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I. INTRODUCTION

In *Nobelman v. American Savings Bank (In re Nobelman)*,[1] the Supreme Court decided the question of just how much special protection home mortgage lenders are entitled to receive under a provision of the Bankruptcy Code.[2] That provision allows debtors in Chapter 13 proceedings[3] to modify the rights of any secured creditor except a mortgage lender with a lien on the debtor's home.[4] The Supreme Court granted certiorari to resolve a conflict among the circuits: The Second, Third, Ninth, and Tenth Circuits had adopted a reading of 11 U.S.C. § 1322(b)(2)[5] that gave Chapter 13 debtors more leverage in dealing with home mortgage lenders,[6] while the Fifth Circuit had adopted a more restrictive reading.[7]

In *Nobelman* the Supreme Court affirmed the Fifth Circuit decision, rejecting the practice of "stripping down" home mortgage liens in Chapter 13 bankruptcy cases. "Lien stripping" is a particular form of relief authorized by the Bankruptcy Code: When the amount owed to a secured creditor exceeds the current value of the collateral, lien stripping

1. 113 S. Ct. 2106 (1993).

2. The Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549-56 (codified as amended at 11 U.S.C. §§ 101-1330 (1988 & Supp. IV 1992)).

3. 11 U.S.C. §§ 1301-1330 (1988). Unlike Chapter 7 proceedings, 11 U.S.C. §§ 701-766 (1988), which are designed to liquidate a debtor's nonexempt assets and distribute the proceeds to creditors, Chapter 13 proceedings are rehabilitative in that the debtor proposes to fund a payment plan lasting three to five years out of current earnings with a view toward keeping some nonexempt property and increasing the return paid to the creditors in bankruptcy.

4. The specific section at issue, 11 U.S.C. § 1322(b)(2) (1988), governs the contents of a plan and in part provides 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." *Id.* (emphasis added). The issue presented in *Nobelman* regarded the interplay of 11 U.S.C. § 506(a) (1988)—which governs the valuation of collateral and the division of creditors' claims into secured and unsecured portions based on that valuation—and § 1322(b)(2)—which governs the rights of home mortgage lenders as a special category of secured creditor. See *infra* part II for a discussion of these statutory provisions.

5. All later section and chapter references are to 11 U.S.C. unless otherwise stated.

6. Under this more liberal reading, Chapter 13 debtors may retain their homes but are required to repay only a portion of their outstanding mortgage balance; to the extent the mortgage exceeds the current value of the home, the debtors are effectively discharged from repaying the excess amount. Bellamy v. Federal Home Loan Mortgage Corp. (*In re* Bellamy), 962 F.2d 176 (2d Cir. 1992); Eastland Mortgage Co. v. Hart (*In re* Hart), 923 F.2d 1410 (10th Cir. 1991); Wilson v. Commonwealth Mortgage Corp., 895 F.2d 123 (3d Cir. 1990); Hougland v. Lomas & Nettleton Co. (*In re* Hougland), 886 F.2d 1182 (9th Cir. 1989), *aff'd sub nom.*, Lomas Mortgage v. Wiese, 980 F.2d 1279 (9th Cir. 1992).

7. The Fifth Circuit's interpretation required Chapter 13 debtors to repay the full amount of the mortgage, even if the current fair market value of the property was less than the outstanding mortgage debt. Nobleman [sic] v. American Sav. Bank (*In re* Nobleman [sic]), 968 F.2d 483 (5th Cir. 1992).

permits debtors to retain possession of the collateral while reducing the amount owed to the value of the collateral securing the debt. The narrow issue decided in *Nobelman* was whether a homeowner in a Chapter 13 proceeding should be allowed to strip down a lien secured by the debtor's primary residence. In broader terms the Court resolved the question of exactly how much special protection Congress intended to grant home mortgage lenders under the Bankruptcy Code.

In *Nobelman* the Court engaged in a perfunctory analysis of the language of the statute. Such a cursory analysis might have been justified in light of recent Supreme Court bankruptcy cases that held when the language of the statute is clear, the beginning and end of the interpretive process is the language of the Bankruptcy Code itself.[8] Yet the language of the provisions of the Bankruptcy Code at issue in *Nobelman* is not as simple as the Court seems to suggest. Moreover, the Court has also held that when statutory language is unclear, resort to the legislative history of the statute is appropriate.[9] A careful analysis of the legislative history of the two Bankruptcy Code sections at issue in *Nobelman*,[10] however, offers no clear answer to the question presented.

Underlying the problems of statutory interpretation raised by *Nobelman* is the tension between two competing federal policies: the policy of promoting home ownership and the policy of granting debtors a fresh start in bankruptcy. Notwithstanding the Court's strained reading of the Code, the *Nobelman* opinion does strike a balance between these policies. That balance, however, tilts in favor of the lenders' perspective on mortgages and the free flow of credit actively promoted by mortgage lenders.

8. Patterson v. Shumate, 112 S. Ct. 2242 (1992); Toibb v. Radloff, 111 S. Ct. 2197 (1991); United States v. Ron Pair Enters., 489 U.S. 235 (1989).

9. Kelly v. Robinson, 479 U.S. 36, 44 (1986).

10. 11 U.S.C. §§ 506(a), 1322(b)(2) (1988).

The *Nobelman* case attracted considerable attention among homeowners,[11] realtors,[12] mortgage lenders and brokers,[13] and investors in markets for mortgage-backed securities.[14] Lenders were concerned that

11. *Cramdowns of Residential Real Estate Mortgages in Chapter 13 Bankruptcies: Hearing Before the Subcomm. on Courts and Administrative Practice on the Judiciary U.S. Senate*, 102d Cong., 1st Sess. 35 (1991) [hereinafter *Cramdown Hearing*] (prepared statement of Henry J. Sommer, Staff Attorney, Community Legal Services, Philadelphia, Pennsylvania) (ability to "strip down" liens under § 506 is essential in preventing unscrupulous creditors from using mortgages as security to avoid bankruptcy discharge); Brief of Consumer Education and Protective Association, Ruby Lee Bradley, Ethel Cook, Clifford Moses, and Chapter 13 Trustee Gary Gaertner as Amici Curiae in Support of Petitioners at 56-58, *Nobelman*, 113 S. Ct. 2106 (No. 92-641) [hereinafter CEPA Brief] (no evidence that lien stripping has reduced availability of credit in Pennsylvania, where lien stripping was permitted for 10 years).

12. *See, e.g.*, Brief of Amici Curiae National Association of Realtors and the California Association of Realtors in Support of Respondent at 14, *Nobelman*, 113 S. Ct. 2106 (No. 92-641) [hereinafter Realtors' Brief] ("Permitting cramdowns could result in serious negative implications for American consumers in general as well as for the residential real estate industry and the hundreds of thousands of Americans who depend upon that industry for their livelihood.").

13. *See, e.g.*, *Cramdown Hearing*, *supra* note 11, at 64 (prepared statement of John P. Davey, Senior Vice President, Draper & Kramer, speaking for Mortgage Bankers Association of America) (today's outstanding mortgages were not priced with cramdown in mind; future homeowners will necessarily absorb the costs); *id.* at 75 (prepared statement of Larry Gilmore, Chief Executive Officer, Oakwood Acceptance Corporation, on behalf of Manufactured Housing Institute and National Manufactured Housing Federation) (Chapter 13 bankruptcy cramdown is especially threatening to manufactured housing); *id.* at 82 (additional submission of Michael S. Polk, Attorney, Polk, Scheer & Prober, representing lenders in California) (loans most susceptible to negative effects of Chapter 13 cramdown are governmental program, low down-payment loans); *id.* at 85 (additional submission of Robert E. McKew, Assistant General Counsel, and Frank M. Salinger, Vice President, American Financial Services Association) (home equity lenders will suffer during times of low real estate values and Chapter 13 debtors will reap windfall in better times); *id.* at 93 (additional submission of Suzanne Hutchinson, Executive Vice President, Mortgage Insurance Companies of America) (debtors will not receive any immediate relief from cramdown, but lenders will consequently restrict flow of mortgage money to depressed real estate areas); Brief of American Bankers Association, American Financial Services Association, and Credit Union National Association as *Amici Curiae* in Support of the Respondent at 26-27, *Nobelman*, 113 S. Ct. 2106 (No. 92-641) [hereinafter ABA Brief] (legislative history and plain meaning of statute protect primary or secondary mortgage liens from stripdown in Chapter 13); Brief of Mortgage Bankers Association of America as *Amicus Curiae* in Support of Respondent at 12, *Nobelman*, 113 S. Ct. 2106 (No. 92-641) [hereinafter MBA Brief] (prohibition against modification of home mortgage promotes congressional policy of fostering affordable home financing); Motion for Leave to File Brief Amicus Curiae of Nationsbanc Mortgage Corporation at 19-20, *Nobelman*, 113 S. Ct. 2106 (No. 92-641) [hereinafter Nationsbanc Brief] (stripdown of home mortgages will diminish availability of residential mortgage funding for individuals of moderate means).

14. *See, e.g.*, *Cramdown Hearing*, *supra* note 11, at 26-27 (prepared statement of Frank Keating, General Counsel, U.S. Department of Housing and Urban Development) (Federal Housing Authority (FHA) and Veterans' Administration (VA) will pay mortgage insurance claims only to extent of cramdown amount if property is subsequently foreclosed, but Government National Mortgage Association (GNMA) remains liable for full amount of original mortgage to investors in securitized mortgage market); *id.* at 49 (prepared statement of Dean S. Cooper, Associate General Counsel, Federal Home Loan Mortgage Corporation)

the more generous reading of the statute adopted by the Second, Third, Ninth, and Tenth Circuits would increase the level of losses they incurred from declining property values. Generally, when a home-securing mortgage is worth less than the outstanding debt, a foreclosing lender must realize a loss if the proceeds from the foreclosure sale and mortgage insurance, if any, do not equal the debt. In this case, however, the debtors sought not only a discharge of personal liability for the deficiency, but also the right to retain possession of their home. The Nobelmans wanted to force their mortgage lender to realize a loss from the depreciation of their home; in return, they offered to pay the current value of the property over time. Though the Nobelmans offered to pay the equivalent of what their property would have realized at a foreclosure sale, the lender resisted for three reasons: (1) the debtors wanted to repay the lender in installments rather than in a lump sum; (2) because no foreclosure sale would take place, the lender's loss would not be offset by mortgage insurance; and (3) mortgage lenders were concerned that debtors would receive a windfall if they could both receive a discharge of the unsecured portion of the debt and retain the property.

What the Nobelmans were proposing would simply have required home mortgage lenders to accept the same treatment given any other secured lender in bankruptcy. Except for home mortgage lenders, virtually all secured creditors in bankruptcy face the possibility of having a lien stripped down.[15] While Congress clearly conferred a special status on home mortgage lenders compared with other secured lenders, the parties disagreed as to the scope of what was conferred. The Nobelmans interpreted this special treatment as granting debtors only a *limited* right to strip down homestead mortgages, while mortgage lenders interpreted it as a prohibition on the practice altogether. Had they been successful, the Nobelmans would have considerably improved their position by choosing to confront their lender in federal bankruptcy court rather than in state court.[16]

The litigation in *Nobelman* purported to clarify the rights and obligations that had been fixed in 1978 when the current Bankruptcy Code took effect. However, much of the controversy surrounding the

(cramdown is "grossly unfair" to providers of mortgage credit and provides windfall to Chapter 13 debtors in depressed market because they alone enjoy benefit of subsequent appreciation when market conditions improve); Brief for Amicus Curiae Federal Home Loan Mortgage Corporation in Support of Respondent at 25-26, *Nobelman*, 113 S. Ct. 2106 (No. 92-641) [hereinafter FHLMC Brief] (lien stripping would significantly disrupt mortgage markets and sharply curtail access to credit among riskier applicants).

