Similarly, payment-

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<sup>21</sup> Painter, *supra* note 5, at 83.

<sup>22</sup> See, e.g., Sabry, *supra* note 4, at 91; Painter, *supra* note 5, at 81.

<sup>23</sup> Painter, *supra* note 5, at 86.

<sup>24</sup> *Id.*

<sup>25</sup> Sabry, *supra* note 4, at 91–92.

<sup>26</sup> See *id.*

<sup>27</sup> See, e.g., *id.*; David Anderson, *The Subprime Lending Crisis*, 71 TEX. B.J. 20 (2008).

<sup>28</sup> Aaron Unterman, *Exporting Risk: Global Implications of the Securitization of U.S. Housing Debt*, 4 HASTINGS BUS. L.J. 77, 84 (2008).

<sup>29</sup> *Legislative Update: ABI Directors Testify Before Congress*, 26 AM. BANKR. INST. J. 10, 70 (Nov. 2007).

<sup>30</sup> FEDERAL RESERVE BOARD, CONSUMER HANDBOOK ON ADJUSTABLE RATE MORTGAGES 15 (2006), available at [http://www.federalreserve.gov/pubs/arms/arms\\_english.htm#arm](http://www.federalreserve.gov/pubs/arms/arms_english.htm#arm). The first number in the fraction stands for the fixed term period in number of years; the second number sets the period of years that the rate is adjustable. *Id.* Normally, the rate adjusts annually, but sometimes the rates adjust every six months after the initial fixed period. *Id.*

option ARMs provide very low interest rates during the initial monthly payments, but the interest rate rises shortly thereafter.<sup>31</sup>

In an interest-only mortgage, which can either be classified as an ARM or a fixed-rate mortgage, the mortgagor pays only the interest for a specified time period.<sup>32</sup> The monthly mortgage payments start low because the borrower is only paying interest, but once the interest-only period ends, the mortgagor must pay back a portion of principal in addition to monthly interest.<sup>33</sup> For example, if a homeowner takes out a twenty-five year mortgage loan with a three year interest-only payment period, the borrower only makes payments on interest for the first three years, but in the fourth year, the borrower must start making principal and interest payments, which substantially increase the borrower's monthly payment.<sup>34</sup>

In contrast, Alt-A mortgages do not necessarily involve lending to the most credit-risky individuals. Alt-A borrowers often have unpredictable sources of income or lack the necessary proof or documentation to be approved for a prime loan.<sup>35</sup> Thus, Alt-A lenders take serious risks in approving borrowers that merely state their income without sufficient documentation to prove that the stated income or source of income is correct.<sup>36</sup> Not surprisingly, these types of loans are a major driver of the subprime mortgage crisis.<sup>37</sup>

Although the subprime lending market was once dominated by small community banks, many of the nation's largest banks and lending institutions have recently delved into the profitable subprime mortgage industry.<sup>38</sup> The lucrative fees and charges associated with subprime mortgage lending drew

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<sup>31</sup> *Id.* at 16–17. Payment-option ARMs have a built-in recalculation period where the total repayment resets at the end of every period, usually causing much higher monthly payments than the mortgagor had ever seen before. *Id.* at 17.

<sup>32</sup> Sabry, *supra* note 4, at 93.

<sup>33</sup> *Id.*; see also FEDERAL RESERVE BOARD, CONSUMER HANDBOOK ON ADJUSTABLE RATE MORTGAGES, *supra* note 30, at 15–16.

<sup>34</sup> FEDERAL RESERVE BOARD, CONSUMER HANDBOOK ON ADJUSTABLE RATE MORTGAGES, *supra* note 30.

<sup>35</sup> Peter Coy, *More Option ARMs and Alt-A Loans*, BUS. WK., Oct. 25, 2005, [http://www.businessweek.com/the\\_thread/hotproperty/archives/2005/10/more\\_option\\_arm.html](http://www.businessweek.com/the_thread/hotproperty/archives/2005/10/more_option_arm.html) (explaining that through the Alt-A loan, borrowers may also be inclined to lie about their income or assets to be approved for a larger loan).

<sup>36</sup> See *id.*

<sup>37</sup> *Id.*

<sup>38</sup> Patricia A. McCoy, *Banking on Bad Credit: New Research on the Subprime Home Mortgage Market*, (July 26, 2005), available at [http://www.chicagofed.org/cedric/files/2005\\_conf\\_discussant\\_session1\\_mccoy.pdf](http://www.chicagofed.org/cedric/files/2005_conf_discussant_session1_mccoy.pdf) (noting that over the past five years, the subprime market has shifted from small independent lenders to national lending institutions).

many large subprime subsidiaries of national banks into this type of lending.<sup>39</sup> It is an attractive market because the profits from subprime mortgages often far exceed those resulting from the loan origination costs of prime mortgages.<sup>40</sup>

As a majority of subprime mortgages' interest rates begin to reset, causing monthly mortgage payments to increase, foreclosure is a likely end result.<sup>41</sup> A 2006 study by Lehman Brothers estimated that of the subprime mortgage loans that originated in 2006, thirty percent will result in foreclosure.<sup>42</sup> The number of foreclosures nationwide soared in 2007, amounting to a loss of 405,000 homes, a seventy-five percent increase over the total number of filings in 2006.<sup>43</sup> By the second quarter of 2008, the number of foreclosures had doubled from the same point in the previous year.<sup>44</sup> However, the most staggering statistic is that “[o]ne in every 171 households was foreclosed on, received a default notice or was warned of a pending auction,” an increase of 121% from 2007.<sup>45</sup> The data suggest a direct correlation between the number of subprime mortgages and the number of recent residential foreclosures.

Furthermore, it is rare that a residential foreclosure “can be conducted without the possibility of direct involvement of a bankruptcy court.”<sup>46</sup> Given the rising number of defaulting subprime borrowers, subprime mortgages should be modified in bankruptcy. An amendment to the antimodification provision in § 1322(b)(2) will begin to alleviate the aforementioned problems evident in many subprime mortgages.

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<sup>39</sup> Painter, *supra* note 5, at 87–88. The subprime lenders have the upper hand because of the lengthy and confusing loan documents. *Id.* at 90.

<sup>40</sup> *Id.* at 89–91. These excessive costs directly deplete the borrower's equity. *Id.* at 92.

<sup>41</sup> *Id.* at 94; see also John Rao, Joint Memo for Proposed Bankruptcy Law Reform: Solutions to Preserve Homeownership, at 5 n.11 (Apr. 27, 2007), available at <http://www.creditslips.org/creditslips/JointMemoforProposedBankruptcyLawReform.pdf>.

<sup>42</sup> See Rao, *supra* note 41 (citing Lehman Brothers, Mortgage Finance Industry Overview at 1 (Dec. 22, 2006)). Another study performed by the Center for Responsible Lending estimated that one out of every five subprime mortgages that originated in 2005 and 2006 will result in foreclosure, costing homeowners as much as \$164 billion. Ellen Schloemer, Wei Li, Keith Ernst & Kathleen Keest, Center for Responsible Lending, *Losing Ground: Foreclosures in the Subprime Market and Their Cost to Homeowners*, at 15 (Dec. 2006), available at <http://www.responsiblelending.org/pdfs/FC-paper-12-19-new-cover-1.pdf>. Further, an estimated 2.2 million Americans holding loans that originated between 1998 and 2006 will have lost homes or will lose homes to foreclosure. *Id.* at 3.

<sup>43</sup> Les Christie, *Foreclosures up 75% in 2007*, Jan. 29, 2008, [http://money.cnn.com/2008/01/29/real\\_estate/foreclosure\\_filings\\_2007/index.htm](http://money.cnn.com/2008/01/29/real_estate/foreclosure_filings_2007/index.htm) (“Total foreclosure filings soared 97% in December alone compared with December of 2006.”).

<sup>44</sup> See Ivry, *supra* note 2.

<sup>45</sup> See *id.*

<sup>46</sup> FRANK S. ALEXANDER, *GEORGIA REAL ESTATE FINANCE AND FORECLOSURE LAW* 215 (4th ed. 2004).

### B. *Foreclosures and Bankruptcy*

There is an inherent conflict in accommodating state foreclosure law and federal bankruptcy law.<sup>47</sup> Foreclosure is a remedy that lenders have against a defaulting borrower; the debtor's real property is sold pursuant to state foreclosure law, and the proceeds from the sale are applied against the outstanding debt.<sup>48</sup> After the foreclosure sale, the debtor's obligation to pay on the mortgage and the creditor's right to demand payment cease.<sup>49</sup> However, federal bankruptcy law, specifically a debtor filing under chapter 13, cannot operate in isolation of the home mortgage lender's contractual rights.<sup>50</sup>

The Bankruptcy Code temporarily prevents the lender from foreclosing on the debtor's residence.<sup>51</sup> When a debtor files for bankruptcy, the filing of the petition triggers a stay on all foreclosure proceedings and actions by the mortgage lender.<sup>52</sup> The home mortgage lender must then look to the debtor's chapter 13 plan to satisfy the debt.<sup>53</sup>

In a chapter 13 bankruptcy, § 1322(b)(3) and § 1322(b)(5) give the debtor an opportunity to cure the default.<sup>54</sup> If the bankruptcy court permits the debtor to cure the default and reinstates the scheduled mortgage payments, the debt accelerates, but the mortgage payments remain the same as the payments that the debtor was making prior to filing bankruptcy.<sup>55</sup> The payments are the same because the Bankruptcy Code prohibits courts from modifying the terms of a residential mortgage.<sup>56</sup> In many instances, subprime mortgage borrowers filing under chapter 13 are simply forestalling the inevitable foreclosure.<sup>57</sup>

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<sup>47</sup> See Daniel W. Mitnik, *Foreclosures and Bankruptcy: The Mortgagee-Mortgagor Relationship*, 2 BANKR. DEV. J. 317, 318 (1985).

<sup>48</sup> ALEXANDER, *supra* note 46, at 1.

<sup>49</sup> *Id.* at 2.

<sup>50</sup> Nobelman v. Am. Sav. Bank (*In re Nobelman*), 508 U.S. 324 (1993).

<sup>51</sup> See *United Sav. Ass'n of Tex. v. Timbers of Inwood Forest Assoc.*, 484 U.S. 365, 369–70 (1988).

<sup>52</sup> 11 U.S.C. § 362(a) (2006).

<sup>53</sup> Mitnik, *supra* note 47, at 337.

<sup>54</sup> 11 U.S.C. § 1322(b)(3) (“[T]he plan may . . . provide for the curing or waiving of any default”); *id.* § 1322(b)(5) (“[T]he plan may . . . provide for the curing of any default within a reasonable time and maintenance of payments while the case is pending on any unsecured claim or secured claim on which the last payment is due after the date on which the final payment under the plan is due.”).

<sup>55</sup> Mitnik, *supra* note 47, at 337.

<sup>56</sup> 11 U.S.C. § 1322(b)(2).

<sup>57</sup> A. Brooke Overby, *Mortgage Foreclosure in Post-Katrina New Orleans*, 48 B.C. L. REV. 851, 878 (2007).

### C. Chapter 13 Plan Confirmation Process and Its Binding Effect

One of the primary purposes of bankruptcy law is to grant debtors a “fresh start.”<sup>58</sup> Despite the fresh start objective, chapter 13 debtors have a commitment to repay some portion of their debts.<sup>59</sup> The chapter 13 filing adjusts the debtors’ debts, rather than liquidating them pursuant to chapter 7 or reorganizing the debts under chapter 11.<sup>60</sup> In chapter 13 cases, the confirmation process plays an integral part in establishing what the debtor owes, how creditors are to be repaid, and how the debtor will return to the black.

Over the past few years, the mortgage marketplace and America’s bankruptcy laws have grown distant, making it increasingly difficult to adjust all of the chapter 13 debtor’s obligations.<sup>61</sup> Since Congress adopted the Bankruptcy Code, “homeowners facing foreclosure have often turned to chapter 13 as a last resort for saving their homes.”<sup>62</sup> However, the advent of nontraditional mortgages has challenged the ability of many financially-burdened families to use chapter 13 proceedings to save their homes from foreclosure.<sup>63</sup>

Within fifteen days of filing a chapter 13 bankruptcy petition, the debtor must file a chapter 13 reorganization plan.<sup>64</sup> The Bankruptcy Code establishes mandatory and permissive chapter 13 plan provisions.<sup>65</sup> Once the debtor files a chapter 13 confirmation plan, the court sets the date for the chapter 13 confirmation hearing.<sup>66</sup> Then, each creditor receives notice of the confirmation hearing date and a copy of the plan, and each creditor has at least twenty-five days to file objections to plan confirmation.<sup>67</sup> Because a creditor has a

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<sup>58</sup> *Marrama v. Citizens Bank of Mass.*, 549 U.S. 365, 365 (2007) (quoting *Grogan v. Garner*, 498 U.S. 279, 286, 287 (1991)); see also Elijah M. Alper, *Opportunistic Informal Bankruptcy: How BAPCPA May Fail to Make Wealthy Debtors Pay Up*, 107 COLUM. L. REV. 1908, 1913–14 (2007).

<sup>59</sup> See Alper, *supra* note 58, at 1913–14; see also Richard H.W. Maloy, “*She’ll Be Able To Keep Her Home Won’t She?*”—*The Plight of a Homeowner in Bankruptcy*, 2003 MICH. ST. DCL L. REV. 315, 339–40 (2003).

<sup>60</sup> See Maloy, *supra* note 59, at 339.

<sup>61</sup> *Legislative Update: ABI Directors Testify Before Congress*, *supra* note 29.

<sup>62</sup> *Id.*

<sup>63</sup> *Id.*

<sup>64</sup> *In re Hudson*, 260 B.R. 421, 429 (Bankr. W.D. Mich. 2001) (court retaining discretion to extend the fifteen day limit to file the reorganization plan if it deems necessary).

<sup>65</sup> 11 U.S.C. § 1322 (2006).

<sup>66</sup> *Id.* § 1324.

