2009 Mortgage Modification Legislation and Cramdown under the Bankruptcy Code

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I. Cramdown under Current Bankruptcy Law-Chapter 13

A. Relevant Bankruptcy Code Provisions

§1322(b)(2): 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.

§1322(b)(5): Notwithstanding paragraph (2), the plan may provide for the curing of any default within a reasonable time and maintenance of payments while the case is pending on any....secured claim on which the last payment is due after the date on which the final payment under the plan is due.

§101(13A): The term "debtor's principal residence" - (A) means a residential structure, including incidental property, without regard to whether that structure is attached to real property; and (B) includes an individual condominium or cooperative unit, a mobile or manufactured home or trailer.

§506(a), (d): Under certain circumstances, the claim of a secured creditor may be bifurcated into a secured claim (the value of the collateral) and an unsecured claim (deficiency) claim.

B. Cramdown

1. Under current bankruptcy law, a chapter 13 plan may modify the rights of the holders of secured claims, except the rights of the holder of a claim secured only by a security interest in real property that serves as the principal residence of the debtor. §1322(b)(2). Thus, once it is determined that a creditor is a holder of a secured claim against residential property that is **not** the debtor's principal residence, the debtor may modify the rights of the creditor. The extent to which the chapter 13 plan may modify the rights of creditors depends upon the application of §1322(b)(5) in each particular case. The modification of a secured creditor's rights is referred to as a **cramdown.**

2. The most common cramdown involves the bifurcation of the creditor's claim into a secured portion (the value of the collateral as of the plan confirmation date) and an unsecured portion (the deficiency). The creation of the

unsecured deficiency claim is referred to as "lien stripping." The debtor is required to pay the secured claim pursuant to the terms of the plan and to treat the unsecured portion of the claim in the same manner as other unsecured claims. Under many chapter 13 plans, unsecured creditors receive no return on their claims. Under certain circumstances the cramdown can include a modification of the interest rate under the loan. **Under current law, a mortgage secured only by the debtor's principal residence is not subject to a cramdown.**

3. Examples:

   a. \$200,000 loan secured only by the debtor's principal residence worth \$150,000 as of plan confirmation: The debtor's plan must provide for payment of \$200,000 according to the terms of the mortgage, *i.e.*, no modification is permitted.

   b. \$200,000 loan secured by nonresidential (*e.g.*, vacation) property worth \$150,000 as of plan confirmation: The debtor's plan must provide for payment of \$150,000 over the life of the plan. The \$50,000 deficiency may be paid (or not) as provided for other unsecured claims.

4. Important Cases

   a. *Nobelman v. American Savings Bank*, 508 U.S. 324, 113 S.Ct. 2106, 124 L.Ed.2d 228 (1993): Confirming that a claim secured only by the debtor's principal residence is not subject to bifurcation into a secured and unsecured claim and that such claim is not subject to any other modification.

   b. *In re Zimmer*, 313 F.3d 1220, 211 B.R. 36 (9th Cir. 2002): Holding that if the creditor's claim is completely undersecured (*e.g.*, no collateral value securing junior lien after senior lien is satisfied) the result would be different because the creditor would not be a "holder of a secured claim" entitled to the protection of the antimodification provision. Since *Nobelman*, such completely undersecured claims have been found to be subject to modification.

   c. *Enewally v. Washington Mutual*, 368 F.3d 1165 (9th Cir. 2004): The issue before the court was whether the chapter 13 debtor could bifurcate a mortgage loan secured by nonresidential real property into secured and unsecured portions, and satisfy only the secured portion of the claim beyond the plan period. Specifically, the debtors proposed to continue their regular monthly mortgage payments on the crammed down valuation of the property. The 9th Circuit held

that a secured claim which has been subject to cramdown must be paid during the plan term (not longer than 5 years).

d. *Till v. SCS Credit Corp.*, 541 U.S. 465 (2004). In *Till*, the creditor had a $4,000 security interest in the debtor's truck with a contract providing for a 21% interest rate. Writing for a divided court, Justice Stevens held that a prime-plus rate (a.k.a the formula approach) is the appropriate method for determining the cramdown interest rate. The formula starts with the prime rate (market's estimate of the amount a commercial bank should charge a creditworthy commercial borrower to compensate for the loan's opportunity costs, the inflation risk and the relatively slight default risk), then adjusting it to account for the higher non-payment risk that bankrupt debtors pose. The adjustment depends on factors such as the estate's circumstances, the nature of the collateral, and the plan's duration and feasibility, and should be determined after a court hearing where the parties may present evidence to dispute the adjustment amount. The creditor's circumstances and its prior interaction with the debtor are not taken into consideration. The burden of proof is on the debtor to show the prime rate and on the creditor to show the appropriate adjustment, which may require an evidentiary hearing. Even before the *Till* decision, the courts in the 9th Circuit had settled on the prime-plus rate as the cramdown interest rate, *In re Fowler*, 903 F.2d 694, 697 (9th Cir. 1990), and continue to do so since *Till*. *See e.g. In re Cachu*, 321 B.R. 716 (Bankr. E.D.Cal. 2005.) In the real property context, *see In re Plourde,* 2009 WL 612145 (Bankr. D.N.H. 2009).

e. Exceptions:

(1) A mortgage encumbering real estate divided into several lots in addition to a lot on which the debtor's property is located was not secured solely by real property that was the debtor's principal residence, and was therefore subject to modification. *In re Donohue*, 221 B.R. 105 (Bankr. D.Vt. 1998) (Reversed on other grounds).

(2) Even if the property is listed on the debtor's driver's license as his/her address, the property will not be considered the principal residence where the debtor had abandoned it a year earlier and was renting it out. *In re Saglio*, 153 B.R. 4 (Bankr. D.R.I. 1993).

(3) If the property is divided into 3 separate lots but has always been used wholly as a single residence by the debtor, the mortgage is not subject to modification. *In re Marenaro*, 217 B.R. 358 (1st Cir. BAP 1998).