15. See *infra* part IV.C for a discussion of different cramdown standards.

16. See *infra* part IV.B for a discussion of state antideficiency laws.

Nobelman case had its roots in more recent changing conditions in housing markets.[17] Starting in the mid-1980s and continuing through the present, booming real estate markets went bust in several different regions of the country, leaving both home mortgagors and mortgagees facing substantial losses. The rising volume of bankruptcy litigation involving stripping home mortgage liens in part reflected this larger struggle among all the parties investing in residential real estate to avoid as large a share of these losses as possible. Mortgage lenders argued in *Nobelman*,[18] and before Congress,[19] that shifting the costs of declining property values from borrowers to lenders would produce a plethora of undesirable consequences without any tangible benefits for borrowers. The Nobelmans and consumers' rights advocates argued that allowing debtors in Chapter 13 a limited right to strip home mortgage liens was necessary to protect the full benefit of a debtor's discharge in bankruptcy.[20]

This Article first examines the Supreme Court's holding in *Nobelman*. Part II reviews the various statutory interpretations and bankruptcy policy arguments marshaled by both debtors and creditors regarding the permissibility of stripping home mortages under the Bankruptcy Code. Part III discusses the issue of lien stripping as addressed in the bankruptcy reform legislation introduced in Congress in 1992 and 1993. Part IV of this Article reviews other similar forms of debtor relief in order to evaluate creditors' claims that lien stripping would disrupt credit markets and impair the free flow of credit to borrowers. The forms of debtor relief considered include state antideficiency laws, stripping down real property liens in Chapter 11 and 12 bankruptcy proceedings, and stripping down other liens on real and personal property in Chapter 13 proceedings.

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17. The primary focus of this Article is on conditions in markets for purchase-money home mortgages secured by first liens on the collateral. The issues raised by nonpurchase money junior liens are discussed briefly *infra* part IV.A.3.

18. Brief on the Merits for Respondent, American Savings Bank, N.A., *Nobelman*, 113 S. Ct. 2106 (No. 92-641) [hereinafter ASB Brief] (lien stripping provides debtor with windfall without furthering debtor's fresh start); Brief of the State of Alaska as *Amicus Curiae* in Support of Respondent, *Nobelman*, 113 S. Ct. 2106 (No. 92-641) [hereinafter Alaska Brief] (Alaska's experience with real estate boom, bust, and subsequent recovery shows how lien stripping can produce penalty for mortgage lender and windfall for debtor); ABA Brief, *supra* note 13; MBA Brief, *supra* note 13; Nationsbanc Brief, *supra* note 13; FHLMC Brief, *supra* note 14.

19. *Cramdown Hearing*, *supra* note 11, at 40-41.

20. Brief on the Merits for Petitioners, Leonard Nobelman and Harriet Nobelman at 7-8, *Nobelman*, 113 S. Ct. 2106 (No. 92-641) [hereinafter Petitioner Brief]; CEPA Brief, *supra* note 11, at 34.

II. The *Nobelman* Litigation

A. Statement of the Case

On June 21, 1984, Leonard and Harriet Nobelman purchased a condominium in Dallas, Texas with an adjustable rate, thirty-year mortgage of $68,500 provided by American Savings Bank, N.A. (ASB).[21] In 1984 the market for real estate in Dallas was booming: Housing costs were soaring, and condominiums, or condos, were popular as a moderately priced alternative to single family homes. Unfortunately for the Nobelmans, boom turned to bust in late 1985, when housing prices plummeted in Texas and throughout the oil-producing regions in the southern and western United States.[22] Condominium prices were among the hardest hit.[23]

The Nobelmans began experiencing financial problems in the late 1980s when Harriet Nobelman lost her job and Leonard Nobelman was unable to work because of illness.[24] Starting in 1989, the Nobelmans tried unsuccessfully to renegotiate the terms of their mortgage with their lender. In 1990, after those negotiations failed, the Nobelmans began withholding mortgage payments and the lender retaliated by posting the condo for foreclosure.[25] By October 25, 1990, when the Nobelmans filed their Chapter 13 plan, the fair market value of their condominium was only $23,500, approximately one-third of the purchase price.[26]

In the popular vernacular, their mortgage was "upside down"[27] or "underwater"[28] because the debt exceeded the value of the property. The

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21. Nobelman v. American Sav. Bank (*In re* Nobelman), 113 S. Ct. 2106 (1993).

22. Robert Reinhold, *Texas in a Tailspin*, N.Y. Times, July 20, 1986, § 6, at 22.

23. This was due to a variety of factors, such as more severe overbuilding of condominiums than other types of residences and fraudulent practices by principals of condominium developments that artificially inflated prices. *See, e.g.*, Rick Calvelli, *Flimflams and Real Estate Scams*, Prob. & Prop., Mar.-Apr. 1988, at 31. In addition, because large numbers of condominiums were only purchased as investments, many investors abandoned their units after price declines and unfavorable changes in tax laws governing such investments, leaving maintenance costs for an entire development on a shrinking number of resident owners. Under such circumstances, further declines in value are attributable in part to the inability of the remaining homeowners to maintain the development.

24. Steve McGonigle, *Pair Lose Court Fight over Condo*, Dallas Morning News, June 2, 1993, at 1A.

25. *Id.* The Nobelmans dealt with the Murray Mortgage Company, the authorized servicing agent for ASB. See *infra* part IV.B.1 for a discussion of the secondary mortgage market.

26. *Nobelman*, 113 S. Ct. at 2107.

27. Richard A. Oppel, Jr. & Steve Brown, *Rates and Balances; Negative Equity Leaves Homeowners in Money Pit*, Dallas Morning News, Mar. 28, 1993, at 1H.

28. Dewsnup v. Timm (*In re* Dewsnup), 112 S. Ct. 773, 782 (1992) (Scalia, J., dissenting) (referring to undersecured portion of claim secured by lien on real estate as "so-called 'underwater' portion of the lien").

Nobelmans had become "condo slaves,"[29] unable to sell their condominium—or even refinance their mortgage at a lower interest rate and reduce their monthly payments—because they could not cover the shortfall between the outstanding mortgage and the current market value. Although precipitous, the decline in value of the Nobelmans' home was hardly unique or even unusual.[30] An attorney for the Nobelmans estimated that the value of the property had further declined to only $19,000 by the time the case reached the Supreme Court in 1993.[31]

By filing under Chapter 13 rather than under Chapter 7 of the Bankruptcy Code, the Nobelmans were seeking the right to restructure their mortgage obligation to ASB. While Chapter 7 debtors receive a prompt discharge of most of their debts in exchange for turning over their nonexempt property and are not obligated to pay most creditors after filing, they enjoy considerably less leverage with secured creditors, including home mortgage lenders, than do Chapter 13 debtors.[32] By contrast, Chapter 13 debtors must submit to several onerous conditions to qualify for a discharge, such as proposing a three-to-five-year plan under which they use all their disposable income to pay their creditors. However, in return, they are given considerable leverage in bargaining with some of their secured creditors.[33]

Under the terms of their proposed Chapter 13 plan, the Nobelmans sought to retain possession of the condominium while reducing, or "stripping down," their mortgage debt from the outstanding balance of $71,335.04 to an amount equal to the fair market value of the property.[34] In order to accomplish this, the Nobelmans wanted to "bifurcate" ASB's claim into secured and unsecured portions.[35] The Nobelmans could then propose a plan that would pay ASB the present value of the secured claim but pay little or nothing of the unsecured claim.[36] If the

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29. Scott Burns, *FHA/VA Refinancing Gets Cheaper*, DALLAS MORNING NEWS, May 16, 1993, at 1H.

30. Single-family home prices in Houston were lower in 1992 than they were in 1982. Rob Norton, *What Will Your House Be Worth?*, FORTUNE, Sept. 7, 1992, at 62.

31. Interview with Philip I. Palmer, Jr., Counsel of Record for Leonard & Harriet Nobelman, in Dallas, Tex. (Feb. 10, 1993).

32. 11 U.S.C. §§ 524, 724, 727 (1988).

33. 11 U.S.C. §§ 1322(b)(5), 1325(a)(5), 1325(b) (1988). The Chapter 13 provisions governing the rights of debtors to modify the rights of secured creditors generally are discussed in detail *infra* part IV.C.3.

34. *Nobelman*, 113 S. Ct. at 2107.

35. 11 U.S.C. § 506(a) (1988).

36. Bankruptcy courts in the Northern District of Texas routinely confirm Chapter 13 plans that offer little or no payments to unsecured creditors. By contrast, in other jurisdictions, bankruptcy judges may refuse to confirm plans that do not offer substantial payments to unsecured creditors. *See, e.g.*, Lynn M. LoPucki, *The Demographics of Bankruptcy Practice*,

Nobelmans had been successful in bifurcating ASB's claim and stripping ASB's mortgage lien, they would have been able to keep their condominium after paying off only the secured claim of $23,500. The Nobelmans offered to continue making the same monthly payments, but only until the value of the secured claim had been paid in full with interest.[37] The plan of reorganization provided that ASB would receive no payments on the "stripped" portion of the loan—roughly $41,000—and that the Nobelmans would be discharged of their personal liability for that amount.[38]

ASB successfully challenged the Nobelmans' attempt to bifurcate its claim and strip its lien, first in the bankruptcy court,[39] then on appeal to U.S. District Court,[40] and next in the Fifth Circuit.[41] When the Fifth Circuit denied the Nobelmans the right to bifurcate and strip down their home mortgage obligation in a Chapter 13 bankruptcy proceeding, however, it created a split in the circuits: The Second,[42] Third,[43] Ninth,[44] and Tenth Circuits[45] had all upheld that right. The Nobelmans petitioned the Supreme Court to determine the validity of lien stripping under Chapter 13. In order to resolve the split in the circuits, the Supreme Court agreed to hear the Nobelmans' case,[46] and on June 1, 1993 unanimously held in favor of ASB.[47]

B. The Supreme Court Opinion

In the opinion written by Justice Thomas, the Court focused on preserving the in rem rights of the secured creditor, but did not articulate a

63 AM. BANKR. L.J. 289, 301 (1989) (documenting large local variations in bankruptcy practice).

37. Debtor's Modified Chapter 13 Plan and Motion for Valuation, *In re* Nobelman, No. 390-35116-HCA-13 (Bankr. N.D. Tex. Mar. 12, 1991).

38. In addition, the Nobelmans sought to pay off the arrearages on their mortgage in the amount of $6577.38 over the three-year term of their proposed plan. *Id.*

39. *In re* Nobelman, No. 390-35116-HCA-13 (Bankr. N.D. Tex. Mar. 12, 1991).

40. Nobelman v. American Sav. Bank (*In re* Nobelman), 129 B.R. 98 (N.D. Tex. 1991).

41. Nobleman [sic] v. American Sav. Bank (*In re* Nobelman), 968 F.2d 483 (5th Cir. 1992).

42. Bellamy v. Federal Home Loan Mortgage Corp. (*In re* Bellamy), 962 F.2d 176 (2d Cir. 1992).

43. Wilson v. Commonwealth Mortgage Corp., 895 F.2d 123 (3d Cir. 1990) (section 506(a) limits secured claim to fair market value and only secured claim is protected under § 1322(b)(2)), *aff'd sub nom.*, Sapos v. Provident Inst. of Sav., 967 F.2d 918 (3d Cir. 1992).

44. Hougland v. Lomas & Nettleton Co. (*In re* Hougland), 886 F.2d 1182 (9th Cir. 1989), *aff'd sub nom.*, Lomas Mortgage v. Wiese, 980 F.2d 1279 (9th Cir. 1992).

45. Eastland Mortgage Co. v. Hart (*In re* Hart), 923 F.2d 1410 (10th Cir. 1991).

46. Nobelman v. American Sav. Bank (*In re* Nobelman), 113 S. Ct. 2106 (1993).

47. *Id.* at 2108.

coherent theory of bankruptcy policy to justify its holding.[48] Although the holding in *Nobelman* is consistent with a theory of bankruptcy law that curtails the debtor's "fresh start" in order to preserve the creditor's state law entitlements to the greatest degree possible, the case is not explicitly grounded in such an interpretation of bankruptcy law and policy. Justice Thomas instead justified his reading of § 1322(b)(2) by contrasting "property" rights that are not subject to modification with "contractual" rights that may be affected by the bankruptcy, and by pointing out the practical problems of administering the relief sought by the petitioners.[49]

The Nobelmans and their amici argued that because the Bankruptcy Code should be construed as a whole, and because as a definitional matter § 506(a) equates any reference to "secured claim" with "collateral value," a more liberal reading of § 1322(b)(2) was appropriate.[50] The petitioners also argued that § 506(a) operated automatically to bifurcate ASB's claim into secured and unsecured portions, and that, as a result, the "antimodification" provisions of § 1322(b)(2) applied only to the secured portion of the claim.[51] In addition, the Nobelmans pointed out that while Congress intended to favor home mortgage lenders, it remained unclear exactly how much preferential treatment Congress intended to confer. Moreover, they argued that preserving the lender's contractual rights to a particular interest rate and monthly repayment amount might conform with congressional intent, notwithstanding the reduction in value of the lien to the current value of the collateral.[52] Finally, the petitioners raised policy issues favoring lien stripping, pointing out that (1) the debtors offered the mortgage lender as much as the lender could hope to realize through foreclosure, and (2) any potential windfall debtors could receive if property values recovered after the strip down was speculative at best.[53]

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48. A coherent theory would relate the rights of secured lenders to the objectives of bankruptcy generally, such as by treating secured status as just another form of priority in bankruptcy, not unlike the priority accorded administrative expenses or certain taxes, or arguing that bankruptcy law should be fundamentally procedural rather than substantive. *See, e.g.*, THOMAS H. JACKSON, THE LOGIC AND LIMITS OF BANKRUPTCY LAW 5 (1986). Another coherent theory might characterize debtor relief in bankruptcy as one element of a broader social support system softening the stresses placed on individuals by a market economy. TERESA SULLIVAN ET AL., AS WE FORGIVE OUR DEBTORS: BANKRUPTCY AND CONSUMER CREDIT IN AMERICA 328 (1989).