<sup>67</sup> *Hudson*, 260 B.R. at 430 n.15 (“[S]ecured creditors . . . are expeditiously given relevant information to allow them to protect their rights and assert legal positions at the confirmation hearing.”).

specified amount of time to object to plan confirmation,<sup>68</sup> it has “a primary obligation to object to its plan treatment” if it is not satisfied with the modifications.<sup>69</sup>

Notwithstanding a creditor’s objection, the bankruptcy court has broad powers to confirm and enforce the debtor’s proposed confirmation plan.<sup>70</sup> The provisions of the confirmed plan are binding on the debtor, the estate, and all of the creditors.<sup>71</sup> In effect, confirmation prevents a secured creditor from demanding greater payment on a secured claim than is imposed by the plan and likewise prevents debtors from attempting to pay anything less than is provided for under the plan.<sup>72</sup>

Typically, a chapter 13 debtor’s rehabilitation begins with confirmation of the plan.<sup>73</sup> Even after plan confirmation, the debtor may not be able to make the appropriate plan payments, which could force the debtor to convert the case to a chapter 7 or permit the creditor to file a motion to dismiss the bankruptcy.<sup>74</sup> If the bankruptcy court grants the motion to dismiss, the debtor will return to the foreclosure proceedings he previously faced. The antimodification provision in § 1322(b)(2) promotes this cycle in all too many situations. Furthermore, mortgage lenders’ frequency of lending to less creditworthy borrowers under subprime mortgages has perpetuated the foreclosure-to-bankruptcy-to-foreclosure cycle. Lenders have failed to consider the possible long-term effects that many borrowers’ inability to make

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<sup>68</sup> See *supra* note 65.

<sup>69</sup> *Hudson*, 260 B.R. at 430.

While we do not understate the importance of the obligation of the bankruptcy court or the trustee to determine that a plan complies with the appropriate sections of the Bankruptcy Code prior to confirmation of the plan, . . . the affirmative obligation to object to the [debtors’] plan rest[s] with [the secured creditor], not with the bankruptcy court or the trustee.

*Id.* (quoting *In re Szostek*, 886 F.2d 1405, 1414 (3d Cir. 1989)).

<sup>70</sup> See *Szostek*, 886 F.2d at 1414. Regardless of the suppositious binding effect of a confirmed chapter 13 plan, most courts will later nullify the confirmed plan that modifies a debtor’s home mortgage. See, e.g., *id.*

<sup>71</sup> 11 U.S.C. § 1327(a); see also *Hudson*, 260 B.R. at 430 (The Court’s final order confirming the plan has res judicata effect.).

<sup>72</sup> *Hudson*, 260 B.R. at 428.

<sup>73</sup> See *supra* note 7 and accompanying text.

<sup>74</sup> 11 U.S.C. § 1307(c)(4) states that

on request of a party in interest or the United States trustee and after notice and a hearing, the court may convert a case under this chapter to a case under chapter 7 of this title, or may dismiss a case under this chapter, whichever is in the best interests of creditors and the estate, for cause, including . . . failure to commence making timely payments under section 1326 of this title . . . .

monthly mortgage payments could have on individual borrowers and the entire United States economy.

## II. ANTIMODIFICATION PROVISIONS AND THE SUBPRIME MARKET AFFECT MORE THAN JUST MORTGAGORS

The subprime mortgage crisis adversely affects more sectors of American society than simply the homeowners experiencing foreclosure or on the verge of foreclosure. Although the subprime crisis directly impacts the subprime homeowners, it also burdens the entire United States economy.<sup>75</sup> Many subprime mortgage lenders have gone belly up or have been acquired by much wealthier companies that can weather the storm until the market stabilizes.<sup>76</sup> Financial institutions that purchased pooled subprime mortgages, known as mortgage-backed securities,<sup>77</sup> have also suffered.<sup>78</sup> Surrounding homes and entire neighborhoods have seen significant decreases in property values as a result of foreclosures.<sup>79</sup> Finally, insurance companies have been forced to bear the brunt of the cost when abandoned homes are lost to suspected arson-related incidents.<sup>80</sup>

From the beginning of 2006 through the first quarter of 2007, twenty-three subprime lenders filed for bankruptcy.<sup>81</sup> The sharp rises in foreclosures led large subprime mortgage lenders like New Century Corporation to close or file for bankruptcy and caused huge drops in stock prices of major lenders like Countrywide Financial.<sup>82</sup> Because of the financial difficulties of some of the major home mortgage lenders, larger players in the loan industry have come to the rescue by acquiring these struggling companies in an attempt to avoid more

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<sup>75</sup> Sabry, *supra* note 4, at 101.

<sup>76</sup> *See id.*

<sup>77</sup> Mortgage-backed securities ("MBS") are instruments which are created and backed by pooling similar mortgages together. Investors buy an MBS because it entitles them to a proportional share of the payments of principal and interest by mortgage holders. Unterman, *supra* note 28, at 83 n.20.

<sup>78</sup> *See, e.g., Lehman Brothers Collapse Stuns Global Markets*, CNN.COM, Sept. 15, 2008, <http://edition.cnn.com/2008/BUSINESS/09/15/lehman.merrill.stocks.turmoil/index.html>; John Waggoner & David Lynch, *Red Flags in Bear Stearns Collapse*, USA TODAY, Mar. 19, 2008, [http://www.usatoday.com/money/industries/banking/2008-03-17-bear-stearns-bailout\\_N.htm](http://www.usatoday.com/money/industries/banking/2008-03-17-bear-stearns-bailout_N.htm).

<sup>79</sup> *See infra* notes 89–91 and accompanying text.

<sup>80</sup> *See infra* notes 92–93 and accompanying text.

<sup>81</sup> Unterman, *supra* note 28, at 95.

<sup>82</sup> Jonathan Stempel, *Countrywide Plunges on Downgrade, Bankruptcy Fear*, THOMPSON REUTERS, Aug. 15, 2007, <http://www.reuters.com/article/idUKN1525333820070815>.

mortgage lender bankruptcies.<sup>83</sup> Even though the long-term outlook is positive for these loan industry leaders, there are near-term challenges with delinquencies and pending foreclosures in the housing market.<sup>84</sup>

As subprime mortgages gained in popularity, Wall Street repackaged them as mortgage-backed securities, and financial institutions, including mutual funds and insurance companies, started investing in them.<sup>85</sup> Many financial institutions entered into deals buying mortgage-backed securities because one borrower's inability to make his mortgage payment did not affect the pool's performance.<sup>86</sup> Thus, these securities appeared to be extremely lucrative investments and a win-win situation. However, the risks significantly increase when many low quality mortgages are pooled together.<sup>87</sup> The condition of the real estate market largely controls the performance of mortgage-backed assets.<sup>88</sup> When the housing bubble burst, it affected the performance of the mortgage-backed assets.<sup>89</sup> Citigroup announced an \$18 billion subprime hit for 2007, the largest of any U.S. investment bank,<sup>90</sup> and in March 2008, JP Morgan Chase acquired Bear Stearns as a result of Bear Stearns' trouble with subprime mortgage debts.<sup>91</sup> In sum, as of March 2008, write-downs relating to subprime debt obligations by large banks, investment banks, and financial guarantors amounted to approximately \$150 billion.<sup>92</sup>

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<sup>83</sup> David Milkenberg & Ari Levy, *Bank of America to Acquire Countrywide for 37% Less*, BLOOMBERG.COM, July 1, 2008, <http://www.bloomberg.com/apps/news?pid=20601087&sid=af9EoP0ySH6c&refer=home> (discussing Bank of America's acquisition of Countrywide Financial amid the speculation of Countrywide's potential bankruptcy).

<sup>84</sup> *Id.* (Eva Weber, an analyst at Aite Group LLC in Boston, stated "There will still be some negative impact with associating Countrywide with Bank of America . . . From a reputation perspective, that's certainly something Bank of America will have to overcome.").

<sup>85</sup> See Sabry, *supra* note 4, at 97. Wall Street simply mixed subprime loans with other types of debt, created complex securities, and sold them to other investors. Waggoner & Lynch, *supra* note 78.

<sup>86</sup> Unterman, *supra* note 28, at 86.

<sup>87</sup> *Id.*

<sup>88</sup> *Id.*

<sup>89</sup> Justin Lahart, *Egg Cracks Differ in Housing, Finance Shells*, WALL ST. J., Dec. 24, 2007, at C1.

<sup>90</sup> *Citigroup's \$9.8 bn Sub-prime Loss*, BBC NEWS, Jan. 15, 2008, <http://news.bbc.co.uk/2/hi/business/7188909.stm>.

<sup>91</sup> *Rescue for Troubled Wall St. Bank*, BBC NEWS, Mar. 17, 2008, <http://news.bbc.co.uk/2/hi/business/7299938.stm>.

<sup>92</sup> Tanya Azarchs, *Subprime Writedowns: Is the Worst Over?*, BUS. WK., Mar. 13, 2008, [http://www.businessweek.com/investor/content/mar2008/pi20080313\\_977654.htm](http://www.businessweek.com/investor/content/mar2008/pi20080313_977654.htm). A write-down occurs when a company reduces the value of an asset because it is overvalued compared to market value. Write-downs reduce a company's net income as they are reflected as in a company's portfolio. See Sabry, *supra* note 4, at 98.

The negative effects of a home foreclosure also extend to surrounding neighbors and the extended community.<sup>93</sup> The studies and statistics that have been compiled regarding neighborhood values are staggering.<sup>94</sup> One study showed that every foreclosure lowered the price of a neighboring home by almost one percent and produced a negative cumulative impact on the block.<sup>95</sup>

Additionally, the subprime crisis produced an unexpected problem and threat to the insurance industry. A few homeowners, desperate to avoid paying their mortgages, have resorted to arson as a way to avoid foreclosure.<sup>96</sup> In these cases, insurance companies sustain the losses associated with the fires because state laws require speedy settlements, which means insurance companies are required to pay before they can conduct conclusive, thorough investigations of the fire's cause.<sup>97</sup>

The subprime mortgage market has had a major spillover effect.<sup>98</sup> For example, the U.S. dollar declined from 2006 to 2007, and there is a concern that the U.S. is headed towards a recession.<sup>99</sup> The 2007 subprime meltdown only marks the beginning of the many foreclosures, losses, and write-downs if some of these subprime mortgages cannot be better managed or modified. Congress must consider the subprime crisis' effects on the economy and scrutinize the legislative purpose of the antimodification provision to determine the amendments necessary to help halt the crisis.

### III. LEGISLATIVE HISTORY AND PURPOSE OF § 1322(B)(2)

The Bankruptcy Reform Act of 1978 expanded the eligibility of chapter 13 debtors to secure and retain their assets by granting these individuals

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<sup>93</sup> Center for Responsible Lending, *Subprime Spillover: Foreclosures Cost Neighbors \$202 Billion; 40.6 Million Homes Lose \$5,000 on Average*, at 1 (Jan. 18, 2008) available at <http://www.responsiblelending.org/pdfs/subprime-spillover.pdf> [hereinafter, Center for Responsible Lending, *Subprime Spillover*].

<sup>94</sup> *Id.* ("The total decline in house values and tax base from nearby foreclosures will be \$202 billion" on subprime loans that originated in 2005 and 2006.).

<sup>95</sup> *Id.* (citing Dan Immergluck & Geoff Smith, *The External Costs of Foreclosure: The Impact of Single-Family Mortgage Foreclosures on Property Values*, at 57, 69, 72, 75, Fannie Mae Foundation (2006), available at [http://www.fanniemaeoundation.org/programs/hpd/pdf/hpd\\_1701\\_immergluck.pdf](http://www.fanniemaeoundation.org/programs/hpd/pdf/hpd_1701_immergluck.pdf)).

<sup>96</sup> Marilyn Lewis, *Broke Homeowners Linked to Arson*, MSN.COM, Jan 28, 2008, <http://articles.moneycentral.msn.com/Insurance/InsureYourHome/BrokeHomeownersTurnToArson.aspx?page=1> ("It is too soon to turn [a minimal number of cases] into meaningful statistics.").

<sup>97</sup> *Id.*

<sup>98</sup> Center for Responsible Lending, *Subprime Spillover*, *supra* note 93.

<sup>99</sup> Uterman, *supra* note 28, at 100 (explaining that halfway through 2007, the U.S. dollar was down 3% from the year before).

bankruptcy protection not provided under chapter 7 liquidation.<sup>100</sup> The Senate and House of Representatives proposed bills that allowed individual debtors to modify secured debt,<sup>101</sup> but banking industry lobbyists quickly objected to these all-inclusive secured debt modification bills.<sup>102</sup> Edward Kulik, speaking on behalf of five real estate lending associations, testified before Congress concerning the impact that the proposed bills would have on real estate lenders.<sup>103</sup> In turn, the Senate and House compromised on a final bill, emanating from the Senate's amended version, which prohibits modification of debts secured by an interest in real property that is the debtor's principal residence and yet still allows modification of other secured debts.<sup>104</sup>

After banking industry representatives lobbied for this antimodification provision in the Bankruptcy Code,<sup>105</sup> both houses of Congress felt compelled to exclude all principal residence mortgages from modification.<sup>106</sup> The statute, as enacted, protects three related interests. First, the antimodification provision encourages the flow of capital into the home-lending market.<sup>107</sup> Second, and as a result of the first interest, the provision establishes stability and insulates the residential home lenders.<sup>108</sup> The final interest safeguarded by the

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<sup>100</sup> George Bourguignon, *Interpretation of Bankruptcy Code § 1322(c)(1), Arguing for a Bright-Line Approach to the Debtor's Statutory Right to Cure a Residential Mortgage Default*, 7 U.C. DAVIS BUS. L.J. 461, 471-72 (2007) (citing the Bankruptcy Reform Act of 1978, Pub L. No. 95-598, 92 Stat. 2549).

<sup>101</sup> *Id.* at 472 (citing H.R. REP. No. 95-595, at 118 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6079); see also *id.* (noting that the banking industry's major concern was the possible reduced flow of capital from the banks and other major lending institutions into the national residential housing market).

<sup>102</sup> *Bankruptcy Reform Act of 1978: Hearing on H.R. 8200 and S. 2266 Before the Subcomm. on Improvements in Judicial Machinery of the S. Comm. on the Judiciary*, 95th Cong. 714 (1977) [hereinafter, Statement of Edward Kulik] (statement of Edward J. Kulik, Senior Vice President, Mass Mutual Life Insurance Company) (attempting to prevent passing Senate Bill 2266 and House Bill 8200 as they were then proposed because these bills recommended significant changes from existing law that could have unintentionally restricted the flow of home mortgage money).

<sup>103</sup> *Id.* at 711 (proposing that Congress pass a bill limiting modification of a mortgage on real property other than investment property).

<sup>104</sup> Bourguignon, *supra* note 100, at 472 (citing S. 2266, 95th Cong. § 1322 (2d Sess. 1978)).

<sup>105</sup> Statement of Edward Kulik, *supra* note 102.

<sup>106</sup> See Bourguignon, *supra* note 100, at 472.