49. *Nobelman*, 113 S. Ct. at 2110.

50. *Id.* at 2111.

51. *Id.* at 2109. Regarding any remaining unsecured portion of the claim, the applicable protections for creditors are found in 11 U.S.C. §§ 1325(a)(4) and 1325(b) (1988).

52. Petitioner Brief, *supra* note 20, at 7.

53. *Id.* at 8.

Respondent ASB and its supporting amici argued that lien stripping itself was an impermissible "modification" of the mortgage lender's claim under § 1322, and that bifurcation into secured and unsecured portions should not be permitted for such claims.[54] In addition, ASB claimed that bifurcation of claims under § 506 was not a self-executing procedure—so that to permit bifurcation of a home mortgage lender's claim would undermine the antimodification language of Chapter 13.[55] As a policy matter, ASB argued that if the Nobelmans were allowed to both strip down the mortgage lien and remain in possession of their home, they would be receiving not just a "fresh start" but a windfall at the expense of their lender.[56] Finally, ASB argued that the legislative history of § 1322(b)(2) clearly supported the position they were advocating.[57]

1. Statutory interpretation

Justice Thomas looked first at the relationship between 11 U.S.C. §§ 506(a) and 1322(b)(2). Section 506(a) provides,

> [a]n allowed claim of a creditor secured by a lien on property in which the estate has an interest . . . is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property . . . and is an unsecured claim to the extent that the value of such creditor's interest . . . is less than the amount of such allowed claim. Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest.[58]

Section 1322(b)(2) provides that a debtor's Chapter 13 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."[59] Justice Thomas noted that the parties agreed that § 1322(b)(2) applied to the facts of this case, that it "proscribes modification of the rights of a homestead mortgagee" and that the

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54. ASB Brief, *supra* note 18, at 42.

55. *Id.* at 6.

56. *Id.* at 29.

57. *Id.* at 18-24.

58. 11 U.S.C. § 506(a). Section 506(a) applies in Chapter 13 by operation of 11 U.S.C. § 103(a) (1988), which provides that "chapters 1, 3, and 5 of this title apply in a case under chapter 7, 11, 12 or 13 of this title." *Id.*

59. *Id.* § 1322(b)(2) (1988).

issue before the Court was whether or not the terms of the Nobelmans' proposed plan constituted a "modification" of ASB's rights.[60]

In attempting to reconcile the two sections, Justice Thomas first noted that the antimodification language of § 1322(b)(2) applied to the "rights of holders" of claims, not to "claims" or "secured claims."[61] Conceding that the application of § 506(a) produced secured and unsecured claims, the Court held that determination of secured status did not necessarily mean that ASB's "rights" were limited by the valuation of its secured claim.[62] In so holding the Court diminished the role of § 506(a) as a fulcrum balancing the competing bankruptcy policies of protecting a secured creditor's state law entitlements and the debtor's fresh start.[63]

It is far from clear as a matter of statutory interpretation that the focus of § 1322(b)(2) is really on "rights" rather than "secured claims." Justice Thomas acknowledged that while it is sensible as a matter of grammar to assume that the phrase "other than" must refer only to "secured claim"—the last two words immediately preceding the comma—such a reading is not compelled as a matter of law by the so-called rule of the last antecedent.[64] Justice Thomas pointed out that even § 506(a) uses a parallel construction to the phrase "claim secured by a [homestead lien]" to refer to both the secured and unsecured portions of an undersecured claim. Another plausible reading of the statute shows that the last antecedent might be the entire phrase, "rights of holders of secured claims."[65] Yet another reading of the statute could contrast the express grant of authority to a Chapter 13 debtor to modify the rights of holders

60. *Nobelman*, 113 S. Ct. at 2109.

61. *Id.* at 2111.

62. *Id.* at 2110. Further evidence that the valuation requirement of § 506(a) does not determine the scope of the prohibition on modification in § 1322(b)(2) is provided by the choice of the unadorned word "claim" within the "other than" proviso itself. The prohibition extends to "claims" that are "secured only by a security interest in real property" rather than to "secured claims." 11 U.S.C. § 1322(b)(2); *see also* ASB Brief, *supra* note 18, at 20 (contrasting § 1322(b)(2) to original House version that provided that any secured indebtedness could be modified).

63. Thomas M. Ward, *The Supreme Court Diminishes the "Redeeming" Qualities of the Bankruptcy Code in* Dewsnup v. Timm, 1993-1994 ANN. SURV. BANKR. L. 147, 150.

64. The "rule of the last antecedent" states that a statutory clause should refer to and modify its immediate antecedent. Thus, in *Nobelman*, "the operative clause 'other than a claim secured only by a security interest in . . . the debtor's principal residence' must be read to refer to and modify its immediate antecedent, 'secured claims.' " *Nobelman*, 113 S. Ct. at 2111 (quoting 11 U.S.C. § 1322(b)(2)).

65. *Id.* Respondent ASB also suggested that an equally plausible reading of the statute shows that the last antecedent is the entire phrase, "rights of holders of secured claims." ASB Brief, *supra* note 18, at 18.

of unsecured claims with the prohibition on modification of claims secured by homestead liens to support the conclusion that the antimodification provision applied only to postbifurcation secured claims. Under this interpretation, holders of claims may have either secured claims that are protected by the prohibition on modification, or unsecured claims that can be modified, or some combination of both. This reading shifts the focus back to the claim itself in determining the scope of § 1322(b)(2). Arguably, it also permits § 506(a) to play the role intended by Congress in mediating the interests of secured creditors, unsecured creditors, and debtors.[66]

However, when Congress intended to protect creditors or their rights as opposed to claims, its intent was clearly expressed.[67] For example, § 509, which deals with the claims of codebtors, provides that codebtors are subrogated to the "rights of such creditor" to the extent that the codebtor has paid the claim of the creditor.[68] Similarly, under § 523 creditors must follow particular procedures in order to except from discharge certain types of debts owed to them.[69]

Justice Thomas decided that because the term "rights," unlike the term "secured claim," is not defined by the Bankruptcy Code, it was necessary to turn to nonbankruptcy law to clarify the substance of these rights.[70] This approach is consistent with that used in *Dewsnup v. Timm (In re Dewsnup)*,[71] the widely criticized[72] opinion that the Court handed down last year. In *Dewsnup*, the Court ruled that debtors had no right to strip down liens on real property in Chapter 7 proceedings. Justice Blackmun, writing for the majority, adopted a rather strained interpretation of two subsections of the Bankruptcy Code.[73] His rationale was to

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66. CEPA Brief, *supra* note 11, at 20.

67. *Id.* at 22.

68. 11 U.S.C. § 509(a) (1988).

69. 11 U.S.C. § 523(c)(1) (1988).

70. *Nobelman*, 113 S. Ct. at 2110 (citing Barnhill v. Johnson, 112 S. Ct. 1386, 1389 (1992); Butner v. United States, 440 U.S. 48, 54 (1979)).

71. 112 S. Ct. 773 (1992).

72. *See, e.g.*, Patterson v. Shumate (*In re* Shumate), 112 S. Ct. 2242, 2251 (1992) (Scalia, J., concurring) (stating that consistency of usage within same statute is necessary, or symbol of law becomes see-saw, not scales); Margaret Howard, *Dewsnupping the Bankruptcy Code*, 1 J. BANKR. L. & PRAC. 513 (1992); Ward, *supra* note 63, at 161.

73. 11 U.S.C. § 506(a)-(d) (1988). For the text of § 506(a), see *supra* note 58 and accompanying text. Section 506(d) provides,

> To the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void, unless—
> (1) such claim was disallowed only under section 502(b)(5) or 502(e) of this title; or
> (2) such claim is not an allowed secured claim due only to the failure of any entity to file a proof of such claim under section 501 of this title.

11 U.S.C. § 506(d).

avoid granting debtors in bankruptcy a remedy that was not available under the prior Bankruptcy Act[74] and was not clearly within the contemplation of the drafters of the Bankruptcy Code. In reaching that interpretation, Justice Blackmun found that the words "allowed secured claim" did not have the same meaning in § 506(a) and § 506(d), though he did concede that such an analysis was "not without its difficulty."[75] To support his position he emphasized the importance of the entitlements conferred on creditors under state law, and the need for bankruptcy law to respect the rights of secured creditors in particular, absent a clear statutory or legislative mandate to the contrary.[76]

The *Dewsnup* Court held that lien stripping was not available to Chapter 7 debtors based on sections 506(a) and 506(d)[77] of the Bankruptcy Code.[78] The rationales advanced in the *Dewsnup* opinion for prohibiting lien stripping in Chapter 7 bankruptcies, however, have little relevance in the context of rehabilitative bankruptcy proceedings under Chapters 11, 12, and 13, where lien stripping is expressly and broadly permitted, subject only to very minor qualifications.[79] The legislative

74. Bankruptcy Act of 1898, Pub. L. No. 62-57, 30 Stat. 544 (codified as amended in scattered sections of primarily 11 U.S.C. and 28 U.S.C.), *repealed by* Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (codified as amended at 11 U.S.C. §§ 101-1330 (1988 & Supp. IV 1992)) [hereinafter Bankruptcy Code or Code].

75. *Dewsnup*, 112 S. Ct. at 778.

76. In writing for the majority in *Dewsnup*, Justice Blackmun adopted the respondent's argument that "allowed secured claim" is not an indivisible term of art defined by § 506(a), although noting that this interpretation was "not without its difficulty." *Id.* at 777-78. The Court held that in § 506(d), "allowed" refers to "allowed claim" as defined in 11 U.S.C. § 502 (1988), whereas "secured" refers to "secured claim" as defined in § 506(a), and "allowed secured claim" need not be given the same reading in § 506(a) and in § 506(d). *Id.* at 778. The rather opaque reasoning of the majority was subjected to scathing criticism in a dissent by Justice Scalia. *Id.* at 780 (Scalia, J., dissenting).

77. See *supra* note 73 for the statutory text.

78. *Dewsnup*, 112 S. Ct. at 778.

79. In *Dewsnup*, the Court addressed the issue of lien stripping in the context of a Chapter 7 case. The holding was limited to interpreting the words "allowed secured claim" as they appear in sections 506(a) and (d), with the Court expressing no opinion on the meaning of those words when they appear in other provisions of the Bankruptcy Code.

> Hypothetical applications that come to mind and those advanced at oral argument illustrate the difficulty of interpreting the statute in a single opinion that would apply to all possible fact situations. We therefore focus upon the case before us and allow other facts to await their legal resolution on another day.

Id. Several courts have held that *Dewsnup* does not apply to Chapter 11 cases. *See, e.g.*, 650 Fifth Avenue Assocs. v. Mutual Benefit Life Ins. Co. (*In re* 650 Fifth Avenue Assocs.), 156 B.R. 726, 732 n.7 (Bankr. S.D.N.Y. 1993); *In re* Jones, 152 B.R. 155, 173 (Bankr. E.D. Mich. 1993); *In re* Butler, 139 B.R. 258, 259 (Bankr. E.D. Okla. 1992). *But see* Blue Pac. Car Wash, Inc. v. St. Croix County (*In re* Blue Pac. Car Wash, Inc.), 150 B.R. 434, 435 (W.D. Wis. 1992); Taffi v. United States (*In re* Taffi), 144 B.R. 105, 113-14 (Bankr. C.D. Cal. 1992).

history of the Code makes clear that lien stripping is permitted in the reorganization chapters.[80]

Given that the antimodification provision of § 1322 was envisioned as giving mortgage lenders special protection, it would have been somewhat ironic to find that the practical consequence of that special protection was that mortgage lenders were worse off than other secured creditors: They would be subject to lien stripping, but unable to demand payment in full within the term of the plan. In addition, Chapter 13 may not have been intended to subject mortgage lenders to lien stripping because it, unlike state law foreclosure, is not a compensable event recognized by mortgage insurers.[81] Thus, mortgage lenders suffer if lien stripping is permitted in Chapter 13 proceedings, but debtors do not enjoy any immediate benefit because they must continue to make full monthly payments to the lender at the same interest rate. The only benefit to debtors is that they make the payments for fewer months or years. Chapter 13 debtors are thus deprived of the usual benefits of "cramming down"[82] mortgage lenders.

While the ruling in *Nobelman* generally prohibits stripping down homestead liens, the holding leaves open several avenues by which debtors may still be able to cramdown some lenders holding security interests in their homes. The opinion does not address whether the scope limitation in § 1322(b)(2) limits antimodification protection to mortgages secured solely by a security interest in the debtor's homestead, or whether the antimodification provision even applies to a junior lien that is wholly unsecured at the time of filing. Since many outstanding mortgages include language that purports to take a security interest in items such as rents, royalties, fixtures, or insurance as well as the residence itself, those mortgages may be outside the protection of the antimodification provision, as are second homes that are not the debtor's principal residence or homes held for rent.[83] Justice Thomas did not directly address the issue

80. 124 CONG. REC. 32,409, 34,009 (1978) (remarks of Rep. Edwards and Sen. DeConcini, respectively).

81. *Cramdown Hearing, supra* note 11, at 26; *see also* VA Office of General Counsel Precedent 1-91, 56 Fed. Reg. 25,156 (June 3, 1991); U.S. Department of Housing and Urban Development Letter No. 91-27 (June 4, 1991).

82. "Cramdown" is the power of the debtor in bankruptcy to force a class of nonconsenting creditors to accept confirmation of a plan of reorganization so long as the plan meets certain minimum standards for the treatment of those nonconsenting creditors. DAVID G. EPSTEIN ET AL., BANKRUPTCY 760 (1993). See *infra* part IV.C.3 for a general discussion of Chapter 13 cramdown provisions.

83. *See, e.g.*, Hammond v. Commonwealth Mortgage Co. (*In re* Hammond), 1993 WL 277546 (E.D. Pa. July 2, 1993) (post-*Nobelman* case holding that "rents, profits and fixtures" language in mortgage was enough to remove it from § 1322(b)(2) protection); Hirsch v. Cit-

of junior liens, leaving open the possibility that a completely unsecured junior lien might still qualify for the special protection of § 1322(b)(2).[84]

The Fifth Circuit's *Nobelman* opinion rejected the reasoning of other circuit and district courts that held that lien stripping is permissible for undersecured home mortgages in Chapter 13 because there is no conflict between § 506(a) and § 1322(b)(2).[85] The Fifth Circuit held that if a

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icorp Mortgage Corp. (*In re* Hirsch), 155 B.R. 688 (Bankr. E.D. Pa. 1993) (post-*Nobelman* case holding that "rents, issues & profits" language in mortgage was enough to remove it from § 1322(b)(2) protection). *But see In re* Davis, 989 F.2d 208 (6th Cir. 1993) (holding that mortgage with interest in hazard insurance and "rents, royalties, profits and fixtures" still qualifies for § 1322(b)(2) protection); *In re* Foster, 61 B.R. 492 (Bankr. N.D. Ind. 1986) (stating if additional security is illusory, then mortgage still protected by § 1322(b)(2)).

84. One commentator has argued, however, that if a junior mortgage was wholly unsecured both at the time it attached and at the time the bankruptcy proceeding commenced, then there is no "secured claim" for § 1322(b)(2) to protect. *Consumer Issues in Bankruptcy Hearing Before the Subcomm. on Economic and Commercial Law of the Comm. on the Judiciary*, 102d Cong., 2d Sess. 121 (1992) (statement of Henry J. Sommer on behalf of National Bankruptcy Conference); National Consumer Law Ctr., Inc., *Homeowners Get No Break: Supreme Court Makes It Harder to Save a Home in Bankruptcy*, 11 NCLC REPORTS, BANKR. & FORECLOSURES ED. 21, 23 (1993). See *infra* part IV.A.3 for a general discussion of junior lien issues.

85. The following lower courts permitted lien stripping: Richards v. Citicorp Mortgage, Inc. (*In re* Richards), 151 B.R. 8 (Bankr. D. Mass. 1993); *In re* Cardinale, 142 B.R. 42 (Bankr. D.R.I. 1992); *In re* Govan, 139 B.R. 1017 (Bankr. N.D. Ala. 1992); *In re* Sainz-Dean, 139 B.R. 739 (Bankr. D. Colo.), *aff'd sub nom.*, United Planters Nat'l Bank v. Sainz-Dean, 143 B.R. 784 (D. Colo. 1992); Taras v. Commonwealth Mortgage Corp. (*In re* Taras), 136 B.R. 941 (Bankr. E.D. Pa. 1992); *In re* Torrez Lopez, 138 B.R. 348 (Bankr. D.P.R. 1992); *In re* Weber, 140 B.R. 707 (Bankr. S.D. Ohio 1992); Franklin v. Union Mortgage Co. (*In re* Franklin), 126 B.R. 702 (Bankr. N.D. Miss. 1991); Loader v. Charlton Credit Union (*In re* Loader), 128 B.R. 13 (Bankr. D. Mass. 1991); *In re* Ward, 129 B.R. 664 (Bankr. W.D. Okla. 1991); Wright v. C & S Family Credit, Inc. (*In re* Wright), 128 B.R. 838 (Bankr. N.D. Ga. 1991); Brouse v. CSB Mortgage Corp. (*In re* Brouse), 110 B.R. 539 (Bankr. D. Colo. 1990); *In re* DiQuinzio, 110 B.R. 628 (Bankr. D.R.I. 1990); *In re* Gadson, 114 B.R. 453 (Bankr. E.D. Va. 1990); Goins v. Diamond Mortgage Corp. (*In re* Goins), 119 B.R. 156 (Bankr. N.D. Ill. 1990); *In re* Hayes, 111 B.R. 924 (Bankr. D. Or. 1990); *In re* Honett, 116 B.R. 495 (Bankr. E.D. Tex. 1990); *In re* Demoff, 109 B.R. 902 (Bankr. N.D. Ind. 1989); *In re* Frost, 96 B.R. 804 (Bankr. S.D. Ohio 1989), *aff'd*, 123 B.R. 254 (S.D. Ohio 1990); *In re* Harris, 94 B.R. 832 (D.N.J. 1989); *In re* Hill, 96 B.R. 809 (Bankr. S.D. Ohio 1989); *In re* Ross, 107 B.R. 759 (Bankr. W.D. Okla. 1989); Kehm v. Citicorp Homeowners Serv., Inc. (*In re* Kehm), 90 B.R. 117 (Bankr. E.D. Pa. 1988); Caster v. United States (*In re* Caster), 77 B.R. 8 (Bankr. E.D. Pa. 1987); *In re* Crompton, 73 B.R. 800 (Bankr. E.D. Pa. 1987); *In re* Jablonski, 70 B.R. 381 (Bankr. E.D. Pa. 1987), *aff'd in part*, 88 B.R. 652 (E.D. Pa. 1988); *In re* Simmons, 78 B.R. 300 (Bankr. D. Kan. 1987); Cameron Brown Co. v. Bruce (*In re* Bruce), 40 B.R. 884 (Bankr. W.D. Va. 1984); Spadel v. Household Consumer Discount Co. (*In re* Spadel), 28 B.R. 537 (Bankr. E.D. Pa. 1983); and *In re* Neal, 10 B.R. 535 (Bankr. S.D. Ohio 1981).

The following courts denied debtors the right to bifurcate and strip home mortgages: *In re* Barnes, 146 B.R. 854 (Bankr. W.D. Okla. 1992); *In re* Doss, 143 B.R. 952 (Bankr. E.D. Okla. 1992); *In re* Wicks, No. Civ.-91-1983-A, 1992 WL 373162 (W.D. Okla. Mar. 11, 1992), *aff'd sub nom.*, Independence One Mortgage Corp. v. Wicks (*In re* Wicks), 1993 WL 377053 (10th Cir. Okla. Sept. 28, 1993); *In re* Davidoff, 136 B.R. 567 (Bankr. M.D. Fla. 1992); *In re* Strober, 136 B.R. 614 (Bankr. E.D.N.Y. 1992); Etchin v. Star Servs., Inc. (*In re* Etchin), 128 conflict does exist between the general provisions of § 506(a) and the specific provisions of § 1322(b)(2), then the specific provisions of Chapter 13 should prevail.[86] By remaining silent on the issue, Justice Thomas therefore tacitly followed the rule enunciated in other Supreme Court cases: Where two sections of a statute can be construed harmoniously, then they are not in conflict.[87]

2. Modification

Because § 1322(b)(2) prohibits "modification" of the rights of a mortgage lender with a lien on the debtor's homestead, the Court had to determine whether lien stripping constitutes "modification." The petitioners in *Nobelman* argued that they were not modifying the rights of the mortgage lender because the lender would continue to receive payments in the amount agreed upon under the original contract, but only until the amount of the allowed secured claim had been paid in full with interest. Thus, the Nobelmans would stop making their mortgage payments much sooner than provided for in the original loan agreement, based on a new amortization schedule proposed as part of the plan. One amicus further observed that if bifurcation of the creditor's claim into secured and unsecured portions takes place by operation of § 506(a)—and not through confirmation of the debtor's plan—then it should not constitute a modification of the creditor's claim.[88]

B.R. 662 (Bankr. W.D. Wis. 1991); *In re* Mitchell, 125 B.R. 5 (Bankr. D.N.H. 1991); Boullion v. Sapp (*In re* Boullion), 123 B.R. 549 (Bankr. W.D. Tex. 1990); *In re* Christiansen, 121 B.R. 63 (Bankr. D. Colo. 1990); *In re* Moran, 121 B.R. 879 (Bankr. E.D. Okla. 1990); *In re* Sauber, 115 B.R. 197 (Bankr. D. Minn. 1990); First Interstate Bank v. Woodall (*In re* Woodall), 123 B.R. 95 (Bankr. W.D. Okla. 1990), *rev'd*, 931 F.2d 64 (10th Cir. 1991); *In re* Chavez, 117 B.R. 733 (Bankr. S.D. Fla. 1990); *In re* Schum, 112 B.R. 159 (Bankr. N.D. Tex. 1990); *In re* Kaczmarczyk, 107 B.R. 200 (Bankr. D. Neb. 1989); Kessler v. Homestead Sav. (*In re* Kessler), 99 B.R. 635 (Bankr. E.D. Pa. 1989); *In re* Russell, 93 B.R. 703 (D.N.D. 1988); *In re* Hemsing, 75 B.R. 689 (Bankr. D. Mont. 1987); *In re* Smith, 63 B.R. 15 (Bankr. D.N.J. 1986); *In re* Bradshaw, 56 B.R. 742 (S.D. Ohio 1985); and *In re* Hildebran, 54 B.R. 585 (Bankr. D. Or. 1985).

At least one court has tried to combine the two positions, permitting bifurcation of the mortgage creditor's claim and also holding that the lien passed through the bankruptcy unaffected. *In re* Dyer, 142 B.R. 364 (Bankr. D. Ariz. 1992), *vacated*, 153 B.R. 601 (Bankr. 9th Cir. 1993).

86. *In re* Nobleman [sic], 968 F.2d 483, 489 (5th Cir. 1992).

87. *See, e.g.*, United States v. Nordic Village Inc., 112 S. Ct. 1011, 1015 (1992) (different statutory provisions should be read, where possible, as complementary rather than in conflict with each other); Pittsburgh & Lake Erie Ry. v. Railway Labor Executives' Ass'n, 491 U.S. 490, 510 (1989) (whenever possible, statutes should be construed so as to avoid potential conflict); United Sav. Ass'n v. Timbers of Inwood Forest Assocs., 484 U.S. 365, 371 (1988) (apparently ambiguous language may be clarified when viewed in context of entire statutory scheme).