<sup>107</sup> See, e.g., *Nobelman v. Am. Sav. Bank (In re Nobelman)*, 508 U.S. 324, 332 (1993) (Stevens, J. concurring); *Litton Loan Servicing, LP v. Beamon*, 298 B.R. 508 (N.D.N.Y. 2003) (provision enacted to encourage the flow of capital by reducing mortgagee's risk in Chapter 13 proceeding); *In re Fountain*, 197 B.R. 748 (Bankr. D.N.H. 1996); *In re DeMaggio*, 175 B.R. 144 (Bankr. D.N.H. 1994) (legislative intent behind statutory prohibition was to encourage the making of home loans in residential housing lending market); *In re Strober*, 136 B.R. 614 (Bankr. E.D.N.Y. 1992) (purpose of the provision was to avoid any adverse impact on flow of mortgage money to individual homeowners).

<sup>108</sup> See *DeMaggio*, 175 B.R. at 144; *In re Hall*, 117 B.R. 425 (Bankr. S.D. Ind. 1990) (primary purpose of the statute is to provide stability in residential long-term home finance industry and market and section is

antimodification provision is the rights that are bargained for between mortgagor and mortgagee upon instituting the mortgage.<sup>109</sup>

#### IV. SPLIT TREATMENT OF CONFIRMATION PLANS

Since the Supreme Court issued its only decision cutting directly at the antimodification provision of §1322(b)(2),<sup>110</sup> debtors and creditors have found numerous ways to litigate the statutory construction, exact terminology, and the mandatory versus permissive nature of § 1322(b)(2). This Part will examine the *Nobelman* decision and then discuss the various ways courts have construed § 1322(b)(2), both strictly and loosely. Although the *Nobelman* holding seems clear on its face, the decision presents some confusion and ambiguity about how to precisely analyze § 1322(b)(2).

Part IV.B. of this Comment will analyze cases that dissect the structure of the antecedent clause of the antimodification provision, address how cases have examined the phrase of § 1322(b)(2) “a claim secured only by a security interest in real property,” evaluate the term “debtor’s principal residence” in the provision, and explore an alternative rationale courts have adopted to construe § 1322(b)(2) very liberally: placing emphasis on the res judicata effect of the chapter 13 confirmation plan.

##### A. *Nobelman v. American Savings Bank*

From the enactment of § 1322(b)(2) in 1978 until 1993, many courts found exemptions to the antimodification provision’s harsh language. Section 1322(b)(2) states that “the plan 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, or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims.”<sup>111</sup> Some courts construe this language as protecting only institutional lenders engaged in providing *long-term* home mortgage financing.<sup>112</sup> Other courts interpreted the

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intended to protect home mortgage lenders rather than home owners); *United Cos. Fin. Corp. v. Brantley* (*In re Brantley*), 6 B.R. 178 (Bankr. N.D. Fla. 1980); *In re Pruitte*, 157 B.R. 662 (Bankr. E.D. Mo. 1993).

<sup>109</sup> *Fountain*, 197 B.R. 748 (quoting *In re Smith* 176 B.R. 298, 301–02 (Bankr. D.N.H. 1994)).

<sup>110</sup> See *Nobelman*, 508 U.S. 324.

<sup>111</sup> 11 U.S.C. § 1322(b)(2) (2006) (referring to the contents of the chapter 13 plan proposed by the debtor and confirmed or rejected by the creditors).

<sup>112</sup> See *Brantley*, 6 B.R. 178. But see *In re Coffey*, 52 B.R. 54, 55–56 (Bankr. D.N.H. 1985), stating

antimodification provision of § 1322(b)(2) “to prohibit modification of the mortgagee’s rights only with respect to the portion of his claim that is deemed secured under the Code.”<sup>113</sup> However, this construction of § 1322(b)(2) ended with the Supreme Court’s decision in *Nobelman v. American Savings Bank*.<sup>114</sup> *Nobelman* is the first and only decision by the Supreme Court regarding the relationship between § 1322(b)(2) and a debtor’s attempt to modify a mortgage on the debtor’s residence.<sup>115</sup>

In *Nobelman*, American Savings Bank held a secured claim on Leonard and Harriet Nobelman’s principal residence.<sup>116</sup> The Nobelmans’ proposed chapter 13 plan bifurcated the bank’s claim into secured and unsecured components,<sup>117</sup> a process known as “stripping down” the mortgage to its secured component as distinct from its unsecured component.<sup>118</sup> The bank and chapter 13 trustee objected to the plan, arguing that bifurcation into a secured claim and worthless unsecured claim violated the antimodification provision of § 1322(b)(2).<sup>119</sup>

Justice Thomas, writing for the unanimous Court, affirmed the Fifth Circuit decision forbidding the bifurcation.<sup>120</sup> The Court held that § 1322(b)(2), which bars a debtor from modifying the rights of holders of claims secured only by the debtor’s principal residence, prohibits chapter 13 debtors from bifurcating

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[The Court] recognized that a respectable argument can be made . . . to the effect that Congress was focusing primarily on the long term mortgage debt situation in enacting the statutory prohibition against modification of secured claims on residential property. However, the primary focus does not ipso facto mean that Congress could not have also intended in its final legislative product to prevent use of chapter 13 proceedings to modify all secured claims against residential property when no other collateral was involved.

<sup>113</sup> *Dewsnup v. Timm*, 502 U.S. 410, 429 (1992); *see, e.g., Eastland Mortgage Co. v. Hart*, (*In re Hart*), 923 F.2d 1410, 1415 (10th Cir. 1991); *Wilson v. Commonwealth Mortgage Corp.*, 895 F.2d 123, 127 (3d Cir. 1990).

<sup>114</sup> *Nobelman*, 508 U.S. 324.

<sup>115</sup> *Id.* at 326.

<sup>116</sup> *Id.*

<sup>117</sup> *Id.*; *see also id.* at 332 (By bifurcating the claim into a secured and unsecured claim, the plan reduced the mortgage to the fair market value of the residence.).

<sup>118</sup> David G. Epstein, *Understanding the Basics of Bankruptcy and Reorganization 2005*, PRACTISING L. INST. COM. L. & PRAC. COURSE HANDBOOK SERIES, PLI Order No. 6171 at 504 (explaining that “stripping down” and “stripping off” are two different phenomena in that “stripping off” involves a second and/or third mortgage where that mortgage has no value; “stripping off” is allowed by most courts, whereas the Supreme Court invalidated the idea of “stripping down” in *Nobelman*).

<sup>119</sup> *Nobelman*, 508 U.S. at 326–27.

<sup>120</sup> Derek C. Abbott, *Some Things Are Better Left Said: A Discussion of the Unstated Arguments Supporting and Opposing the Supreme Court’s Opinion in Nobelman v. American Savings Bank*, 72 N.C. L. REV. 1113, 1117 (1994). *See generally Nobelman*, 508 U.S. 324.

an oversecured homestead mortgage lender's claim to reduce the mortgage to the home's fair market value.<sup>121</sup> Moreover, the Court directed lower courts to apply § 1322(b)(2) according to its literal terms.<sup>122</sup>

Although the *Nobelman* holding attempted to mandate a literal interpretation of § 1322(b)(2), some lower courts, when analyzing § 1322(b)(2) in conjunction with other Bankruptcy Code sections, have not adhered to such a literal interpretation.<sup>123</sup> “In the Court’s fervor of focusing on a mortgagee’s ‘rights,’ . . . the decision in *Nobelman* failed to absolutely resolve the ambiguities of § 1322(b)(2) . . . .”<sup>124</sup> Even though there has not been a split in lower court authority concerning the interpretation of § 1322(b)(2), lower courts still find various ways to tweak the Bankruptcy Code to produce a particular outcome. The *Nobelman* decision leaves too much room for lower court discretion when other issues concerning a debtor’s attempt to modify his residential mortgage arise. This leeway allowed two courts in particular to do exactly what the *Nobelman* Court sought to prevent.<sup>125</sup>

### B. Various Interpretations by the Courts

Many courts have interpreted Congress’ antimodification provision and various terms contained within the provision.<sup>126</sup> The *Nobelman* Court “employed a two-step statutory construction process to reconcile the ostensibly conflicting provisions of the Code.”<sup>127</sup> Under this two-step approach, the Court believed it had disposed of any incongruities through a literal interpretation of the Bankruptcy Code.<sup>128</sup>

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<sup>121</sup> *Nobelman*, 508 U.S. at 331.

<sup>122</sup> *See id.*

<sup>123</sup> *See infra* Part IV.B.

<sup>124</sup> Hanson, *supra* note 13, at 820.

<sup>125</sup> *See Hirsch v. Citicorp Mortgage Corp. (In re Hirsch)*, 155 B.R. 688 (Bankr. E.D. Pa. 1993) (holding that bifurcation of a home mortgage into secured and unsecured components is permissible if the secured creditor takes a security interest in items other than the borrower’s principal residence); *Hammond v. Commonwealth Mortgage Corp. of Am. (In re Hammond)*, 27 F.3d 52, 57 (3d Cir. 1994) (concluding that a mortgage which creates a security interest in addition to a lien on the borrower’s principal residence takes the mortgage beyond the protection granted by § 1322(b)(2) of the Bankruptcy Code).

<sup>126</sup> 11 U.S.C. § 1322(b)(2) (2006) (stating “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”).

<sup>127</sup> Abbott, *supra* note 120, at 1117; *see also id.* (explaining that the two step approach consisted of the Court (1) fixing the meanings of the terms “rights” and “claims” and (2) applying those meanings to the analysis of § 1322(b)(2) and its interplay with § 506(a)).

<sup>128</sup> *Id.* at 1117–18. *But see* Hanson, *supra* note 13, at 820 (stating that *Nobelman* provided lower courts with an option to circumvent its harsh effect).

Consistent with *Nobelman*, the majority of courts strictly construe the wording of § 1322(b)(2). When construing a statute, “[t]he ‘plain meaning’ of the language is the ‘primary, and ordinarily the most reliable, source of interpreting its meaning.’”<sup>129</sup> However, a few courts have reasoned around the mandatory wording of § 1322(b)(2).<sup>130</sup>

Some bankruptcy courts purposefully use their authority to clear up any further ambiguities in § 1322(b)(2).<sup>131</sup> This Section explains how courts have interpreted the antecedent clause to the antimodification provision, “rights of holders of secured claims,” in § 1322(b)(2).<sup>132</sup> Next, this Section addresses how courts have examined the phrase “a claim secured only by a security interest in real property.”<sup>133</sup> Then, this Section discusses how courts have analyzed the term “debtor’s principal residence.”<sup>134</sup> Finally, this Section explores a loose interpretation of § 1322(b)(2), which places emphasis on the res judicata effect of a confirmed chapter 13 plan.<sup>135</sup> After *Nobelman* and its progeny, it is clear that most courts have construed this section “to prohibit modification of any material term in any mortgage or security interest on the debtor’s principal residence.”<sup>136</sup>

### 1. *Rights of Holders of Secured Claims*

The antecedent clause to the antimodification provision reads “the plan may modify the rights of holders of secured claims.”<sup>137</sup> This clause plays an important role in determining which creditor has a right to a particular claim.<sup>138</sup> The word “rights” is the central focus of § 1322(b)(2) because when a creditor holds a secured claim, in effect, that creditor has a substantiated right.<sup>139</sup> The

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<sup>129</sup> *In re Harris*, 94 B.R. 832, 835 (D.N.J. 1989) (quoting *Watts v. Alaska*, 451 U.S. 259, 266 n. 9 (1981)) (other citations omitted).

<sup>130</sup> See *infra* notes 151 and 179.

<sup>131</sup> See discussion *infra* Parts IV.B.1–3.

<sup>132</sup> See *infra* Part IV.B.1.

<sup>133</sup> See *infra* Part IV.B.2.

<sup>134</sup> See *infra* Part IV.B.3.

<sup>135</sup> See *infra* Part IV.B.4.

<sup>136</sup> *In re Carr*, 318 B.R. 517, 519 (Bankr. W.D. Wis. 2004); *Scarborough v. Chase Manhattan Mortgage Corp.* (*In re Scarborough*), 461 F.3d 406, 411 (3d Cir. 2006); *Lam v. Investors Thrift* (*In re Lam*), 211 B.R. 36, 41 (B.A.P. 9th Cir. 1997); *In re Schum*, 112 B.R. 159, 162 (Bankr. N.D. Tex. 1990).

<sup>137</sup> 11 U.S.C. § 1322(b)(2) (2006).

<sup>138</sup> *Id.*

<sup>139</sup> *In re Collins*, No. 07-30454, 2007 WL 2116416, at \*5 (Bankr. E.D. Tenn. July 19, 2007) (“[The provision] does not state that the plan may modify ‘claims’ or that the plan may not modify ‘a claim secured only by’ a home mortgage. Rather, it focuses on the modification of the ‘rights of holders’ of such claims.”) (quoting *Nobelman v. Am. Sav. Bank* (*In re Nobelman*), 508 U.S. 324, 328 (1993)).

relevant loan and security agreement documents contain all of the mortgage creditor's rights.<sup>140</sup> These state law, nonbankruptcy, contractual rights impose duties upon the mortgagor and mortgagee in the agreement.<sup>141</sup> The parties' attempts to modify such contractual agreements are exactly what Congress was trying to prevent by the implementation of § 1322(b)(2) and the antimodification clause located therein.<sup>142</sup>

Section 1322(b)(2) emphasizes the importance of a creditor's *secured claim* because it is the secured claim that gives the creditor its rights.<sup>143</sup> "[T]he code does not generally classify creditors based on the existence of a piece of paper purporting to give a creditor rights in specified collateral, but rather on whether a creditor actually holds a claim supported by valuable estate property."<sup>144</sup> A creditor holding a security interest is simply not enough; a lienholder must hold a secured claim to have protection from modification under the statute.<sup>145</sup>

Although bifurcation of a residential mortgage into a secured and unsecured claim is a violation of the antimodification statute,<sup>146</sup> a completely unsecured second claim in a debtor's principal residence is fair game for modification.<sup>147</sup> However, if the holder of a security interest in a debtor's principal residence is secured by even the slightest amount, those rights may not be modified in any way.<sup>148</sup> For instance, if property is appraised at \$50,002 and is encumbered by a first mortgage of \$50,000 and a second mortgage of \$10,000, then the second mortgagee has a secured claim of \$2.<sup>149</sup> Many courts who understand *Nobelman* to strictly interpret § 1322(b)(2) view modifying this type of claim as a violation of the statute.

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<sup>140</sup> *Id.* at \*6.

<sup>141</sup> *Id.* (citing *Nobelman*, 508 U.S. at 329); see also William P. Nacy, Note, *Survival Underwater: Wholly-Unsecured Security Interest in Bankruptcy*, 40 WASHBURN L.J. 87, 99–100 (2000) (including the rights to repayment of the principal at the fixed or adjustable rate, retain the lien until the debt is paid off, proceed against residence by foreclosure and public auction, and recover any deficiency after foreclosure and public auction).