88. CEPA Brief, *supra* note 11, at 37-39.

The Court's emphasis on the "rights of holders," however, led to an expansive interpretation of "modification," and a rejection of the Nobelmans' reasoning. The Court held that protection against modification in § 1322(b)(2) extends to the rights of holders of claims, without regard to whether those claims are secured or unsecured.[89] Accordingly, bifurcation of a home mortgage lender's claim into secured and unsecured portions is clearly a "modification" of the lender's rights prohibited by the plain language of § 1322(b)(2).

With regard to formal legal entitlements, lien stripping clearly diminishes the rights of lenders. As one respondent queried in her brief, what protection against modification would Congress be providing lenders if they were protected against nominal changes in interest rate or payment amount but not from a more than sixty-five percent reduction in principal?[90] However, the rationale for forcing secured lenders other than home mortgage lenders to accept lien stripping is that it merely forces them to recognize a changed economic reality—the decline in value of the collateral. The issue raised in *Nobelman* is whether forcing mortgage lenders to recognize a changed economic reality by revising the legal description of their rights must constitute a "modification" for bankruptcy purposes.

Citing *Dewsnup*, Justice Thomas argued that § 1322(b)(2) protects home mortgage lenders from having the rights "bargained for by the mortgagor and mortgagee" modified without their consent.[91] However, many provisions of Chapters 1, 3, and 5 alter the rights of home mortgage lenders in Chapter 13 proceedings by operation of law. Justice Thomas conceded that not all rights of mortgagees survive unaltered in bankruptcy,[92] pointing out that a secured lender's right to foreclose is halted by the automatic stay,[93] that an undersecured lender's right to receive interest during the pendency of a reorganization is lost,[94] and that a debtor has the right to cure prepetition defaults and reinstate a mortgage that is already accelerated and due under state law.[95] The issue, then, is not simply whether such an alteration is possible, but rather the

89. *Nobelman*, 113 S. Ct. at 2110.

90. Brief on the Merits for Respondent, Standing Chapter 13 Trustee at 22, *Nobelman*, 113 S. Ct. 2106 (No. 92-641) [hereinafter Trustee Brief].

91. *Nobelman*, 113 S. Ct. at 2110.

92. *Id.* at 2106 (citing *Timbers*, 484 U.S. at 369-70); *see also* Wright v. Vinton Branch of the Mountain Trust Bank, 300 U.S. 440 (1937) (discussing rights of mortgagees).

93. 11 U.S.C. § 362 (1988).

94. *Timbers*, 484 U.S. at 369-70.

95. Section 1322(b)(5) provides,

> Notwithstanding . . . [§ 1322(b)(2)'s antimodification provisions, a plan may] provide for the curing of any default within a reasonable time and maintenance of payments

more difficult question of when an alteration of those rights is so great that it constitutes an impermissible "modification."

The only basis Justice Thomas offered for distinguishing between permissibly "affecting" a secured creditor's rights and impermissibly "modifying" them was that "contract" rights and the "power to enforce [property] rights" can be affected by bankruptcy, but "property" rights must pass through bankruptcy unaffected.[96] This distinction is conclusory at best and is hardly a reasoned analysis of when bankruptcy law should not be permitted to modify a creditor's state law entitlements. Moreover, Justice Thomas failed to note that his examples may not prove the proposition for which he cited them. The operation of the automatic stay, like bifurcation under § 506(a), modifies the rights of secured creditors by operation of the Bankruptcy Code itself, not through implementation of the debtor's plan of reorganization.[97] Also, again like bifurcation, the automatic stay was designed to diminish the nonbankruptcy rights of secured creditors in order to improve the position of the debtor.[98]

The problem of defining what constitutes an impermissible "modification" of a home mortgage lender's rights was vigorously debated soon after the Code was enacted. The issue at that time was the debtor's power to cure and reinstate a home mortgage under § 1322(b)(5). Mortgage lenders argued that once the debt had been accelerated, the debtor had no way to cure the default under the Bankruptcy Code except to pay the full amount as required by state law. This was rejected by most courts as too narrow a reading of "curing any default" and because it failed to give full import to the "notwithstanding paragraph (2)" language.[99]

> 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; . . .

11 U.S.C. § 1322(b)(5) (1988).

96. *Nobelman*, 113 S. Ct. at 2110.

97. CEPA Brief, *supra* note 11, at 36-38. It should be noted, however, that unlike the automatic stay, bifurcation is achieved through a valuation hearing brought on by a motion of an interested party. FED. R. BANKR. PROC. 3012.

98. James J. White, *The Recent Erosion of the Secured Creditor's Rights Through Cases, Rules and Statutory Changes in Bankruptcy Law*, 53 MISS. L.J. 389, 398-400 (1983).

99. DiPierro v. Taddeo (*In re* Taddeo), 685 F.2d 24 (2d Cir. 1982); *see also* Grubbs v. Houston First Am. Sav. Ass'n (*In re* Houston), 730 F.2d 236 (5th Cir. 1984) (en banc) (cited by Justice Stevens in his concurrence in *Nobelman*). The en banc *Grubbs* opinion overturned an earlier Fifth Circuit opinion for the mortgage lender on this issue. Grubbs v. Houston First Am. Sav. Ass'n, 718 F.2d 694 (5th Cir. 1983). Mortgage lenders had more success rejecting the debtor's attempt to cure if they had already reduced the debtor's liability to judgment under state law before the bankruptcy proceeding was initiated, with some courts holding that the debt had been merged into the judgment and so § 1322(b)(5) no longer applied because no

3. Bifurcation

Justice Thomas conceded that § 506(a) limits a creditor's secured claim to an amount equal to the value of the collateral, but denied that § 506(a) valuation has any impact on the "rights" of home mortgage lenders protected by § 1322(b)(2).[100] This narrow reading of § 506(a) undermines not only the rights of other unsecured creditors, but also undermines the policy of a "fresh start" for debtors. After *Nobelman* a creditor might require a homeowner to grant the lender a mortgage even if, at the time the loan was made, the borrower had no unencumbered equity in the property.[101] Such a creditor would later be in a position to deprive the homeowner of part of the value of a bankruptcy discharge if the total debt secured by the homestead exceeded the value of the property. A debtor in such a position would be forced to choose between paying more than the current value of the homestead in order to retain possession, or surrendering the property in order to receive the full economic benefit of the bankruptcy discharge. Granting a special, privileged status to junior homestead liens of this type might also disadvantage other unsecured creditors if all the debtor's disposable income was directed to paying undersecured lienholders in full instead of all unsecured claims equally.[102] This special treatment of financially worthless mortgage liens creates a potential trap for unwary consumer debtors. In so doing, it contrasts with other provisions of the Bankruptcy Code that are designed to preserve the value of the debtor's discharge, such as the special procedures mandated whenever the debtor wishes to reaffirm a debt,[103] or the ability of the debtor to avoid nonpossessory, nonpurchase-money liens in household goods.[104]

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payments on the debt were due after the plan. *See, e.g.*, Percy Wilson Mortgage & Fin. Corp. v. McCurdy (*In re* McCurdy), 21 B.R. 535 (Bankr. S.D. Ohio 1982). However, other opinions have held that the debtor may cure and reinstate the mortgage debt right up to the time a foreclosure sale is held. *See, e.g.*, *In re* Glenn, 760 F.2d 1428 (6th Cir.), *cert. denied*, 474 U.S. 849 (1985).

100. *Nobelman*, 113 S. Ct. at 2110.

101. This problem rarely arises in Texas because of the general prohibition on granting liens on a homestead, subject only to three exceptions: purchase-money liens, home-improvement liens, and tax liens. TEX. CONST. art. XVI, § 50; TEX. PROP. CODE ANN. § 41.001 (West 1984 & Supp. 1993). The problem of wholly unsecured junior liens therefore rarely arises in Texas, although it is a possibility. For example, a lien securing the purchase price of home improvements might be undersecured when it attached and become wholly unsecured following a general decline in house prices.

102. *See* National Consumer Law Ctr., *supra* note 84, at 23.

103. 11 U.S.C. § 524(c) (1988).

104. 11 U.S.C. § 522(f)(2) (1988). See *infra* part IV.A.3 for a discussion of the debtor's ability to avoid nonpossessory, nonpurchase-money security interests in household goods.

The importance of forcing undersecured creditors to accept claims bifurcation, and to limit their right to "adequate protection" to the financial value of the secured portion alone, was recently emphasized by the Supreme Court in *United Savings Ass'n v. Timbers of Inwood Forest Associates, Ltd.*[105] There, the Court rejected an attempt by undersecured creditors to receive interest payments on their allowed secured claims during the pendency of a Chapter 11 reorganization before other unsecured creditors received any payment on their claims.[106] In *Nobelman* the Court effectively granted the undersecured lender the right to principal as well as interest payments on its unsecured claim before any payment to other unsecured creditors, thereby violating the principal of equal treatment of similarly situated creditors.[107]

When Congress perceived a conflict between the general requirement of § 506(a)—that claims be treated as secured only to the extent of the judicially determined value of the collateral—and the specific requirements of a rehabilitative bankruptcy proceeding, it expressly qualified the application of § 506. Section 1111(b) provides that undersecured, nonrecourse lenders will be treated as having recourse against the debtor unless they elect to have both the secured and unsecured portions of their claim treated as secured for certain purposes.[108] Section 1111(b)(2) specifically provides that "if such an election is made, then *notwithstanding section 506(a) of this title*, such claim is a secured claim to the extent that such claim is allowed."[109] Section 1322(b)(2), however, does not refer to § 506(a), nor does it qualify in any way the application of § 506(a) in Chapter 13 plans.

The relationship between the reorganization chapters and § 506 is not always clear, however, and silence in § 1322(b)(2) is not dispositive on the issue of congressional intent. Section 1124(1), governing impairment of claims or interests, provides that a Chapter 11 debtor may leave unaltered the rights of holders of claims.[110] It does not refer to § 506, suggesting that § 506(a) bifurcation cannot be as automatic as the petitioners' argument might suggest. Furthermore, the language of § 506(a)

105. 484 U.S. 365 (1988).

106. *Id.* at 381.

107. CEPA Brief, *supra* note 11, at 54-55.

108. 11 U.S.C. § 1111(b) (1988). A more detailed discussion of the rights of secured creditors in Chapter 11 proceedings, including the right of certain creditors to make § 1111(b) elections, is found *infra* part IV.C.2.

109. 11 U.S.C. § 1111(b)(2) (1988) (emphasis added).

110. *Id.* § 1124(1) provides that a class of claims is impaired under a plan unless the plan "leaves unaltered the legal, equitable, and contractual rights to which such claim or interest entitles the holder of such claim or interest."

concerning valuation seems to suggest that an asset might have multiple, inconsistent valuations during the course of a reorganization proceeding, making it unclear which value would apply automatically to bifurcate a claim into secured and unsecured portions.[111]

4. Discharge

Another weakness in the petitioners' interpretation of § 1322's antimodification provision emerges when the scope of the debtor's discharge is considered. Bankruptcy courts have no power to grant the Chapter 13 debtor a discharge for personal liability on a debt that is neither paid in full under the plan nor paid according to the original terms of the agreement between the debtor and the creditor. Under § 1325(a)(5) a debtor may cramdown a secured creditor only by allowing the creditor to retain its lien and by offering to pay within the plan the value of the claim.[112] If the debtor can pay the amount of the allowed secured claim within the three-to-five-year term of a plan, then the debtor can receive a discharge on any unpaid balance under § 1328.[113]

As noted by ASB, permitting a mortgagor to make standard contract payments for less than the original term of the loan following bifurcation of the mortgagee's claim arguably frustrates the congressional intent of the antimodification provision of § 1322(b)(2). However, provided all payments on the secured claim are made by the end of the reorganization, such a shortened maturity may still enable the debtor to receive a discharge on the debt under § 1328(a). On the other hand, if the debtor proposes to pay the mortgage outside the plan and continues to make payments beyond the life of the plan, then the court cannot grant the debtor a discharge of personal liability on that debt.[114] Nevertheless, many debtors have sought to strip down mortgages with maturi-

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111. The relevant language in § 506(a) is "[s]uch value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest." *Id.* § 506(a).