<sup>142</sup> See *Collins*, 2007 WL 2116416, at \*5.

<sup>143</sup> See *id.*

<sup>144</sup> *Lam v. Investors Thrift (In re Lam)*, 211 B.R. 36, 41 (B.A.P. 9th Cir. 1997) (quoting *In re Homes*, 160 B.R. 709, 715 (Bankr. D. Conn. 1993)).

<sup>145</sup> *Lam*, 211 B.R. at 41.

<sup>146</sup> See Epstein, *supra* note 118, at 503.

<sup>147</sup> *Lam*, 211 B.R. at 41; see also *In re Plouffe*, 157 B.R. 198, 200 (Bankr. D. Conn. 1993).

<sup>148</sup> *In re Lee*, 161 B.R. 271, 273 (Bankr. W.D. Okla. 1993).

<sup>149</sup> *Lam*, 211 B.R. at 41; see also *id.* (explaining that if the appraiser valued the property at \$50,000, instead of \$50,002, the second mortgage on the debtor's residence of \$10,000 is not a secured claim and is subject to modification by the debtor).

## 2. Claim Secured Only by a Security Interest in Real Property

The language of § 1322(b)(2) is clear in that it refers to “a claim secured only by a security interest in real property.”<sup>150</sup> The statute does not mention, however, the *types* of lenders or mortgages protected from modification.<sup>151</sup> Furthermore, the word “only” provides little room for judicial discretion when the lender holds a security interest in more property than just the residence.<sup>152</sup> Still, courts differ in applying the *Nobelman* holding.

The statute contains no stated distinction between short-term and long-term loans, and “the statute clearly does not contain any purchase money requirement for a creditor to qualify for the protection given by § 1322(b)(2).”<sup>153</sup> Prior to the *Nobelman* holding, the lack of legislative history led some courts to allow modifications of non purchase-money mortgages and short-term home mortgages:<sup>154</sup>

[A] relatively short-term debt at a high rate of interest and secured by a junior lien . . . [is] exactly the type of consumer loan secured by a security interest in residential real estate that should be denied protection of § 1322(b)(2) notwithstanding the fact that the value of the real estate may be high enough to make the debt fully secured.<sup>155</sup>

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<sup>150</sup> 11 U.S.C. § 1322(b)(2) (2006).

<sup>151</sup> See *In re Carr*, 318 B.R. 517, 519 (Bankr. W.D. Wis. 2004).

<sup>152</sup> See *Hammond v. Commonwealth Mortgage Corp.* (*In re Hammond*), 27 F.3d 52, 57 (3d Cir. 1994).

<sup>153</sup> *In re Bradshaw*, 56 B.R. 742, 746 (S.D. Ohio 1985); see also *In re Braylock*, 120 B.R. 61 (Bankr. N.D. Miss. 1990) (noting that nothing is expressly stated in the Bankruptcy Code to suggest that § 1322(b)(2) was designed solely for particular types of mortgages); 9D AM. JUR. 2D *Bankruptcy* § 3041 (2006). Purchase-money liens are “used to furnish the credit necessary for the purchase of the collateral . . . [i.e.,] houses . . .” ELIZABETH WARREN & JAY LAWRENCE WESTBROOK, *THE LAW OF DEBTORS AND CREDITORS* 40 (5th ed. 2006) (citation omitted).

<sup>154</sup> See *In re Williams*, 109 B.R. 36, 42 (Bankr. E.D.N.Y. 1989) (comparing the residential home lending market of today to the market that existed at the time § 1322(b)(2) was enacted to determine Congressional intent); *Capitol Credit Plan of Tenn. v. Shaffer*, 116 B.R. 60 (W.D. Va. 1988).

<sup>155</sup> *Capitol Credit Plan*, 116 B.R. at 61 (quoting *In re Shaffer*, 84 B.R. 63, 67 (Bankr. W.D. Va. 1988), *aff'd*, 116 B.R. 60 (W.D. Va. 1988)) (alteration in original) (citation omitted); see also *Williams*, 109 B.R. at 42 (The current subprime lenders differ from the lenders whom the banking industry supported in the 1978 congressional hearings. Those lenders provided stability to the residential housing market with initial financing that allowed a buyer to purchase a home.). *But see Capitol Credit Plan*, 116 B.R. at 61 (The *Shaffer* court believed that Congress’s intent focused on insuring the long-term mortgage industry, so that lenders engaged in that line of financing could expect to see their loans repaid.).

This is relevant because although many courts have failed to adopt the explanations set forth in *Capitol Credit Plan*, this holding is still good law.<sup>156</sup> While the legislative history is silent on the drafters' true intentions for enacting this provision, the enactment of § 1322(b)(2) may have altered the manner in which home mortgage lending companies conduct business.<sup>157</sup>

Other courts have explained that the plain language leaves no room for the conclusion that the antimodification provision in § 1322(b)(2) is limited solely to purchase-money mortgages and long-term residential purchase-money mortgages.<sup>158</sup> In fact, the legislature has not had a problem limiting specific provisions in the Bankruptcy Code solely to purchase-money transactions.<sup>159</sup> A Bankruptcy Court in the Western District of Wisconsin read § 1322(b)(2) to include non purchase-money mortgages in restricting the right to modify the mortgage lender's claim when the sole security interest was in the debtor's principal residence.<sup>160</sup> The court determined that once a mandatory provision of the Bankruptcy Code is violated, a debtor's plan confirmation must be deemed nugatory.<sup>161</sup> Another bankruptcy court in the Northern District of Texas rejected the argument that the antimodification provision applied only to long-term residential purchase-money mortgages.<sup>162</sup> In holding against modification of the residential mortgage, the court made a policy determination, noting that placing a restriction merely on long-term mortgages would, in essence, penalize those risk-taking lenders willing to extend short-term credit mortgages to less creditworthy mortgagors.<sup>163</sup> These courts and

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<sup>156</sup> Compare *id.* with *In re Moser*, 247 B.R. 431, 433 (Bankr. N.D. Ohio 2000) (opining that the *Capitol Credit Plan* supposition is without merit because adding a condition to § 1322(b)(2) would only be necessary if the condition were actually needed to make the statute functional).

<sup>157</sup> *Bradshaw*, 56 B.R. at 746.

<sup>158</sup> See *In re Carr*, 318 B.R. 517, 521 (Bankr. W.D. Wis. 2004); *In re Schum*, 112 B.R. 159, 162 (Bankr. N.D. Tex. 1990).

<sup>159</sup> See *In re Coffey*, 52 B.R. 54, 56 (Bankr. D.N.H. 1985) (citing 11 U.S.C. § 522(f)(2) for specific language to limit avoidance provisions with regard to purchase-money transactions).

<sup>160</sup> See *Carr*, 318 B.R. at 520–21 (explaining that it does not matter whether there is purchase-money or non purchase-money financing when the creditor is secured by the debtor's residence). But see *Bank of Va. v. Lindamood (In re Lindamood)*, 34 B.R. 330, 331–32 (Bankr. W.D. Va. 1983) (limiting the antimodification clause to purchase-money mortgages); *Shaffer*, 84 B.R. at 65 (same).

<sup>161</sup> *Carr*, 318 B.R. at 521 (relying on *In re Escobedo*, 28 F.3d 34, 35 (7th Cir. 1994)).

<sup>162</sup> Compare *Schum*, 112 B.R. at 162 with *In re Williams*, 109 B.R. 36 (Bankr. E.D.N.Y. 1989) and *Shaffer*, 84 B.R. at 65–66.

<sup>163</sup> Compare *Schum*, 112 B.R. at 162 with *Williams*, 109 B.R. at 42 (stating that Congress did not intend for the antimodification provision to protect lenders who are financing high-risk, financially unstable individuals at a high interest rate).

others have been reluctant to adopt the loose interpretation of § 1322(b)(2) when the language is unambiguous.<sup>164</sup>

Courts' reluctance to adopt a loose interpretation of § 1322(b)(2) continued after *Nobelman* even if that meant deciding a case contrary to the *Nobelman* holding.<sup>165</sup> The Third Circuit permitted bifurcation of a mortgage into secured and unsecured components when the mortgage created a security interest in the debtor's personal property in addition to the lien on the debtor's principal residence.<sup>166</sup> That court relied on pre-*Nobelman* decisions in the Circuit to allow bifurcation and modification of the unsecured portion of the homestead mortgage.<sup>167</sup> Even though *Nobelman* casts doubt on the pre-*Nobelman* law in the Third Circuit, the holding's failure to specifically clear up ambiguities in the antimodification provision enabled courts to rely on other sections of the Bankruptcy Code to decide in a particular manner.<sup>168</sup>

### 3. Debtor's Principal Residence

Section 1322(b)(2) prohibits a debtor from modifying or stripping down a mortgagee's claim to market value that is secured by "real property that is the debtor's principal residence."<sup>169</sup> The final three words in the antimodification clause, "debtor's principal residence," have been the subject of considerable litigation in regards to mortgages. A strict interpretation of the statute equates the terms "real property" and "principal residence" because of the simple verb "is" that links the terms together.<sup>170</sup> Because the statutory construction is

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<sup>164</sup> See, e.g., *Carr*, 318 B.R. at 521; *Schum*, 112 B.R. at 162; *In re Hobaica*, 65 B.R. 693, 695 (Bankr. N.D.N.Y. 1986) (refusing to "utilize the sketchy legislative history as justification for ignoring the plain statutory language").

<sup>165</sup> See *Hirsch v. Citicorp Mortgage Corp. (In re Hirsch)*, 155 B.R. 688 (Bankr. E.D. Pa. 1993); *Hammond v. Commonwealth Home Mortgage Corp. (In re Hammond)*, 27 F.3d 52, 58 (3d Cir. 1994).

<sup>166</sup> *Hammond*, 27 F.3d at 58 (holding that this type of mortgage takes the mortgage beyond the protection of the antimodification clause in § 1322(b)(2)).

<sup>167</sup> See *Sapos v. Provident Inst. of Sav.*, 967 F.2d 918, 925-26 (3d Cir. 1992); *Wilson v. Commonwealth Mortgage Corp.*, 895 F.2d 123, 128 (3d Cir. 1990).

<sup>168</sup> *Hanson*, *supra* note 13, at 822-23.

<sup>169</sup> Douglas A. Lynn, *Defining a Debtor's Principal Residence*, 43 TENN. B.J. 27 (2007).

<sup>170</sup> See Hon. Nancy E. Dreher, *Third Circuit Holds Section 1322(b)(2) Provisions Do Not Apply*, BANKR. AWARENESS ALERT No. 10, Oct. 2006 (The Honorable Nancy C. Dreher of the Third Circuit holds that antimodification provisions of § 1322(b)(2) do not apply in the case of a mortgage taken on a multiunit building in which debtor has a principal residence.) (citing *Scarborough v. Chase Manhattan Mortgage Corp. (In re Scarborough)*, 461 F.3d 406, 411 (3d Cir. 2006)). Compare *Scarborough*, 461 F.3d at 411 with *In re Macaluso*, 254 B.R. 799, 800 (Bankr. W.D.N.Y. 2000) (interpreting the word "is" in the antimodification provision as "includes" and does not exclude preventing modification of other uses of property in addition to debtor's principal residence).

extremely particular, the language of the mortgage is crucial for subsequent application of the antimodification provision.<sup>171</sup>

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) attempted to clarify any ambiguity in the aforementioned phrase by defining a “debtor’s principal residence.”<sup>172</sup> A debtor’s principal residence is “a residential structure, including incidental property, without regard to whether that structure is attached to real property.”<sup>173</sup> A debtor’s principal residence “includes an individual condominium or cooperative unit, a mobile or manufactured home, or trailer.”<sup>174</sup>

Congress aimed to clarify the term “debtor’s principal residence” by inserting the verb construction “shall apply” in the introductory portion of § 101 in an effort to “mandate that the definitions for terms in § 101, including the term ‘debtor’s principal residence,’ are to be applied wherever these terms appear in subsequent sections of the Bankruptcy Code.”<sup>175</sup> By defining and bridging these sections, Congress extended the protection of the antimodification provision to pieces of property beyond those normally included as “real property.”<sup>176</sup>

However, lower courts still grapple with the coexistence of the definitions in § 101 and the antimodification provision in § 1322(b)(2). The addition of § 101(13A)(B) troubles courts because it, in effect, broadened the scope of § 1322(b)(2) to prohibit modification of obligations owed to creditors holding security interests in residential structures such as condos and mobile homes, despite the fact that the debtor does not own, and the creditor does not hold a lien upon, the real property upon which the structures are located.<sup>177</sup> Today’s home lending market has evolved to increasingly include loans for the purchase of manufactured housing, such as mobile homes.<sup>178</sup> Thus, applying the definition of “debtor’s principal residence” as stated in § 101(13A)(B) to § 1322(b)(2) would “encourage the flow of capital into the home lending market”<sup>179</sup> and make the Bankruptcy Code consistent.

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<sup>171</sup> *Scarborough*, 461 F.3d at 412.

<sup>172</sup> 11 U.S.C. § 101 (2006).

<sup>173</sup> *Id.*

<sup>174</sup> *Id.*

<sup>175</sup> *See Lynn*, *supra* note 169, at 30.

<sup>176</sup> *See id.*

<sup>177</sup> *See generally In re Shepherd*, 354 B.R. 505 (Bankr. E.D. Tenn. 2006).

<sup>178</sup> *See Lynn*, *supra* note 169, at 30.

<sup>179</sup> *See Statement of Edward Kulik*, *supra* note 102, at 19709.

Broadening the antimodification provision to include mortgages that fall outside of the debtor's principal residence would interfere with chapter 13's availability to debtors seeking relief.<sup>180</sup> Some circuits have only applied the antimodification provision when the creditor's security interest lies solely in the real property in which the debtor resides.<sup>181</sup> Living in one unit and leasing or renting out another unit on the same piece of property is simply not enough to prevent bifurcation of a mortgage into a secured and unsecured claim.<sup>182</sup>

#### 4. *Emphasis on Res Judicata Effect of Plan Confirmation*

A small minority of courts has considered that confirmation of a chapter 13 plan precludes a subsequent objection by a lender.<sup>183</sup> This almost always arises when a secured creditor holds a security interest in real property that is the debtor's principal residence and that creditor fails to object to the debtor's proposed plan, which modified the mortgage on the residence.