112. 11 U.S.C. § 1325(a)(5) (1988) provides that the court shall confirm a plan if,

> with respect to each allowed secured claim provided for by the plan—
> (A) the holder of such claim has accepted the plan;
> (B) (i) the plan provides that the holder of such claim retain the lien securing such claim; and
> (ii) the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim; or
> (C) the debtor surrenders the property securing such claim to such holder.

Id.

113. *Id.* § 1328 (1988 & Supp. IV 1992).

114. *Id.* § 1328(a)(1).

ties that considerably exceed the term of their proposed Chapter 13 plans, and courts have confirmed these plans despite the plain language of § 1328(a)(1).[115] However, this attempt to strip down long-term debts not fully paid within the term of the plan can effect no more than a moratorium on the power of the mortgagee to foreclose, not a discharge.[116]

Another difficulty with the petitioners' position appears when the debtor attempts to set up a new amortization schedule that does not "modify" the contractual rights that even they conceded are protected under § 1322(b)(2). Even jurisdictions that permitted lien stripping prior to *Nobelman* required that debtors continue to make payments in the amount provided in the original contract, not some lesser amount. As Justice Thomas noted in the opinion, however, a problem arises when the original mortgage is not a fixed-rate mortgage, because payment amounts and the interest rate are subject to modification over the term of the loan, as was the case with the Nobelmans' mortgage.[117]

By broadly interpreting "rights of holders" of claims secured by the debtor's homestead, Justice Thomas may have done more than prevent lien stripping. Without a clear standard to determine which rights of lienholders pass through bankruptcy unaffected, one possible interpretation of Justice Thomas's holding is that the debtor cannot receive a discharge of personal liability for a debt secured by a lien on his or her homestead.[118] Such a ruling would fly in the face of the clear language of the Bankruptcy Code.[119] The fact that Justice Thomas's reasoning supports such an implausible outcome, however, undermines the credibility of his interpretation of the language at issue in the case.

C. Legislative History

Justice Thomas analyzed the issues in *Nobelman* very narrowly, with nary a mention of the legislative history of either § 506(a) or § 1322(b)(2). Justice Stevens filed a concurrence asserting that Justice Thomas's "literal" reading of the statute was consistent with the legislative history of § 1322(b)(2).[120] Justice Stevens conceded, however, that

115. *See, e.g.*, Bellamy v. Federal Home Loan Mortgage Corp. (*In re* Bellamy), 962 F.2d 176 (2d Cir. 1992).

116. *In re* Dyer, 142 B.R. 364, 370-72 (Bankr. D. Ariz. 1992), *vacated*, 153 B.R. 601 (Bankr. 9th Cir. 1993).

117. *Nobelman*, 113 S. Ct. at 2111; *see* Trustee Brief, *supra* note 90, at 22-24.

118. DOUGLAS G. BAIRD, THE ELEMENTS OF BANKRUPTCY 58 (rev. ed. 1993); Margaret Howard, Nobelman v. American Sav. Bank: *Of Literalism, Retroactivity and Discharge*, 1993 NORTON BANKR. L. ADVISOR 1, 3.

119. *See* 11 U.S.C. § 524(a)-(b) (1988).

120. *Nobelman*, 113 S. Ct. at 2112 (Stevens, J., concurring).

there was an apparent paradox in requiring the debtor to surrender his or her homestead while permitting the debtor to strip down liens on other property, but concluded that the legislative history mandated such a result.[121] His concurrence accepts the interpretation of the legislative history of § 1322(b)(2) put before the Court by ASB and its amici. However, the legislative history does not support the holding in *Nobelman* any more clearly than does the language of the statute.

Some commentators have argued that the Bankruptcy Reform Act of 1978 represented something of a high-water mark of rising popular and congressional support for debtors, including consumer debtors, and that since its passage, Congress,[122] state legislatures,[123] and the courts[124] have gradually undermined many of its more prodebtor provisions.[125] The *Nobelman* case can be seen as an example of this trend. It is based on a narrow reading of § 506(a) and § 1322(b)(2) that obscures the extent to which the holding subverts some of the major policy initiatives of the 1978 reforms. Although the Court failed to analyze the fundamental bankruptcy policy issues implicated in its decision, its restricted reading produced a result that is consistent with the broader trend of eroding those reforms. The Court tacitly rejected the theory that permitting bifurcation of the claims of home mortgage lenders into secured and unsecured claims before applying the special protections of § 1322(b)(2) would simultaneously preserve both a fresh start for honest debtors and equal treatment for similarly situated creditors.[126]

The Court also failed to note that the legislative history is silent on precisely the point at issue in *Nobelman*—whether the exclusion from modification in the debtor's Chapter 13 plan applies *before or after* bifurcation of the mortgage lender's claim under § 506(a). The legislative history is silent because many of the differences between the Senate and House versions of the Bankruptcy Reform Act of 1978 arose in a series of

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121. *Id.* at 2114 (Stevens, J., concurring). See *infra* part II.C. for discussion of the legislative history.

122. *See, e.g.*, 11 U.S.C. § 707(b) (1988) (substantial abuse); *id.* § 523(a)(2)(C) (exception to discharge for luxuries purchased within 40 days of filing); *id.* § 524(d) (relaxation of reaffirmation provisions); *id.* § 1328(a) (narrowing Chapter 13 discharge).

123. 11 U.S.C. § 522(b) permits states to opt out of the federal exemptions in 11 U.S.C. § 522(d). By 1993, 36 states had done so. 3 COLLIER ON BANKRUPTCY, § 522.02, at 522-11 n.4a, 522-12 (Lawrence P. King ed., 15th ed. 1993) [hereinafter COLLIER 15].

124. ELIZABETH WARREN & JAY L. WESTBROOK, THE LAW OF DEBTORS AND CREDITORS 392-94 (2d ed. 1991) (stating variations of local legal culture produce large regional variations in bankruptcy practice, with courts adopting radically differing interpretations of Bankruptcy Code provisions).

125. White, *supra* note 98, at 389; Barry L. Zaretsky, *Some Limits on Mortgagees' Rights in Chapter 13*, 50 BROOK. L. REV. 433 (1984).

126. H.R. DOC. No. 137, 93d Cong., 1st Sess. 75 (1975).

informal, unreported compromises entered into with a view toward getting the legislation enacted in the final days of the 95th Congress. Only certain issues were discussed in depth—such as the status of bankruptcy judges and the funding of a U.S. trustee system—and the ban on modifications of home mortgages in Chapter 13 proceedings was not among them.[127]

One of the fundamental objectives of the revision of bankruptcy law in the 1970s was the reform of the consumer bankruptcy process. Prior to the enactment of the Code, consumer debtors received little relief in bankruptcy because security interests encumbered most debtors' assets and debts often were excepted from discharge or reaffirmed by debtors.[128] These problems were exacerbated by the lack of effective legal representation for consumer debtors.[129] The generous cramdown provisions of Chapter 13,[130] which granted debtors substantial leverage in restructuring their secured debts, were part of the legislative response to these problems.

Section 67(d) of the Bankruptcy Act originally provided that properly perfected liens could not be affected in bankruptcy proceedings.[131] This was later revised by the provisions of the Chandler Act of 1938 with regard to reorganization proceedings.[132] Under the Bankruptcy Act, a Chapter XIII wage-earner plan could deal with claims secured by personal property, but could not be confirmed unless every secured creditor dealt with under the plan consented.[133] Chapter XIII debtors could not modify at all the rights of a creditor holding a claim secured by real property.[134] Chapter XIII was thus of limited utility to debtors trying to deal with secured claims. Judicial attempts to circumvent the rigid rules regarding the treatment of secured claims in Chapter XIII often failed.[135] The Commission on the Bankruptcy Laws of the United States, created

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127. Petitioner Brief, *supra* note 20, at 17.

128. Richard I. Aaron, *The Bankruptcy Reform Act of 1978: The Full-Employment-For-Lawyers Bill Part II: Consumer Bankruptcy*, 1979 UTAH L. REV. 175, 177.

129. *Id.*

130. See *infra* part IV.C.3 for a general discussion of Chapter 13 cramdown provisions.

131. Bankruptcy Act of July 1, 1898, ch. XIII, 30 Stat. 564 (as amended) (repealed 1978).

132. Act of June 22, 1938, ch. 575, 52 Stat. 840, *repealed by* Act of Nov. 6, 1978, Pub. L. No. 95-598, 92 Stat. 2549.

133. Chapter XIII was the predecessor to Chapter 13. 10 COLLIER ON BANKRUPTCY § 651, ¶ 29.01, § 651, ¶ 29.02 (James W. More & Lawrence P. King eds., 14th ed. 1978) [hereinafter COLLIER 14].

134. Bankruptcy Act of July 1, 1898, ch. XIII, 30 Stat. 544-66 (as amended) (repealed 1978) (exclusion from relevant definition of "claim"); 10 COLLIER 14, *supra* note 133, § 601(1), ¶ 22.02, § 646(2), ¶ 28.03.

135. *In re* Kaczmarczyk, 107 B.R. 200, 203 (Bankr. D. Neb. 1989) (citing Worley v. Budget Credit, Inc., Bankr. L. Rep. (CCH) ¶ 64,285 (6th Cir. 1971), *cert. denied*, 406 U.S. 907 (1972),

by Congress in 1970 to review existing bankruptcy law and propose changes,[136] recommended that debtors in a new Chapter 13 proceeding be allowed generally greater power to deal with claims secured by personal property.

In drafting the current Bankruptcy Code, Congress significantly revised the law governing the determination of the secured status of creditors. Section 506 was intended to shift the focus from the status of creditors as secured or unsecured, and to clarify the treatment of creditors with liens on property worth less than the amount of their claims in bankruptcy. In the words of the Senate Committee Report discussing section 506 of Senate Bill 2266,

> [t]hroughout the bill, references to secured claims are only to the claim determined to be secured under this subsection and not to the full amount of the creditor's claim. This provision abolishes the use of the terms 'secured creditor' and 'unsecured creditor' and substitutes in their places the terms 'secured claim' and 'unsecured claim.'[137]

Section 506 focused on economic reality, rather than formal legal attributes, as the determinative factor in classifying nominally secured claims.

In reforming the bankruptcy law, Congress was persuaded that both creditors and debtors would benefit from concentrating attention on secured claims instead of secured creditors. Creditors would receive the benefits of "adequate protection" to the full extent of their security, while the obligations of the debtor with regard to secured creditors would be clarified.[138] Undersecured creditors would no longer be allowed to use the ambiguity of the law to exercise unwarranted leverage over the debtor and to benefit at the expense of unsecured creditors generally.[139] The House Report specifically rejected "a few misguided decisions" under the Bankruptcy Act in which creditors whose debts greatly exceeded their security were permitted to assert the entire debt as a secured claim "in preference to all unsecured creditors."[140]

The rationale in *Nobelman* for narrowing the scope of § 506(a) was derived from the Court's reading of the antimodification language in

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and rejecting on appeal trial court's approval of plan's bifurcation of secured claim into secured and unsecured portions).

136. Act of July 24, 1970, Pub. L. No. 91-354, 84 Stat. 468.

137. S. REP. No. 989, 95th Cong., 2d Sess. 68 (1978). The version of section 506 that appeared in Senate Bill 2266 was identical to § 506 as enacted, except for one comma. *Compare* H.R. REP. No. 595, 95th Cong., 1st Sess. 180-81 (1977) *with* 11 U.S.C. § 506.

138. H.R. REP. No. 595, 95th Cong., 1st Sess. 180-81.

139. *Id.*

140. *Id.* at 123.

§ 1322(b)(2), which mandates special treatment for liens secured by the debtor's homestead. The legislative history of § 1322(b)(2) casts some light on the nature of the special protections Congress intended to grant home mortgage lenders.[141] From the outset of the bankruptcy reform process in the 1970s, consideration was given to treating real property liens, including liens on the debtor's homestead, differently from other security interests. The Bankruptcy Commission recommended that Chapter 13 debtors be allowed to modify the rights of creditors with real property security interests only to the extent of curing a default and continuing to make scheduled mortgage payments.[142] The original House version did not follow the Commission's recommendation, but proposed instead that a Chapter 13 debtor should be allowed to "modify the rights of holders of secured claims or of holders of unsecured claims."[143] The Senate version, however, preserved the Chapter XIII rule intact by prohibiting modification of "claims wholly secured by mortgages on real property."[144] In the final compromise version enacted in 1978, both the Senate and House modified these versions along the lines recommended by the Commission. According to the Joint Explanatory Statement agreed upon by House and Senate floor managers, under Section 1322(b)(2) of the compromise version, "the plan may modify the rights of holders of secured claims other than a claim secured by a security interest in real property that is the debtor's principal residence. It is intended that a claim secured by the debtor's principal residence may be treated under Section 1322(b)(5)."[145] The Senate thus retreated from its position that no modification was to be permitted to any mortgage secured by real estate, agreeing instead to permit only cure and reinstatement, but no other modification of claims secured by the debtor's home.[146]

This limited bar on modification of secured claims in Chapter 13 was apparently in response to suggestions advanced in legislative hearings concerning the impact of the original House version on the home

141. Grubbs v. Houston First Am. Sav. Ass'n, 730 F.2d 236, 245 (5th Cir. 1984) (en banc).

142. H.R. Doc. No. 137, 93d Cong., 1st Sess., pt. 1, at 13 (1973), *reprinted in* COLLIER 15, *supra* note 123, app. 2, at I-1.

143. H.R. 8200, 95th Cong., 1st Sess. 429 (1977).

144. *Bankruptcy Reform Act of 1978; Hearings Before the Subcomm. on Improvements in Judicial Machinery of the Senate Comm. on the Judiciary*, 95th Cong., 1st Sess. 273 (1977) [hereinafter *Improvements Hearings*].

145. 124 CONG. REC. 34,009, 32,409 (1978) (statement of Sen. DeConcini and Rep. Edwards, respectively).

146. *Nobleman* [sic], 968 F.2d 483, 488-89 (5th Cir. 1992); *see In re* Sauber, 115 B.R. 197, 199 (Bankr. N.D. Minn. 1990).

mortgage lending industry.[147] The compromise language in § 1322(b)(2) was enacted after a hearing at which Edward J. Kulik of Massachusetts Mutual Life Insurance Company expressed concern about the potential impact of the language of the House version on the availability of home mortgage loans.[148] However, the Senate subcommittee that heard Mr. Kulik's testimony never reported its findings after hearing the evidence of nearly eighty witnesses over twenty-four days, along with the testimony of another several hundred interested parties. Thus it is impossible to determine what impact, if any, Mr. Kulik's testimony had on the final Senate determination.[149] Furthermore, statements of interested witnesses are generally not accepted as authoritative legislative history for purposes of statutory construction.[150]

III. Pending Legislation

In 1992 and 1993 Congress made repeated, unsuccessful attempts to clarify the rights and obligations of Chapter 13 debtors and their home mortgage lenders. Each bankruptcy reform bill introduced in the 102d and 103d Congresses dealt with the issue of lien stripping.[151] The proposed legislation generally reaffirmed the antimodification protection now enjoyed by home mortgage lenders, but at the same time granted some limited relief to debtors. The provisions that authorize a limited form of lien stripping may be so cumbersome for debtors to actually use, however, that any victory for debtors is more apparent than real.

Notwithstanding a bewildering array of special interests associated with particular provisions of the proposed bankruptcy reform legislation,[152] several overriding reasons for promoting comprehensive bankruptcy reform motivated Congress to act. One was the urge to respond to the soaring volume of bankruptcy filings, from only 348,488 in 1984 to 971,517 in 1992—an increase of 179%.[153] Virtually all the increase had

147. *Grubbs*, 730 F.2d at 246 (en banc).

148. *Improvements Hearings*, *supra* note 144, at 708-15.

149. Petitioner Brief, *supra* note 20, at 15.

150. How Federal Laws Are Made 26 (rev. ed. 1984).

151. S. 1985, 102d Cong., 2d Sess. § 310 (1991); H.R. 5321, 102d Cong., 2d Sess. § 2(g) (1992); H.R. 6020, 102d Cong., 2d Sess. § 202 (1992); S. 540, 103d Cong., 1st Sess. § 201 (1993); H.R. 2326, 103d Cong., 1st Sess. § 2(g) (1993).

152. Aaron Pressman, *Can Chapter 11 Be Put Back Together? Reform Movement in Senate Could Undo Portions of the '78 Bankruptcy Reform Act*, Investment Dealers Dig., Apr. 27, 1992, at 16.

153. The eight-year surge in bankruptcies now appears to have abated. John H. Cushman, Jr., *Bankrupt Individuals Are Fewer*, N.Y. Times, June 28, 1993, at C1. During 1992 the national increase in bankruptcy filings was less than 3%, the smallest increase in the last eight years, and well below the 20.6% increase recorded in 1990. Administrative Office of the

come in filings of Chapter 7 and Chapter 13 cases.[154] As Representative Jack Brooks asserted, "More Americans now come into contact with the bankruptcy court system than any other branch of our judiciary."[155] Another reason was the desire to update the Bankruptcy Code, acting on the lessons learned in the fourteen years following its enactment in 1978.[156]

The accelerating tempo and rising volume of bankruptcy litigation and the increasing significance of bankruptcy to many areas of economic regulation and commercial and corporate law practice are increasing the pressure for bankruptcy reform.[157] At least some of the pressure for an overhaul comes from groups that were never happy with the balance struck between debtor and creditor interests when the Code was originally enacted.[158] Many of the basic compromises between debtor, creditor, and other interests reflected in the Bankruptcy Code have come under renewed critical scrutiny in recent years.[159] In addition to thoughtful reconsideration of the basic premises of existing bankruptcy law, energetic lobbying by special interest groups has produced an accumulation of proposed qualifications to the original provisions of the Bankruptcy Code, many of which would argue obscure its basic premises.[160]

Other controversial issues unrelated to lien stripping created obstacles to getting a bankruptcy reform bill through Congress. Given that

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U. S. COURTS, BANKRUPTCY STATISTICAL INFORMATION (1993) [hereinafter ADMINISTRATIVE OFFICE].

154. Chapter 11 case filings peaked in 1986, dropped considerably during 1987 and 1988, increased by 36% from 1989 to 1991, and decreased by 5.6% during 1992. ADMINISTRATIVE OFFICE, *supra* note 153, at 1.

155. *Consumer Issues in Bankruptcy: Hearings on H.R. 5321 Before the Subcomm. on Economic and Commercial Law, House Comm. on the Judiciary*, 102d Cong., 2d Sess. (1992) [hereinafter *1992 Hearings*] (statement of Rep. Brooks).

156. 138 CONG. REC. S8250 (1992) (statement of Sen. Heflin).

157. *See* David F. Bantleon & Kathy L. Kresch, *A Bankruptcy Law for the '90s*, BUS. L. TODAY, Jan.-Feb. 1993, at 25, 25. Of course, some deny that the Bankruptcy Code is in need of substantial revisions. *See, e.g.*, Leonard M. Rosen, *Book, Chapter and Worse*, BUS. L. TODAY, July-Aug. 1992, at 47, 47.

158. *See, e.g.*, Zaretsky, *supra* note 125 (suggesting that Code was high-water mark for debtors' rights and that pendulum has been swinging back in favor of creditors ever since it was enacted).

159. These include the apparent ease with which major corporations are able to use Chapter 11 reorganization proceedings to gain an advantage over competitors; the rate of compensation of legal, financial, and accounting professionals in major corporate reorganizations; the viability of the corporate reorganization process itself; and the ease with which individual debtors can avoid making any significant payments to creditors while retaining a substantial number of assets. *See, e.g.*, Mary Graham, *Bankrupt and Bullish*, ATLANTIC, Mar. 1992, at 24.

160. Rob Rossi, *Bar Groups Spar over Bankruptcy Code Reform*, LEGAL TIMES, Feb. 17, 1992, at 6.

the success or failure of bankruptcy reform legislation now turns on issues unrelated to lien stripping, it is difficult to predict the likelihood that Congress will act to overrule or qualify the result in *Nobelman* in the near future. If comprehensive bankruptcy reform legislation is passed by Congress and enacted into law, however, the various bills offer insights into what such legislation is likely to provide with regard to lien stripping.

A. 1992 Bankruptcy Reform Legislation

In November 1991 Senators Howell Heflin and Charles Grassley introduced Senate Bill 1985, a bipartisan comprehensive bankruptcy reform bill.[161] When Senate Bill 1985 passed the Senate ninety-seven to zero on June 17, it appeared possible that 1992 would bring substantial reform in bankruptcy law. After Representative Michael Synar introduced a bill dealing with consumer bankruptcy issues[162] in June, the House Judiciary Subcommittee on Economic and Commercial Law held oversight hearings on bankruptcy issues. Representatives of the credit industry testified to the need for bankruptcy reform legislation along the lines of that passed by the Senate in June, and consumer advocates testified against limiting bankruptcy relief for individual debtors.[163] On October 3, the House passed House Bill 6020,[164] a bipartisan bankruptcy reform bill with narrower coverage than Senate Bill 1985. A compromise version passed the Senate on October 7. In the final negotiations to resolve the differences between the House and Senate versions of the bankruptcy reform bill, a controversial provision providing greater protection for collective bargaining agreements and payment of insurance benefits to retirees was added, ending the legislation's remaining chances of passing before Congress adjourned.[165]

The first version of Senate Bill 1985 introduced in November 1991 provided that a Chapter 13 plan may not "modify a claim pursuant to section 506 of a person holding a primary security interest in real property or a manufactured home . . . that is the debtor's principal resi-

161. S. 1985, 102d Cong., 2d Sess. (1991).

162. H.R. 5321, 102d Cong., 2d Sess. (1992).

163. *1992 Hearings*, *supra* note 155 (statements of Barbara L. Clore, Associated Industries Credit Union; Willard Gourley, Jr., Mortgage Bankers Assoc. of America; Henry J. Sommer, National Bankruptcy Conference; and Gary Klein, National Consumer Law Center).

164. H.R. 6020, 102d Cong., 2d Sess. (1992).

165. *Id.* § 313. These frantic last-minute attempts to forge a compromise failed on October 9, 1992, when the House adjourned and tabled the issue of comprehensive bankruptcy reform until the new Congress convened in 1993. Bantleon & Kresch, *supra* note 157, at 25.

dence."[166] The version enacted by the Senate on June 19, 1992, had been amended to provide that a Chapter 13 plan may not modify a primary or a junior security interest in the debtor's home, except that a plan could modify a junior lien to the extent that it was undersecured at the time it attached.[167] Senator Heflin described this provision as "one of the most important provisions of the bill."[168] He stated that this section would protect the mortgage-backed securities market, and completely insulate the entire claim in cases of first mortgages on the debtor's home. It was also designed to "protect junior security interests except in circumstances where the security interest was undersecured at the time of contracting."[169] A junior lien could only be stripped down to the extent that it remained undersecured at the time of the bankruptcy.[170] This section was designed both to acknowledge the courts' power to bifurcate home mortgages under § 1322 by the operation of § 506, but at the same time protect the stability of the mortgage marketplace.[171]

The first bankruptcy reform bill introduced in the House provided that a Chapter 13 plan may

> modify the rights of the holders of secured claims, but the plan may not modify a claim pursuant to section 506 of a person holding a primary or a junior security interest in real property that is the debtor's principal residence, except that the plan may modify the claim of a person holding such a junior security interest that was undersecured at the time the interest attached to the extent that the interest remains undersecured.[172]

The later version passed by the House Judiciary Subcommittee provided that a plan may modify the rights of secured creditors,

> except that the rights of the holder of a claim secured only by the most senior security interest in real property that is the debtor's principal residence may not be modified to reduce the secured claim to a value that is less than the value, as of the date the security interest arose, of the creditor's interest in the estate's interest in such property.[173]

The committee report states that this section was designed to resolve the split in the federal circuit courts created by the *Nobelman* case by pro-

166. S. 1985, 102d Cong., 2d Sess. § 310 (1991) (version 1).
167. *Id.* (version 4).
168. 138 CONG. REC. S8252 (1992) (statement of Sen. Heflin).
169. *Id.*
170. *Id.*
171. *Id.* at S8252-53.
172. H.R. 5321, 102d Cong., 2d Sess. § 2(g) (1992).
173. H.R. 6020, 102d Cong., 2d Sess. § 202.

tecting senior mortgage liens from bifurcation under § 506 to the extent they were not undersecured when they were originated.[174] The final version of Senate Bill 1985, which passed the Senate on October 7, 1992, provided that "notwithstanding section 506(a), the rights of the holder of the most senior security interest in real property that is the debtor's principal residence may not be modified to reduce the secured claim to a value that is less than the value of the allowed claim."[175]

B. 1993 Bankruptcy Reform Legislation

On March 10, 1993 Senators Heflin and Grassley introduced the Bankruptcy Amendments Act of 1993.[176] On March 31, the Senate Subcommittee on Courts and Administrative Practice held hearings on Senate Bill 540.