"In rare circumstances, the res judicata effect of a confirmed chapter 13 plan can effectively avoid a creditor's lien or modify its in rem rights even if there *is no valid legal basis* for doing so, provided that the plan does so explicitly and due process considerations are met."<sup>184</sup> Due process considerations entail receiving notice under the standards set forth in *Mullane*

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<sup>180</sup> Bank of Va. v. Lindamood (*In re Lindamood*), 34 B.R. 330, 332 (Bankr. W.D. Va. 1983).

<sup>181</sup> Compare *Scarborough v. Chase Manhattan Mortgage Corp.* (*In re Scarborough*), 461 F.3d 406, 411 (3d Cir. 2006) ("[S]ection 1322(b)(2) protects claims secured only by a security interest in real property that is the debtor's principal residence, not real property that includes or contains the debtor's principal residence, and not real property on which the debtor resides.") (quoting *In re Adebajo*, 165 B.R. 98, 104 (Bankr. D. Conn. 1994)) with *In re Macaluso*, 254 B.R. 799, 800 (Bankr. W.D.N.Y. 2000) ("[T]he statute does not limit its application to property that is used only as a principal residence, but refers generally to any parcel of real property that the debtor uses for that purpose.") and *In re Guilbert*, 176 B.R. 302, 305 (Bankr. D.R.I. 1995) ("[T]he language of § 1322(b)(2) [in no way implies] that if the debtor's principal residence is also used to house other tenants, paying or otherwise, that [the mortgagee's claim] may be open to modification by the homeowner.") (alteration in original). See also *Scarborough*, 461 F.3d at 408 (The debtor could modify the mortgage on his residence when the debtor converted the residence into a multiunit dwelling and rented out one of the units.).

<sup>182</sup> See, e.g., *Scarborough*, 461 F.3d at 414; *Lomas Mortgage v. Louis*, 82 F.3d 1, 4 (1st Cir. 1996) (modification of a secured claim on a multiunit property is not barred when the debtor's principal residence is one unit and security interest extends to the other units); *In re McGregor*, 172 B.R. 718 (Bankr. D. Mass. 1994) (under § 1322(b)(2), a claim secured by four-unit apartment building, in which debtor resided in one unit, could be bifurcated into secured and unsecured claims).

<sup>183</sup> See *In re Thaxton*, 335 B.R. 372 (Bankr. N.D. Ohio 2005); *Great Lakes Higher Educ. Corp. v. Pardee* (*In re Pardee*), 193 F.3d 1083 (9th Cir. 1999).

<sup>184</sup> *Ventura Tax Collector v. Brawders* (*In re Brawders*), 325 B.R. 405, 407 (B.A.P. 9th Cir. 2005) (emphasis added).

v. *Central Hanover Bank*.<sup>185</sup> After receiving notice of the proposed plan and confirmation hearing, the creditor has a certain amount of time to object to the plan.<sup>186</sup>

A bankruptcy court in the Northern District of Ohio held that a creditor's failure to act should bar it from bringing an objection thus penalizing the creditor for its inaction.<sup>187</sup> The court rejected the plain language of the Bankruptcy Code.<sup>188</sup> The court placed more weight on § 1327(a) than on the antimodification provision.<sup>189</sup> The belief is that the creditor's disregard of the court's procedural requirements, regardless of the merits of the claim, should be given *res judicata* effect.<sup>190</sup>

Even if the Bankruptcy Code would not permit certain provisions of the plan, the finality of a confirmed plan will be recognized.<sup>191</sup> Therefore, to challenge a provision of the plan, a creditor must timely object to the plan in the given time period.<sup>192</sup> This raises a potential conflict between the bankruptcy court, trustee, and nonobjecting secured creditor. If the bankruptcy

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<sup>185</sup> *Mullane v. Cent. Hanover Bank & Trust Co.*, 339 U.S. 306, 314 (1950) (requiring that a creditor receive notice that is reasonably calculated, under all the circumstances, to apprise the creditor that its rights may be altered); see also Leann Rosnick, *A Measure of Harmony: The Orchestration of Rule 32(h) with the "Discordant Symphony" of Booker*, 57 DUKE L.J. 231, 253–54 (2007).

<sup>186</sup> FED. R. BANKR. P. 3015(f).

<sup>187</sup> See *Thaxton*, 335 B.R. at 374; see also *Heins v. Ruti-Sweetwater, Inc. (In re Ruti-Sweetwater, Inc.)*, 836 F.2d 1263, 1267 (10th Cir. 1988) (“[C]reditors are obligated to take an active role in protecting their claims.”); *Factors Funding Co. v. Fili (In re Fili)*, 257 B.R. 370, 373 (B.A.P. 1st Cir. 2001) (creditor disregards at its own risk a notice that its rights and interests may be altered); *Khabbaz v. Sallie Mae Servicing Corp. (In re Khabbaz)*, 264 B.R. 204, 209 (Bankr. N.D. Iowa 2001) (creditors have the option to object if they believe treatment of claims does not meet expectations, but failure to object leads to possibly being bound by undesirable terms); *Lawrence Tractor Co. v. Gregory (In re Gregory)*, 19 B.R. 668, 670 (B.A.P. 9th Cir. 1982), *aff'd*, 705 F.2d 1118 (9th Cir. 1983) (“At such a late point in [the bankruptcy proceeding], a meaningful modification of the plan is difficult . . . and the objecting creditor is in a position to circumvent the protective shield provided debtors under Chapter 13.”).

<sup>188</sup> *Thaxton*, 335 B.R. 372 (holding that the creditor's failure to timely object to the plan's language, which provided lower arrearage payments than agreed to in the relevant documents, precludes the creditor from objecting now).

<sup>189</sup> 11 U.S.C. § 1327 (2006) (“The provisions of a confirmed plan bind the debtor and each creditor, whether or not the claim of such creditor is provided for by the plan, and whether or not such creditor has objected to, accepted, or rejected the plan.”). Section 1327(a) serves essentially the same purpose as the doctrine of *res judicata*. 5 COLLIER ON BANKRUPTCY ¶ 1327.01[1] (Lawrence P. King ed., 1996).

<sup>190</sup> See *Thaxton*, 335 B.R. at 375.

<sup>191</sup> *Great Lakes Higher Educ. Corp. v. Pardee (In re Pardee)*, 193 F.3d 1083 (9th Cir. 1999) (stating that the creditor has a duty to object to any word or phrase that it is opposed to in a proposed plan).

<sup>192</sup> *In re Wegscheid*, 361 B.R. 144, 147 (Bankr. D. Ariz. 2007); see also *Andrews v. Loheit (In re Andrews)*, 49 F.3d 1404 (9th Cir. 1995) (secured creditor's failure to object to the plan is acceptance of the plan).

court and trustee do not comply with Bankruptcy Code requirements when approving the plan, each party has not fulfilled its obligations.<sup>193</sup> Thus, even if no objections are made by creditors, the bankruptcy court still holds an independent duty to examine the plan for compliance.<sup>194</sup> However, notwithstanding the court's inherent obligation, the affirmative duty to object to a plan lies in the hands of the creditor.<sup>195</sup>

The interplay of different sections in the Bankruptcy Code bestows upon courts the opportunity to emphasize one statute over another to decide a particular way. The *Nobelman* Court intended to impose a literal interpretation of § 1322(b)(2), but the opinion failed to precisely identify and explain how courts implement the decision. On the other hand, a very similar statute to § 1322(b)(2) under chapter 12 of the Bankruptcy Code has not created such ambiguity and inconsistency.<sup>196</sup> It is important to view similar sections in different chapters to understand how the Bankruptcy Code can be improved. Congress should consider the history behind enacting chapter 12 in the midst of the farming crisis and address the subprime crisis by amending § 1322(b)(2) of the Bankruptcy Code.

#### V. COROLLARY OF § 1322(B)(2) TO OTHER SECTIONS IN THE BANKRUPTCY CODE

The antimodification clause of § 1322(b)(2) applies only to the mortgage on the debtor's primary residence.<sup>197</sup> Therefore, people who own multiple homes may get relief from their mortgages on vacation or investment homes.<sup>198</sup> Further, the antimodification provision does not apply to those debtors filing under chapter 11, business owners of commercial real estate, or debtors filing under chapter 12, which is the section of the Bankruptcy Code under which family farmers file.<sup>199</sup>

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<sup>193</sup> See *In re Szostek*, 886 F.2d 1405, 1414 (3d Cir. 1989).

<sup>194</sup> See, e.g., *id.*; *In re Steinhorn*, 27 B.R. 43 (Bankr. S.D. Fla. 1983); *In re Lucas*, 3 B.R. 252 (Bankr. S.D. Cal. 1980) (holding that bankruptcy courts maintain the responsibility for determining whether a debtor's plan meets Code requirements).

<sup>195</sup> See *Szostek*, 886 F.2d at 1414 (holding that a confirmed plan not complying with 11 U.S.C. § 1325(a)(5)(B)(ii), the present value provision, will not be vacated because of the inconsistency with policy favoring the finality of confirmed plans).

<sup>196</sup> See 11 U.S.C. § 1222(b)(2) (2006).

<sup>197</sup> See *supra* note 166.

<sup>198</sup> Mark Huffman, *Tweaking Bankruptcy Law Could Reduce Foreclosures*, CONSUMER AFF., Nov. 9, 2007, [http://www.consumeraffairs.com/news04/2007/11/foreclosure\\_bankruptcy.html](http://www.consumeraffairs.com/news04/2007/11/foreclosure_bankruptcy.html).

<sup>199</sup> See notes 166 & 202.

The corresponding provision to § 1322(b)(2) in chapter 11 is § 1123(b)(5).<sup>200</sup> The language in § 1123(b)(5) is identical to that in § 1322(b)(2), exempting mortgages secured by the debtor's principal residence from modification.<sup>201</sup> The drafters anticipated that this provision in chapter 11 would be necessary in the case that individuals filed under chapter 11 as opposed to chapter 13.<sup>202</sup> However, § 1123(b)(5) "does not apply to a commercial property, or to any transaction in which a creditor acquired a lien on property other than real property used as the debtor's residence."<sup>203</sup> Thus, the statute imposes no analogous exemption on mortgages for a company's principal place of business or any other business-related property.<sup>204</sup> If the drafters wanted consistency in the Bankruptcy Code, it would only seem natural to have an analogous provision in the business bankruptcy context, exempting a business's mortgage on its principal place of business from modification.

Chapter 12 also contains a corresponding provision to § 1322(b)(2), but the chapter 12 provision is much more lenient to the debtor than the chapter 11 and 13 provisions.<sup>205</sup> The chapter 12 statute allows modification of a mortgage on the debtor's principal residence if it is located on the family farm.<sup>206</sup> Chapter 12 was temporarily added to the Bankruptcy Code in the mid-1980s to provide additional protections to farmers during the farm crisis.<sup>207</sup> The temporary

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<sup>200</sup> See 11 U.S.C. § 1123(b)(5).

<sup>201</sup> Compare *id.* ("[A] plan 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, or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims.") with *id.* § 1322(b)(2).

<sup>202</sup> See Baxter Dunaway, *Effect of the Bankruptcy Reform Act of 1994 on Real Estate*, 30 REAL PROP. PROB. & TR. J. 601, 636 (1996).

<sup>203</sup> *Id.* (citing H.R. REP. NO. 103-835, at 46 (1994), reprinted in 1994 U.S.C.C.A.N. 3340, 3354–55).

<sup>204</sup> Rao, *supra* note 41, at 5 n.11.

<sup>205</sup> Compare 11 U.S.C. § 1222(b)(2) with *id.* § 1322(b)(2) and *id.* § 1123(b)(5) (Chapter 12's reorganization powers exceed those in chapters 11 and 13.). See also Susan A. Schneider, *Bankruptcy Reform and Family Farmers: Correcting the Disposable Income Problem*, 38 TEX. TECH L. REV. 309, 325 n.126 (2006).

<sup>206</sup> See 11 U.S.C. § 1222(b)(2) ("[A] plan may modify the rights of holders of secured claims, or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims.").

<sup>207</sup> See, e.g., Mike Lowry, Note, *A New Paint Job on an '85 Yugo: BAPCPA Improves Chapter 12 But Will It Really Make a Difference?*, 12 DRAKE J. AGRIC. L. 231, 232 (2007); Alexander Williams III, Note, *More Assistance Please: Lifting the Cuban Embargo May Help Revive American Farms*, 7 DRAKE J. AGRIC. L. 455, 464 (2002) (explaining that the legislation helped revive and rejuvenate the farm economy).

measure was designed to phase out by the seven-year sunset clause, but Congress extended chapter 12 several times to protect the farming economy.<sup>208</sup>

Evidenced by the temporary enactment of chapter 12 in the mid-1980s, politicians had become impassioned about ending the “plight of the American farmer.”<sup>209</sup> Some congressional representatives urged their colleagues to keep chapter 12 as a safety net for family farmers because family farms represent an important part of America’s economy and heritage.<sup>210</sup> Congress made chapter 12 an official part of the Bankruptcy Code under the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (“BAPCPA”).<sup>211</sup>

Although the farming industry has dissipated somewhat since the farm crisis and only a small percentage of farmers have even filed for bankruptcy under chapter 12, it still provides meaningful relief.<sup>212</sup> A study of chapter 12 cases filed in Iowa revealed that nearly three-quarters of the farmers who filed for bankruptcy in the midst of the farm crisis were operating the family farm in 1994.<sup>213</sup> If nothing else, the temporary relief at least helped stabilize a farming industry declining because of foreclosures.<sup>214</sup>

The temporary relief, and later enactment of chapter 12, demonstrates that a change in the Bankruptcy Code can be extremely advantageous to suffering debtors. The farm crisis of the mid-1980s is comparable to the subprime market crisis currently affecting the United States.<sup>215</sup> Although the measures

<sup>208</sup> See Lowry, *supra* note 207, at 243; Jacob E. Gersen, *Temporary Legislation*, 74 U. CHI. L. REV. 247, 247 (2007) (Sunset clauses limit the duration of the legislation’s own validity by setting a date on which the statutory scheme will terminate unless the legislature takes affirmative action to extend this time.).

<sup>209</sup> Katherine M. Porter, *Phantom Farmers: Chapter 12 of the Bankruptcy Code*, 79 AM. BANKR. L.J. 729, 731 (2005). See also *id.* at 731 n.16, stating

The numbers of farms in financial trouble or on the brink of foreclosure is well known. But the measure of the crisis in agriculture isn’t measured by cold numbers on a page. Instead, I measure it in terms of the human tragedy, the disruption of lives, and the despair of being a middle-aged farmer suddenly told to find another livelihood to support a family. . . . We must stop the bleeding on the farm.

(quoting 132 CONG. REC. 515074-05 (Oct. 3, 1986) (statement of Sen. Grassley)).

<sup>210</sup> Lowry, *supra* note 207, at 245–46 (citing 143 CONG. REC. S7607 (daily ed. July 16, 1997) (statement of Sen. Grassley)).

<sup>211</sup> Porter, *supra* note 209, at 729.

<sup>212</sup> See *id.* at 744.

<sup>213</sup> See *id.* (citing SCOTT L. HIPPEL & NEIL E. HARL, *THE EXPERIENCE OF CHAPTER 12 BANKRUPTCY FILERS IN IOWA* 47 (1995)).

<sup>214</sup> John C. Pietila, “[W]e’re Doing This to Ourselves”: *South Dakota’s Anticorporate Farming Amendment*, 27 J. CORP. L. 149, 151 (2001).

<sup>215</sup> *Legislative Update: ABI Directors Testify Before Congress*, *supra* note 29 (testimony of John Rao).

taken in enacting chapter 12 should be closely followed in implementing some of the changes necessary today, the detail concerning a sunset provision remains a debated topic amongst the proposed bankruptcy bills.<sup>216</sup>

Admittedly, the Bankruptcy Code will not be able to remedy all of the problems caused by the subprime mortgage crisis given its complexity, just as federal bankruptcy law could not solve every problem intertwined in the farming crisis.<sup>217</sup> Just as the Bankruptcy Code was amended to deal with the farmers' grievances, amendments to the antimodification provision in § 1322(b)(2) should be implemented to redress the suffering homeowners' grievances.

## VI. CONGRESSIONAL BILLS TO ALLEVIATE SOME OF THE SUBPRIME MESS

Many different parties contributed to the subprime mortgage crisis. The government, financial institutions, mortgage lenders, and certain homeowners are all partially culpable. To help put an end to the subprime mortgage crisis, all parties involved, and even some others, must intervene. Many different parties have already taken action to better manage the crisis, but the latest housing rescue bill, passed by Congress and approved by President Bush, falls short of alleviating the subprime mess.<sup>218</sup> Prior to enactment of The Housing and Economic Recovery Act, Bank of America acquired Countrywide Financial,<sup>219</sup> and the Bush Administration implemented the HOPE NOW Plan<sup>220</sup> and Project Lifeline.<sup>221</sup> The Federal Reserve conducted open market operations and granted loans through the discount window to ensure that member banks have access to funds to meet the strong demand for liquidity while lowering the interest rates charged to member banks for short-term loans.<sup>222</sup> Some mortgage lenders started reaching out to homeowners to offer

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<sup>216</sup> See *infra* note 247.

<sup>217</sup> See Porter, *supra* note 209, at 745.

<sup>218</sup> See Housing and Economic Recovery Act of 2008, Pub. L. No. 110-289, 122 Stat. 2654 (2008).

<sup>219</sup> See Ivry, *supra* note 2.

<sup>220</sup> Press Release, The White House, President George W. Bush, Fact Sheet: Helping American Families Keep Their Homes (Dec. 6, 2007), available at <http://www.whitehouse.gov/news/releases/2007/12/20071206-7.html> [hereinafter White House Dec. 6, 2007 Press Release].

<sup>221</sup> Damian Paletta & James R. Hagerty, *Banks Boost Their Efforts to Head Off Foreclosures*, WALL ST. J., Feb. 12, 2008, at A3.

<sup>222</sup> Central banks had to step in because banks became reluctant to lend to each other as the uncertainty mounted over who would pay the bill for the United States subprime mortgage collapse. Loans through the discount window differ from open market operations because they can be made against a wider variety of collateral. However, both are similar in that they provide banks with liquidity, not risk capital. See, e.g., Ben

loan modification and refinancing in an effort to avoid foreclosure, since foreclosure is costly, lengthy, and inefficient for every homeowner and lender involved.<sup>223</sup>

The Bush Administration implemented the HOPE NOW Plan and Project Lifeline to help struggling homeowners on the brink of foreclosure.<sup>224</sup> The HOPE NOW Plan attempted to help individual homeowners who have ARMs<sup>225</sup> by freezing the current interest rate, which would prevent it from rising to a level that would surpass the mortgagor's ability to pay.<sup>226</sup> The Bush Administration prodded six major mortgage lenders, who together service about half of the United States' mortgage market, to participate in Project Lifeline.<sup>227</sup> The process commences when a participating mortgage lender contacts those borrowers who are overdue by more than ninety days on their home mortgages.<sup>228</sup> In some instances, the mortgage lender would pause foreclosure proceedings for thirty days while the borrower and lender negotiate affordable terms for the mortgage payment.<sup>229</sup> This program was intended to aid both subprime and prime mortgage borrowers. The only homeowners who did not qualify for Project Lifeline are homeowners in bankruptcy, homeowners with a foreclosure sale date set within thirty days, and those homeowners who purchased their home as an investment.<sup>230</sup> However, these two initiatives seemed to fail as a result of most mortgage lenders not taking action to start the process.

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Bernanke, Chairman, Bd. of Governors of the Fed. Reserve Sys., Speech at the Economic Club of New York: The Recent Financial Turmoil and its Economic and Policy Consequences, (Oct. 15, 2007), available at <http://federalreserve.gov/newsevents/speech/bernanke20071015a.htm>; *Down the Drain*, ECONOMIST, Sept. 6, 2007.

<sup>223</sup> Noelle Knox & Sue Kirchhoff, *Criticism Rains Down on Mortgage Industry*, USA TODAY, Oct. 23, 2007, [http://www.usatoday.com/money/economy/housing/2007-10-23-mortgages-refinance\\_N.htm](http://www.usatoday.com/money/economy/housing/2007-10-23-mortgages-refinance_N.htm); see also *Why Congress is Unlikely to Act Soon on Foreclosures*, WALL ST. J., Sept. 4, 2007, at D4 (Senator Charles Schumer, the co-sponsor of Senate Bill 2136, urged people on the ground to help innocent homeowners on the edge of foreclosure refinance while they still could.).

<sup>224</sup> White House Dec. 6, 2007 Press Release, *supra* note 220 (implementing HOPE NOW Plan should assist nearly 1.2 million homeowners); see also Paletta & Hagerty, *supra* note 221.

<sup>225</sup> See *supra* notes 27–30.

<sup>226</sup> White House Dec. 6, 2007 Press Release, *supra* note 220.

<sup>227</sup> See Paletta & Hagerty, *supra* note 221 (The six major U.S. mortgage lenders include Bank of America Corp., Citigroup, Inc., Countrywide Financial Corp., J.P. Morgan Chase & Co., Washington Mutual, Inc., and Wells Fargo & Co.).

<sup>228</sup> *Id.*

<sup>229</sup> *Id.*

<sup>230</sup> *Id.* But see Mallory Simon, *Can 'Project Lifeline' Help Troubled Homeowners or Will It Flatline?*, CNN.COM, Feb. 14, 2007, <http://www.cnn.com/2008/LIVING/homestyle/02/14/project.lifeline/index.html>.

After many bills were introduced in the House of Representatives and Senate to combat this crisis, both the House and Senate approved The Housing and Economic Recovery Act of 2008.<sup>231</sup> Initially, President Bush maintained his ground by vetoing the Act, but he decided to sign it at the end of July 2008 much to the chagrin of some.<sup>232</sup> The worsening of the housing and credit crises surely added to the pressure on President Bush to sign the bill; however, this Act is far from the long-term solution necessary to truly resolve the subprime mortgage crisis. Still, Congress must act to secure a more effective long-term solution for this crisis. It is too late in the game to reverse the damage done to both borrowers and lenders, but some adjustments will lessen future devastation, especially as it relates to foreclosures and bankruptcies. Adopting new legislation to amend the antimodification provision of § 1322(b)(2) is a very promising next step.

#### A. *Congressional Action*

Republicans and Democrats have introduced bills in both the Senate and the House to combat the subprime mess and rising rate of foreclosures.<sup>233</sup> As with many contentious political issues, there was not a congressional consensus on how to effectively curb the crisis and stop or slow down foreclosures, until House Speaker Nancy Pelosi proposed the Housing and Economic Recovery Act of 2008.<sup>234</sup> Some of the earlier proposed bills attempted to address the foreclosure problem through the refinancing of potential at-risk subprime borrowers thus preserving liquidity in the mortgage lending markets.<sup>235</sup> Other bills attacked the rising foreclosure problem by treating mortgages differently in bankruptcy.<sup>236</sup>

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<sup>231</sup> Jeanne Sahadi, *Bush Signs Housing Rescue Law*, CNN MONEY, July 30, 2008, [http://money.cnn.com/2008/07/30/news/economy/housing\\_bill\\_Bush/index.htm?postversion=2008073011](http://money.cnn.com/2008/07/30/news/economy/housing_bill_Bush/index.htm?postversion=2008073011).

<sup>232</sup> *Id.*

<sup>233</sup> *See infra* notes 235–36.

<sup>234</sup> *See* Housing and Economic Recovery Act of 2008, Pub. L. No. 110-289, 122 Stat. 2654 (2008).

<sup>235</sup> Senator Charles Schumer first introduced the Protecting Access to Safe Mortgages Act on September 10, 2007 but introduced an amended version of the same bill with a different name on November 13, 2007. *See* Protecting Access to Safe Mortgages Act, S. 2036, 110th Cong. (2007); Promoting Refinancing Opportunities for Mortgages Impacted by the Subprime Emergency Act of 2007, S. 2346, 110th Cong. (2007). The Protecting Access to Safe Mortgages Act was introduced in the House on October 9, 2007 by Representative Melissa Bean, but a very similar bill to Senator Schumer's amended bill was introduced in the House on October 16, 2007. *See* Protecting Access to Safe Mortgages Act, H.R. 3777, 110th Cong. (2007); Promoting Refinancing Opportunities for Mortgages Impacted by the Subprime Emergency Act of 2007, H.R. 3838, 110th Cong. (2007).

<sup>236</sup> *See, e.g.*, Home Owners' Mortgage and Equity Savings Act, S. 2133, 110th Cong. (2007); Helping Families Save Their Homes in Bankruptcy Act of 2007, S. 2136, 110th Cong., (2007); HOMES Act, H.R.

### 1. *The Housing and Economic Recovery Act*

The Housing and Economic Recovery Act (the “Act”) was created to help homeowners stave off foreclosure and keep Fannie Mae and Freddie Mac operating near full strength.<sup>237</sup> The program started October 1, 2008 and expires after three years. Lawmakers project that the Act will help an estimated 400,000 homeowners avoid foreclosure by refinancing the home mortgage into a thirty-year fixed-rate loan, which would be backed by the Federal Housing Authority.<sup>238</sup> Additionally, the Act provides for a \$180 million financial counseling program for homeowners facing foreclosure.<sup>239</sup> The Act also attempts to aid some of the hardest hit neighborhoods by granting these communities \$4 billion to buy and renovate foreclosed homes.<sup>240</sup>

To qualify for the Act’s benefits, homeowners must meet specific requirements. Homeowners must spend more than thirty-one percent of their monthly incomes on their mortgages and use the homes as their primary residences.<sup>241</sup> They also must agree to share any profits with the government if they later sell their homes.<sup>242</sup> Lastly, lenders have the discretion of whether to restructure the subprime loan, which means that the least promising loans are the only ones that the government will step in to insure.

### 2. *Bills Preserving Liquidity in the Mortgage Lending Market*

The Promoting Refinancing Opportunities for Mortgages Impacted by the Subprime Emergency Act (“PROMISE Act”), which has been introduced in both the House and Senate, proposes to increase the portfolio caps of certain government-sponsored enterprises responsible for securitizing pools of subprime mortgages and then sell them to investors to facilitate refinancing of subprime loans into safer, more affordable loans.<sup>243</sup> These bills also contain

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3778, 110th Cong. (2007); Emergency Home Ownership and Mortgage Equity Protection Act of 2007, H.R. 3609, 110th Cong. (2007).

<sup>237</sup> 122 Stat. 2654.

<sup>238</sup> *Id.*

<sup>239</sup> *Id.*

<sup>240</sup> *Id.*

<sup>241</sup> *Id.*

<sup>242</sup> *Id.*

<sup>243</sup> The PROMISE Act has no direct relation to bankruptcy law, but is important to ensure that liquidity is available in the subprime market as mortgages are restructured. H.R. 3778; S. 2346; *but see* Neil Adler, *Lifting Portfolio Cap Could Hurt Fannie, Freddie*, WASH. BUS. J., Oct. 5, 2007, <http://washington.bizjournals.com/washington/stories/2007/10/08/story6.html> (speculating that expanding their portfolios to take on too much risk could certainly affect their financial results).

some of the congressional findings on the anticipated number of foreclosures and the impact that the high number of foreclosures will have on the economy.<sup>244</sup> As a result of the enactment of the Housing and Economic Recovery Act, these bills are irrelevant because the new legislation explicitly gives the government's backing to Fannie Mae and Freddie Mac to rescue both companies if necessary, either through loans or by infusing them with capital.<sup>245</sup>

### 3. *Altering the Treatment of Subprime Mortgages in Bankruptcy*

Congressional leaders introduced two bills in both the Senate and House that relate directly to § 1322(b)(2) of the Bankruptcy Code.<sup>246</sup> However, Representative Conyers, a member of the House Judiciary Committee, amended Representative Miller's bill, the Emergency Home Ownership and Mortgage Equity Protection Act of 2007; subsequently, the Committee on the Judiciary approved Representative Conyers's amended bill.<sup>247</sup> With the introduction of multiple bills in both houses, Congress recognized the urgency of modifying § 1322(b)(2).

#### a. *Helping Families Save Their Homes in Bankruptcy Act*

Senator Durbin introduced the Helping Families Save Their Homes in Bankruptcy Act of 2007 on October 3, 2007.<sup>248</sup> Senator Durbin's bill is broader in scope than the other bills because it extends its protections past the subprime mortgage crisis by granting debtors extra protections in bankruptcy that have not been otherwise provided.<sup>249</sup> Further, the bill does not contain a sunset provision or limitation based on the mortgage origination date.<sup>250</sup> The bill also attempts to minimize foreclosures by amending portions of § 1322(b), but does not add to or alter the wording of § 1322(b)(2) in any way.<sup>251</sup> Instead, it permits a bankruptcy plan to modify the mortgage if the debtor has

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<sup>244</sup> See S. 2346; H.R. 3778 (stating that foreclosures are expected to increase as ARMs reset to higher rates and financing for all mortgages could be threatened if there is a continued lack of liquidity in the subprime mortgage market).

<sup>245</sup> 122 Stat. 2654.

<sup>246</sup> See *infra* Parts VI.A.3.a–c.

<sup>247</sup> 153 CONG. REC. H11,261-67 (2007).

<sup>248</sup> See 153 CONG. REC. S12,533-01 (2007). Senator Specter introduced the Home Owners' Mortgage and Equity Savings Act to the Senate the same day. *Id.*

<sup>249</sup> Helping Families Save Their Homes in Bankruptcy Act of 2007, S. 2136, 110th Cong. (2007).

<sup>250</sup> *Id.*

<sup>251</sup> *Id.*

insufficient income to cure arrearages and make mortgage payments.<sup>252</sup> If modification of the mortgage is permitted, the plan may adjust the rate of interest, as determined by the bankruptcy court, and the term of years to pay off the mortgage, not to exceed thirty years from the date of origination.<sup>253</sup> Lastly, under this bill, debtors are allowed a waiver of the prepayment penalty in the chapter 13 plan, even if the requirements to modify the mortgage are not met.<sup>254</sup>

Senator Durbin's bill allows for limited modification of the home mortgage; nonetheless, it takes the most expansive approach to amend the current bankruptcy law. Even though Senator Durbin's bill accommodates debtors broadly with a number of additional protections, Representative Miller introduced a bill that takes the most radical stance on amending bankruptcy law to aid families suffering amidst the subprime crisis.<sup>255</sup>

*b. Emergency Home Ownership and Mortgage Equity Protection Act*

Since the introduction of the Emergency Home Ownership and Mortgage Equity Protection Act by Representative Miller, the bill has increased in approval as the number of cosponsors has risen fairly rapidly.<sup>256</sup> Representative Miller's bill proposes to totally eliminate the antimodification provision of § 1322(b)(2).<sup>257</sup> The bill limits the "1978 exemption that prevents federal bankruptcy courts from making modifications to the terms of a mortgage on a debtor's principal residence."<sup>258</sup> Supplementing the striking of the antimodification clause in § 1322(b)(2), the drafters decided it was necessary to amend § 1322(b) by inserting a new paragraph (11) to permit modification of claims secured by the debtor's principal residence.<sup>259</sup>

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<sup>252</sup> *Id.*

<sup>253</sup> *Id.*

<sup>254</sup> *Id.*

<sup>255</sup> Compare *id.* with Emergency Home Ownership and Mortgage Equity Savings Act of 2007, H.R. 3609, 110th Cong. (2007).

<sup>256</sup> *Id.* The cosponsors at the time of introduction included Representatives Sanchez, Frank, Maloney, and Watt. From the date of introduction until Congress sent the bill to the Committee on the Judiciary, thirty-eight Representatives cosponsored the bill. Since the bill was amended by the Committee, another twenty-seven Representatives joined as cosponsors.

<sup>257</sup> H.R. 3609.

<sup>258</sup> *Id.* (Bill proposes that "Section 1322(b)(2) of title 11, United States Code, is amended by striking 'other than a claim secured only by a security interest in real property that is the debtor's principal residence.'").

<sup>259</sup> *Id.* Adding to the Contents of the Plan:

Furthermore, like Senator Durbin's bill, Representative Miller's bill does not incorporate a sunset provision or limitation based on the date of mortgage origination.<sup>260</sup> It provides that the debtor's plan may extend the mortgage payments beyond the term of the mortgage with no limitation on the period of repayment and that the debtor may adjust the interest rate of the mortgage in accordance with the bankruptcy court ruling on this issue.<sup>261</sup> Finally, if modification of the mortgage is allowed, under this bill the debtor can waive the prepayment penalty in the chapter 13 plan.<sup>262</sup>

Of all the bills, Representative Miller's and Senator Durbin's bills propose the most liberal changes to the Bankruptcy Code.<sup>263</sup> For a change to be effective, it is not always necessary to tackle an issue with an extreme stance. Because these bills are being proposed to curtail a nationwide, and hopefully temporary, crisis, limitations on the various provisions are necessary to prevent any possible long-term abuse. Senator Specter and Representative Chabot propose a much less extreme approach to amending the Bankruptcy Code and the antimodification clause in § 1322(b)(2).<sup>264</sup>

### *c. Home Owners' Mortgage and Equity Savings Act*

The Home Owners' Mortgage and Equity Savings Act ("HOMES Act") has been introduced in both houses of Congress with one slight discrepancy between the two bills. Senator Specter's version of the bill mandates that if modification of the mortgage is permitted, the debtor and mortgage lender agree in writing to strip down the mortgage lien to the value of the home.<sup>265</sup> Representative Chabot's version of the bill allows strip down of the mortgage

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(a) Section 1322(b) of title 11, the United States Code, is amended—(1) in paragraph (10) by striking "and" at the end, (2) by redesignating paragraph (11) as paragraph (12), and (3) by inserting after paragraph (10) the following: "(11) provide for payment of allowed claims secured by the debtor's principal residence consistent with section 1325(a)(5), over a period exceeding the period permitted under section 1322(d); and"

(b) Confirmation of Plan. Section 1325(b)(5) of title 11, the United States Code, is amended by inserting "except as otherwise provided in section 1322(b)," after "(5)".

<sup>260</sup> Compare *id.* and Helping Families Save Their Homes in Bankruptcy Act of 2007, S. 2136, 110th Cong. (2007) (containing no sunset provision) with H.R. 3778 (incorporating a seven-year sunset provision beginning following the date of the Act's enactment).

<sup>261</sup> H.R. 3778.

<sup>262</sup> *Id.* Contra S. 2136 (permitting a debtor to waive the prepayment penalty in the chapter 13 plan regardless of whether modification of the mortgage is allowed).

<sup>263</sup> See H.R. 3778; S. 2136.

<sup>264</sup> See *infra* Part VI.A.2.c.

<sup>265</sup> Home Owners' Mortgage and Equity Savings Act of 2007, S. 2133, 110th Cong. (2007).

lien to the value of the home irrespective of whether the debtor and mortgage lender agree to the strip down.<sup>266</sup>

The HOMES Act proposes to modify certain mortgages if the debtor meets specific income requirements and the mortgage was initiated before September 26, 2007.<sup>267</sup> In this bill, modification would only apply to cases filed during the sunset period, which lasts seven years and starts on the date of the Act's enactment.<sup>268</sup> The principal balance will be lowered to the fair market value of the residence if the property meets certain criteria.<sup>269</sup> Other additions to paragraph (11) include permitting the waiver of applicable early repayment and prepayment penalties and voiding or delaying an increase in the interest rate of an ARM.<sup>270</sup> Lastly, the bill mandates that the Comptroller General of the United States “conduct a study to determine the impact of allowing

<sup>266</sup> H.R. 3778.

<sup>267</sup> *Id.* The Senate version proposed the following language:

Section 1322(b) of title 11, United States Code, is amended—

(1) in paragraph (2), by inserting “except as provided in paragraph (11),” after “residence,”; (2) by redesignating paragraph (11) as paragraph (12); (3) in paragraph (10), by striking ‘and’ at the end; and (4) by inserting after paragraph (10) the following: ‘(11) with respect to a claim secured by a security interest in real property initiated before September 26, 2007, that is the debtor’s principal residence, if the current monthly income of the debtor and the debtor’s spouse combined, when multiplied by 12, is less than, in the case of a debtor in a household of 1 person, 150 percent of the median family income of the applicable State for 1 earner, in the case of a debtor in a household of 2, 3, or 4 individuals, the highest median family income of the applicable State for a family of the same number or fewer individuals, or in the case of a debtor in a household exceeding 4 individuals, the highest median family income of the applicable State for a family of 4 or fewer individuals, plus \$525 per month for each individual in excess of 4 . . . .

S. 2133.

<sup>268</sup> *Id.* at § 6; H.R. 3778.

<sup>269</sup> S. 2133.

(A) modify the rights of any holder of such claim by lowering the principal amount of the loan to the fair market value of the real property securing the loan at the time of submission of the plan, to the extent that such fair market value is less than the principal amount outstanding on the loan, if such action is agreed to in writing by the debtor and the holder of the claim.

*Id.* In the Senate version of the bill, the strip down is allowed only if the debtor and lender agree in writing on the terms. *Id.* *But see* H.R. 3778 (allowing strip down of mortgage lien to the value of the home with no requirement of an agreement between debtor and lender).

<sup>270</sup> S. 2133. The amendment provided in part:

(B) waive any otherwise applicable early repayment or prepayment penalties; and (C) in any case in which the applicable rate of interest is adjustable under the mortgage contract, modify the rights of any holder of such claim, by prohibiting or delaying adjustments to the rate of interest applicable to the debt on and after the date of filing of the plan or voiding any such adjustments that occurred during the 2-year period preceding that date of filing . . . .

*Id.*

bankruptcy judges to restructure principal residence mortgages on the secondary market for mortgages” and submit a final report to Congress within 180 days of the Act’s enactment.<sup>271</sup>

The introduction of various bills in both Houses of Congress signifies the growing importance of amending the Bankruptcy Code and the antimodification clause of § 1322(b)(2). However, it is imperative that Congress enact a resolution that places some limits on debtors’ abilities to modify home mortgages while in bankruptcy. Following the proposed legislation described above, Representative Conyers and Representative Chabot, both members of the House Judiciary Committee, compromised on specific limitations and provisional language to amend Representative Miller’s bill.

*d. Conyers-Chabot Compromise Bill*

When Representative Miller’s bill, House Bill 3609, was referred to the House Judiciary Committee, Representative Conyers submitted a revised version of House Bill 3609 to the Committee.<sup>272</sup> The details of this bill are dissimilar to the amendments proposed in the original House Bill 3609.<sup>273</sup> The substituted version (“Conyers-Chabot Compromise bill”) reflected an agreement made with Representative Chabot to integrate some of his bill’s provisions while adding a few provisions Representative Conyers deemed necessary.<sup>274</sup> Representative Chabot immediately cosponsored the bill, and the House Committee on the Judiciary voted in favor of the amended version, seventeen to fifteen.<sup>275</sup>

The Conyers-Chabot Compromise bill proposes to amend § 1322(b)(2) to allow modification of mortgages on the debtor’s principal residence, but this bill differs from the four prior bills in that it specifies the only types of mortgages that may be modified are subprime mortgages and nontraditional mortgages.<sup>276</sup> For a debtor to take advantage of the mortgage modification

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<sup>271</sup> *Id.*; H.R. 3778.

<sup>272</sup> Press Release, U.S. H.R. Comm. on the Judiciary, *House Judiciary to Consider Bipartisan Subprime Mortgage Bill Compromise* (Dec. 11, 2007), available at [http://www.house.gov/conyers/news\\_hr3609.shtml](http://www.house.gov/conyers/news_hr3609.shtml).

<sup>273</sup> S. 2133; H.R. 3778.

<sup>274</sup> *House Judiciary to Consider Bipartisan Subprime Mortgage Bill Compromise*, *supra* note 272.

<sup>275</sup> Emergency Home Ownership and Mortgage Equity Protection Act of 2007, H.R. 3609, 110th Cong. (2007).

<sup>276</sup> *Id.* Nontraditional mortgages are interest-only mortgages and negatively amortized mortgages. *House Judiciary to Consider Bipartisan Subprime Mortgage Bill Compromise*, *supra* note 272. Negative amortization means that any unpaid interest is added to the amount owed on the mortgage, increasing the loan balance; after

provisions, the debtor must have insufficient current monthly income to make mortgage payments and cure arrearages, and the court must find that modification is in good faith.<sup>277</sup> Additionally, mortgage modification applies only to mortgages originating after January 1, 2000 but before the legislation's date of enactment, and would be subject to a seven year sunset provision.<sup>278</sup> If the chapter 13 debtor and mortgage qualify for modification, the debtor's plan may modify the mortgage in the following ways: high interest rates may be reduced, the term of the mortgage may be extended to a term of thirty years starting from the date of origination, the principal amount of the mortgage may be stripped down to the fair market value of the residence, and onerous prepayment penalties need not be paid.<sup>279</sup> Lastly, this bill mandates that the Comptroller General perform the same study that was required under Representative Chabot's earlier bill and report the findings to Congress no later than 180 days after the enactment of the legislation.<sup>280</sup>

In reviewing the contrasting bankruptcy-related bills, the House and Senate are not on the same path to enacting a resolution. The Senate is idle at the moment about any bankruptcy-related changes. The Conyers-Chabot compromise mustered some support in the House, and although adding a Republican to the equation looked to be the catalyst this bill needed to receive enough votes to be passed, Congress has since moved in a different direction. The route chosen will fall far short of resolving the crisis unless a bankruptcy-related bill is also passed.

Chart 1 lists and compares the various provisions of the different bills proposing to amend § 1322(b)(2) to permit modification of mortgages on a debtor's principal residence.<sup>281</sup> The earlier discussion of the bills represents the obvious disagreement concerning what needs to be done to curb foreclosures and, more importantly, to end the subprime mortgage crisis. Enactment of legislation to combat the subprime crisis is a step in the right direction, but Congress must arrive at some sort of agreement on a bankruptcy-related bill to come close to resolving the subprime mess. Representative

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making a number of payments, the debtor could owe more than he did at the beginning of the loan. FEDERAL RESERVE BOARD, *supra* note 30, at 4.

<sup>277</sup> H.R. 3609.

<sup>278</sup> *Id.*

<sup>279</sup> *Id.*

<sup>280</sup> *Id.*

<sup>281</sup> Mark S. Scarberry, *Detailed Chart Comparing Provisions of Current Bankruptcy Bills Dealing with Modification of Home Mortgages*, AM. BANKR. INST. (Dec. 2007), available at <http://www.abiworld.org/pdfs/UpdatedMortgageModificationLegislationChart.pdf>.

Sanchez is correct in stating that “[the Conyers-Chabot] compromise [bill] is an important step towards safeguarding the American dream of homeownership.”<sup>282</sup> The Conyers-Chabot compromise bill, or a bill containing similar provisions, must be passed because the antimodification provision of § 1322(b)(2) presents an insurmountable barrier to many subprime mortgage borrowers attempting to salvage their home in the midst of bankruptcy.

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<sup>282</sup> *House Judiciary to Consider Bipartisan Subprime Mortgage Bill Compromise*, *supra* note 272 (quoting Representative Linda Sanchez, Democrat, California).

CHART 1

	<b>Helping Families Save Their Homes in Bankruptcy Act of 2007</b>	<b>Emergency Home Ownership and Mortgage Equity Protection Act of 2007</b>	<b>Sen. Specter Bill, S. 2133 Rep. Chabot Bill, H.R. 3778</b>	<b>Conyers-Chabot Compromise, Amendment to H.R. 3609</b>
<b>Contains Sunset Provision</b>	No sunset provision.	No sunset provision.	Would apply only to cases filed before the sunset date, seven years after the date of enactment.	Would apply only to cases filed before the sunset date, seven years after the date of enactment.
<b>Limitation based on mortgage origination date</b>	No limitation based on time of mortgage origination.	No limitation based on time of mortgage origination.	Provisions dealing with modification of mortgages would apply only to mortgages "initiated before September 26, 2007."	Provisions dealing with modification of mortgages would apply only to mortgages securing debts incurred during period after Jan. 1, 2000 and ending on date of enactment.
<b>Limitation on antimodification provision in § 1322(b)(2)</b>	Yes. Modification would be permitted if debtor has insufficient current income to make mortgage payments and cure arrearages.	Strikes antimodification provision in § 1322(b)(2).	Yes. In certain cases the bills would permit modification, but only in specified ways. Mortgage modification permitted if debtor's and spouse's current monthly income times twelve is less than 150% of relevant median income.	Yes. In certain cases the bill would permit modification. Only nontraditional mortgages and subprime mortgages could be modified, and only if debtor has insufficient current monthly income to make mortgage payments and cure arrearages. To confirm plan, court must find that "modification is in good faith."
<b>Allows strip down of mortgage lien to the value of the home</b>	Yes, if modification is permitted. Strip down is not addressed specifically but would be permitted under the general authorization to modify.	Yes. Strip down is not addressed specifically but would be permitted under the general authorization to modify.	Specter Bill: Yes, if modification of mortgage is permitted, <i>if debtor and lender agree in writing</i> . Chabot Bill: Yes, if modification is permitted <i>with no requirement of agreement by lender</i> .	Yes, if modification of mortgage is permitted. Allows "claim for a debt ... secured by" the mortgage to be reduced to the fair market value of the property.

	<b>Helping Families Save Their Homes in Bankruptcy Act of 2007</b>	<b>Emergency Home Ownership and Mortgage Equity Protection Act of 2007</b>	<b>Sen. Specter Bill, S. 2133 Rep. Chabot Bill, H.R. 3778</b>	<b>Conyers-Chabot Compromise, Amendment to H.R. 3609</b>
<b>Allows chapter 13 plan to extend payment period beyond the terms of the mortgage</b>	Yes, if modification of mortgage is permitted. Mortgage term can be extended to thirty years from origination of mortgage.	Yes, without any express limitation on the term of years.	No.	Yes, if modification of mortgage is permitted. Allows modified mortgage to be paid by the longer term of either: term ending thirty years from origination of mortgage or period provided by original payment schedule.
<b>Allows for a change in the mortgage interest rate</b>	Yes, if modification permitted.	Yes, but not much guidance provided by the Bill.	Yes, if modification permitted. Debtor could lock in below-market teaser rate for life of mortgage or could adjust the interest rate to any rate it had during the two-year period preceding the date of filing.	Yes, if modification permitted. Plan may set interest rate. Alternatively, with respect to adjustable rate mortgage, plan may modify interest rate by "prohibiting, reducing, or delaying adjustments to such rate of interest applicable on and after the date of filing of the plan." Debtor with below-market teaser rate can lock it in for life of mortgage.
<b>Allows waiver of prepayment penalty in chapter 13 plan</b>	Yes, regardless of whether mortgage may be modified.	Yes; not stated specifically but as part of general authorization to modify mortgage.	Yes, in chapter 13 plan, but only if modification of mortgage permitted.	Yes, in chapter 13 plan, but only if modification of mortgage permitted.
<b>Requires a study to be performed by the Comptroller General of the U.S.</b>	No.	No.	Must conduct a study to determine the impact of allowing bankruptcy judges to restructure principal residence	Must conduct a study to determine the impact of allowing bankruptcy judges to restructure principal residence

			mortgages on the subprime mortgage market and submit a report to Congress within 180 days of enactment.	mortgages on the subprime mortgage market and submit a report to Congress within 180 days of enactment.
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### *B. Analysis of the Various Bills*

The five proposed bankruptcy-related bills discussed above offer a multitude of solutions to amend the antimodification provision in § 1322(b)(2).<sup>283</sup> Each included particular elements that Congress felt were necessary to allow homeowners in bankruptcy to modify their home mortgages in an effort to slow down the rising number of foreclosures. Some of the recommended elements provide meaningful solutions to the subprime crisis, while other elements are too extreme or broad to implement.

The only pending bill limiting the types of mortgages that may be modified is amended House Bill 3609. The other bills would allow chapter 13 plans to rewrite the terms of home mortgages irrespective of the original terms of the mortgage. The original House Bill 3609 takes a very aggressive stance by striking the entire modification clause.<sup>284</sup> Allowing an all-inclusive modification provision does not consider the legal and economic implications and would be detrimental to mortgage lenders. Any negative impact on mortgage lenders could only adversely affect the flow of capital into the home-lending market.<sup>285</sup>

The legislation must contain a limitation to cases filed under chapter 13, sunset provisions, and a limitation based on the date the mortgage originated. Senate Bill 2136 is too broad because it attempts to amend too many sections in the Bankruptcy Code and does not concentrate on alleviating the subprime mortgage crisis. The remaining bills focus on amending chapter 13. Furthermore, the sunset provisions give an exact time frame limiting when mortgages may be modified. Again, the purpose for proposing these bills is to resolve the crisis now; therefore, the legislators should not prolong the filing time too far into the future. Seven years is a reasonable time period because many interest rates begin steep hikes in the two to four year span after origination.

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<sup>283</sup> See *supra* Part VI.A.2.

<sup>284</sup> Housing and Economic Recovery Act of 2008, Pub. L. No. 110-289, 122 Stat. 2654 (2008).

<sup>285</sup> See Statement of Edward Kulik, *supra* note 102.

Additionally, any legislation should include the limitation based on the time of mortgage origination. The time span presented in the amended version of House Bill 3609 seems like the best possible solution because it does not extend too far back and also does not reward future reckless lending and borrowing.

As *Nobelman* clarified, bankruptcy courts do not have the authority to strip down the balance of a mortgage to the fair market value of the residence.<sup>286</sup> However, stripping down the mortgage helps the mortgagor refinance, sell the house without still owing the lender money, or build equity in the house.<sup>287</sup> Adding a clause explicitly allowing “stripping down” if modification is permitted is a necessary change, and it should be clearly provided for in the newly enacted legislation to eliminate any possible confusion in advance. Courts use their discretion in a multitude of ways, and the more litigation that arises from the passage of a subprime mortgage solution, the less effective the resolution will have been in combating the subprime mess.<sup>288</sup>

Currently, a chapter 13 plan may not provide for payments past a period of three years, unless the court approves a longer period, not to exceed five years.<sup>289</sup> Thus, along with a much needed change to the antimodification provision in § 1322(b)(2), the Conyers-Chabot Compromise bill fixes the term at thirty years from the mortgage origination date or, if longer, the original period of the mortgage.<sup>290</sup> Without this adjustment to the amortization period, monthly payments on a stripped-down loan could be too high for mortgagors to afford.<sup>291</sup> Term limitations must be set because a limitless repayment term could harm lenders, and anything longer than thirty years could be a vast change in the normal maximum mortgage term allowed by lenders.

Furthermore, as the antimodification clause is currently constructed, chapter 13 precludes bankruptcy courts from altering the interest rate.<sup>292</sup> Thus, bankruptcy courts do not have the authority to reduce incredible interest rates or convert an ARM to a fixed-rate mortgage to make it affordable and

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<sup>286</sup> See *Nobelman v. Am. Sav. Bank (In re Nobelman)*, 508 U.S. 324 (1993).

<sup>287</sup> Rao, *supra* note 41.

<sup>288</sup> This author believes that when determining the effectiveness of a piece of legislation all factors must be considered including subsequent litigation.

<sup>289</sup> See 11 U.S.C. § 1322(c) (2006).

<sup>290</sup> See Home Owners' Mortgage and Equity Savings Act of 2007, H.R. 3778, 100th Cong. (2007).

<sup>291</sup> See Rao, *supra* note 41.

<sup>292</sup> See 11 U.S.C. § 1322(b)(2).

maintainable.<sup>293</sup> All of the bills provide for a modification of the interest rate if modification is permitted, but the amended version of House Bill 3609 utilizes the best approach by synthesizing the mortgage interest rate approaches proposed by Senator Durbin, Senator Specter, and Representative Chabot.<sup>294</sup> This approach gives debtors options when adjusting their mortgages to a lower fixed rate.<sup>295</sup> Providing the debtor, who is still in the teaser rate stage, the option of locking this rate in punishes the already hurting lenders, but for policy reasons, could deter similar lending in the future.

Another provision contained in the proposed bills allows a waiver of all prepayment penalties in a chapter 13 plan. Once again, however, it is important that this provision only be allowed if modification of the mortgage is permitted and it must be clearly stated in the legislation. Senate Bill 2136 grants a prepayment penalty waiver regardless of whether the mortgage may be modified.<sup>296</sup> This automatic waiver would provide an undeserving debtor the opportunity to waive fees that the mortgage lender has a right to collect.

An integral addition that must be included in the adopted resolution relates to the Comptroller General's required study to determine the impact that restructuring mortgages has had on the subprime mortgage market. Senators Conyers and Chabot felt the same sentiment when they agreed to include it as a provision in the amended version of House Bill 3609.<sup>297</sup> This requirement will provide Congress with nearly precise statistics as to the impact that the new legislation has had on the subprime crisis and the number of foreclosures.

The bipartisan coalition of the Conyers-Chabot Compromise Bill provides a tremendous solution to the subprime mortgage lending crisis. The bill provides a perfect balance of flexibility and limitation. In terms of flexibility, the bill permits adjustment of the various mortgage terms, and in terms of limitation, the bill specifies the types of mortgages that qualify for modification and the sunset provision period.<sup>298</sup>

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<sup>293</sup> See Rao, *supra* note 41.

<sup>294</sup> See Emergency Home Ownership and Mortgage Equity Protection Act of 2007, H.R. 3609, 110th Cong. (2007); H.R. 3778.

<sup>295</sup> Option one is setting the interest rate at the prime rate plus risk premium. Helping Families Save Their Homes in Bankruptcy Act of 2007, S. 2136, 110th Cong. (2007). Option two allows a debtor who is at the teaser rate to lock that in for the life of the mortgage. Home Owners' Mortgage and Equity Savings Act of 2007, S. 2133, 110th Cong. (2007); H.R. 3778. Option three gives the debtor with an ARM the opportunity to adjust the interest rate from that on the day of filing. *Id.*

<sup>296</sup> See S. 2136.

<sup>297</sup> *House Judiciary to Consider Bipartisan Subprime Mortgage Bill Compromise*, *supra* note 272.

<sup>298</sup> H.R. 3609.

## CONCLUSION

Subprime mortgages and the foreclosures associated with these risky mortgages are the focus of the media outlets as America spirals deeper into the subprime mortgage crisis. The severe scourge of home losses harms not only those losing their homes, but also lenders, neighborhoods, financial institutions, and the entire United States economy. While there are many to blame for the crisis, Congress enabled the subprime crisis to occur by not bridging the gap between growing housing market trends and bankruptcy law, and therefore, has an obligation to help alleviate the situation.

Congress and President Bush approved the Housing and Economic Recovery Act in an attempt to stabilize the housing market for the short term.<sup>299</sup> There is a strong likelihood that a few hundred thousand homeowners facing foreclosure will not lose their homes, but the outlook is bleak on this bill making a substantial difference. The lender has the discretion to refinance the loan; this does not guarantee that those in danger of foreclosure will benefit. According to chief global strategist, Peter Schiff, “the new law will actually encourage lenders to be even more reckless . . . . [T]he government is telling lenders not to worry about the loans they make, because if borrowers do not repay, the government will.”<sup>300</sup>

Aside from causing lenders to become more reckless, the Housing and Economic Recovery Act does not even remotely curtail the subprime crisis. Many homeowners on the brink of foreclosure have a second or even third mortgage on their residence.<sup>301</sup> Second and third mortgages are hindrances and make restructuring a loan difficult. Additionally, this enacted legislation does not give homeowners in bankruptcy any recourse. Congress took a step in the right direction with the enactment of this bill, but to more sufficiently resolve the subprime crisis Congress must pass a bankruptcy-related bill modifying § 1322(b)(2).

Chapter 13 permits debtors to modify the rights of all creditors except for one type, the mortgage lender. “Bankruptcy courts are currently powerless to defer or change [subprime mortgage] payments as that would be a modification

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<sup>299</sup> Housing and Economic Recovery Act of 2008, Pub. L. No. 110-289, 122 Stat. 2654 (2008).

<sup>300</sup> Peter Schiff, *Congress Taps Paulson's Helmet*, FIN. SENSE U., July 25, 2008, <http://www.financialsense.com/fsu/editorials/schiff/2008/0725.html>.

<sup>301</sup> Henry Savage, *Mortgage Q&A: Homeowner Bailout Bill Questioned*, WASH. TIMES, Aug. 8, 2008, <http://www.washingtontimes.com/news/2008/aug/08/mortgage-qa-homeowner-bailout-bill-questioned/>.

of the mortgage not permitted under § 1322(b)(2).”<sup>302</sup> Because debtors currently cannot modify any terms in their mortgages, foreclosures are inevitable, as bankruptcy does not provide debtors with a means of refinancing the payment of this debt.

Congress’s action in the midst of the farming crisis in the mid-1980s serves as precedent that a few amendments to the Bankruptcy Code may benefit individual homeowners and the economy as a whole. Congressional leaders have introduced several bills that propose to amend the Bankruptcy Code, intending to provide some relief to distressed homeowners. This Comment urges Congress to adopt the Conyers-Chabot Compromise Bill because of its flexible but limiting elements. The specific provisions in the Conyers-Chabot Compromise bill do not overrule *Nobelman* because of the limiting restrictions and provide authority to the bankruptcy courts to modify principal residential mortgages.

Although the extremely high numbers of monthly subprime mortgage foreclosures is alarming, the worst is still ahead. With as many as two million foreclosures predicted to occur in the next two to three years, it is essential that Congress take action to assist struggling homeowners.<sup>303</sup> Congress’s adoption of the Conyers-Chabot Compromise bill, or at the very least many of the provisions therein, is necessary to combat the subprime mortgage crisis and rising rate of foreclosures.

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<sup>302</sup> *Legislative Update: ABI Directors Testify Before Congress*, *supra* note 29.

<sup>303</sup> Center for Responsible Lending, *Subprime Spillover*, *supra* note 93.

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