Section 306 of Senate Bill 540 provides that a "plan may not modify a claim pursuant to section 506 of a person holding a primary or a junior security interest in" the debtor's home, except that the plan may modify the claim of a junior lienor that was undersecured at the time it attached to the extent that the interest remains undersecured.[177] On May 27, 1993, Congressman Synar introduced a bankruptcy reform bill in the House that included an identical provision governing lien stripping.[178]

C. National Bankruptcy Conference Recommendations

While Congress attempted to pass comprehensive, bipartisan bankruptcy reform legislation on Capitol Hill, the National Bankruptcy Conference (NBC), in a program sponsored by the American Law Institute and the American Bar Association, produced perhaps the most thorough study of the operation of bankruptcy law since the Bankruptcy Code was enacted in 1978.[179] This report, the *Bankruptcy Code Review Project*

174. H.R. REP. No. 996, 102d Cong., 2d Sess. 21-22 (1992).

175. 138 CONG. REC. S17,502 (1992).

176. S. 540, 103d Cong., 1st Sess. (1993). Following the model of Senate Bill 1985, this bill would create a new small business chapter, permit pension regulators to participate in corporate reorganizations, streamline the bankruptcy process, increase the eligibility ceilings for Chapter 13, extend the life of Chapter 12, and create a national commission to study proposals to reform further the Bankruptcy Code, as well as address the issue of lien stripping in Chapter 13. In addition, following the model of the final version of the bankruptcy reform bill that passed the Senate on October 7, 1992, Senate Bill 540 regulates professional fees and facilitates the collection of alimony and child support from debtors in bankruptcy.

177. *Id.*

178. H.R. 2326, 103d Cong., 1st Sess. § 2(g) (1993).

179. BANKRUPTCY REFORM CIRA 1993: A PRESENTATION OF THE NATIONAL BANKRUPTCY CONFERENCE'S BANKRUPTCY CODE REVIEW PROJECT at i (ALI-ABA Committee on Continuing Professional Education, 1993) [hereinafter BCRP]. The National Bankruptcy

(BCRP), covers many of the same issues addressed by the proposed bankruptcy reform bills introduced in 1992 and 1993, although from a more "global" perspective.[180] One of the major conclusions of the report is that while the Bankruptcy Code needs updating in many respects, it is fundamentally sound law and is not in need of sweeping overhaul at this time.[181] However, the report did address specific issues, including lien stripping in Chapter 13.

The NBC generally recommends reaffirming the basic principles established in the Bankruptcy Code with regard to the individual debtor's fresh start,[182] in effect throwing down the gauntlet to the creditors' lobbies massing on Capitol Hill. With regard to lien stripping, the NBC not only recommends that a debtor in Chapter 13 should be entitled to use § 506 to strip any lien, including the lien against the debtor's principal residence,[183] but also recommends that *Dewsnup* be overruled and lien stripping be authorized for Chapter 7 debtors as well.[184] The NBC endorses lien stripping for home mortgages in Chapter 13 and in Chapter 7 because it believes that lien stripping offers creditors as much as they would receive in a foreclosure sale while permitting the debtor to retain the property.[185] In addition, the NBC argues that, based on the experience of jurisdictions that have permitted lien stripping and the experience of lenders with mortgages on properties other than the debtor's principal residence, the impact of broadly permitting lien stripping is unlikely to have a significant impact on secondary mortgage markets.[186]

Just as it is difficult to predict whether comprehensive bankruptcy reform legislation will pass Congress soon, it is difficult to predict how much practical impact a scholarly study like the BCRP will have on the legislative process. Members of the NBC recognize that without any special interest to promote their study, its impact may be slight.[187] For example, even the American Bankruptcy Institute, the other leading professional bankruptcy organization in the United States, supports con-

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Conference (NBC) is a voluntary, non-profit organization with about 60 members, founded in the 1930s by bankruptcy law scholars.

180. Rossi, *supra* note 160, at 6.

181. BCRP, *supra* note 179, at ii. This conclusion is not surprising in view of the fact that the Bankruptcy Code embodied so many of the recommendations made by the NBC during the 1970s reform process. Aaron, *supra* note 128, at 21.

182. BCRP, *supra* note 179, at 105.

183. *Id.* at 157.

184. *Id.* at 120.

185. *Id.* at 157.

186. *Id.* at 121, 157.

187. Barbara Franklin, *Bankruptcy Reform: Experts Suggest Ways to Streamline the Process*, N.Y. L.J., Mar. 25, 1993, at 5.

gressional proposals to convene a bankruptcy review commission rather than to endorse the work of the NBC.[188]

D. Analysis

All versions of the proposed bankruptcy reform legislation have several points in common, and almost all show some variation from the holding in *Nobelman*. The common elements of the draft legislation include the reaffirmation of antimodification policy for home mortgage lenders generally, rejection of the NBC recommendation that bifurcation be permitted for all home mortgages, and a higher degree of concern for primary lien holders than for junior lien holders.

Some versions protect both primary and junior lien holders, but provide that a junior lien could be stripped down in bankruptcy to the extent that it was undersecured at the time of attachment.[189] Other versions protect only primary lien holders.[190] These qualified reaffirmations of the special protection enjoyed by home mortgage lenders are designed to preserve the special status conferred on purchase money home mortgage lenders while meeting the criticism of consumer groups[191] and the NBC[192] that the prohibition on stripping even undersecured or unsecured junior liens impairs the value of the debtor's discharge in bankruptcy and constitutes unfair leverage in the hands of an undeserving class of lenders.[193] This limited form of consumer protection may survive in future bankruptcy reform legislation and restrict the ruling in *Nobelman* to primary, purchase money home mortgages only.

If the most recent version of the legislation[194] is intended to give consumers somewhat more protection than they will enjoy under the *Nobelman* interpretation of § 1322(b)(2), it seems unlikely to achieve that result in practice. If debtors are allowed to avoid junior liens only to the extent that the liens were undersecured both at the time of attachment and at the time of the bankruptcy proceeding, then the debtor must

188. The American Bankruptcy Institute (ABI) was founded in 1982, has 3500 members, is open to attorneys, accountants, and other bankruptcy practitioners and professionals, and in some sense is a rival of the NBC. The ABI support of a national commission is arguably due to efforts to increase its own influence as compared to the more exclusive NBC. Rossi, *supra* note 160, at 6.

189. S. 1985, 102d Cong., 2d Sess. (1991) (version 4); H.R. 5321, 102d Cong., 2d Sess. (1992).

190. S. 1985, 102d Cong., 2d Sess. (1991) (version 1); H.R. 6020, 102d Cong., 2d Sess. (1992); S. 1985, 102d Cong., 2d Sess. (1991) (final version).

191. *Cramdown Hearing, supra* note 11, at 28-34 (statement of Henry J. Sommer).

192. BCRP, *supra* note 179, at 122.

193. See *infra* part IV.A.3 for a discussion of undersecured junior liens.

194. S. 540, 103d Cong., 1st Sess. (1993).

establish the value of the collateral at two different times before qualifying for any form of lien stripping. This standard for measuring how much of a junior mortgagee's lien will be protected in bankruptcy resembles the provisions of the Bankruptcy Code governing whether a preferential transfer exists in cases involving inventory or accounts receivable financing.[195] In these cases, in order to prevent the trustee in bankruptcy from avoiding a secured creditor's lien in inventory or accounts receivable, the secured creditor must establish the value of its lien ninety days prior to filing and on the eve of filing.[196] Even if a two-step test to determine the value of a secured creditor's lien is workable in a business bankruptcy context, it is not clear that it is equally workable in a consumer bankruptcy context.

In some cases the parties may have obtained an appraisal at the time of attachment and may be willing to accept that as evidence of the value of the property at the time the lien attached. If the parties are not able to agree on the value at the time of attachment, it may be an equally difficult problem to establish the value of the property at some specific time prior to the filing. Given the difficulty of proving the value of assets during the pendency of the bankruptcy proceeding,[197] it is not hard to predict that determining the value of the collateral at some time prior to the filing will be an even more complicated and subjective process.

If the burden of proof for this two-step test is placed on the debtor rather than the creditor, then a heavy evidentiary burden will be placed on the party with fewer resources to finance litigation.[198] In the terms that Grant Gilmore used to describe the drafting of Uniform Commercial Code Article 4 by bank counsel, the proposed legislation bears the hallmarks of a protective ordinance for cats drawn up by a committee of

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195. 11 U.S.C. § 547(c)(5) (1988).

196. See generally 1 EPSTEIN ET AL., *supra* note 82, at § 6-35 on the complexity of administering this two-step test. This provision enables "floating liens" in inventory or accounts receivable to survive a preference avoidance challenge from the trustee by comparing the amount by which a debt was undersecured 90 days prior to filing with the amount by which a debt was undersecured at the time of filing. The trustee is permitted to avoid any reduction in the amount of unsecured debt as a preference. The draft lien stripping provision by contrast involves the same comparison between the amount by which a debt was undersecured at the time of attachment and filing but seems to permit avoidance of the lien only to the extent of the lesser of the two amounts.

197. For a discussion of the shifting and elusive value of assets over the course of a bankruptcy case, see, for example, David G. Carlson, *Secured Creditors and the Eely Character of Bankruptcy Valuations*, 41 AM. U. L. REV. 63 (1991) (noting that bankruptcy courts have produced standards of value that are highly contextual).

198. The debtor in a Chapter 13 case must file a list of property held on the petition filing date, a requirement that arguably places the initial burden of proof of asset valuation on the debtor. 5 COLLIER 15, *supra* note 123, ¶ 1325.05[2][a].

dogs.[199] This problem could be resolved in part by creating a rebuttable presumption that if a junior lien is undersecured or unsecured at the time of filing, then it was unsecured or undersecured to the same degree at the time of attachment, and then allowing the junior lienor to come forward with evidence to rebut the presumption.

No matter which party bears the burden of proof under the proposed two-step test for lien stripping, the practical problems associated with judicial determination of value in bankruptcy may substantially vitiate any debtor protection the legislation is intended to provide. The appeal of a two-step test in spite of the problems associated with its implementation may be due to its reliance on the same "benefit of the creditor's bargain" standard to define the rights of secured creditors that the Supreme Court has articulated in *Dewsnup* and *Nobelman* rather than on its practical effect.

IV. CRAMDOWN, CREDIT AVAILABILITY, AND LIEN STRIPPING

At issue in *Nobelman* was the ability of debtors, notwithstanding a creditor's objection, to strip down their mortgage liens to the current fair market value of the creditor's home and receive a discharge for that portion of the mortgage debt thereby rendered unsecured. Lien stripping is a variation of cramdown, or power of the debtor in bankruptcy to force a nonconsenting creditor to accept confirmation of a plan of reorganization so long as the plan meets certain minimum standards for the treatment of that nonconsenting creditor.[200] Cramdown standards embody one of the fundamental tensions of bankruptcy law: the desire to provide an opportunity for rehabilitation for the debtor while simultaneously preserving as much as possible of the creditor's rights as defined by state law.

Many of the arguments made in the *Nobelman* litigation and before Congress with regard to proposed legislation are based on certain assumptions about the costs and benefits that lien stripping would impose on homeowners and mortgage lenders. As is often the case in debates over any form of debtor relief, the arguments have been characterized by a great deal of invective, not much theory, and even less empirical evidence.[201] In order to evaluate the plausibility of some of the claims made

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199. Donald J. Rapson, Book Review, 41 BUS. LAW. 675, 677 (1986) (reviewing FRED H. MILLER & ALVIN C. HARRELL, THE LAW OF MODERN PAYMENT SYSTEMS AND NOTES (1985)).

200. 3 EPSTEIN ET AL., *supra* note 82, at 33 n.3.

201. SULLIVAN ET AL., *supra* note 48, at 143, 146 n.19 ("[A]rguments about costs and benefits of different forms of debtor relief remain matters of faith on all sides."); Michael H. Schill, *An Economic Analysis of Mortgagor Protection Laws*, 77 VA. L. REV. 489, 490 (1991)

in *Nobelman*, part IV describes the different cramdown standards and surveys what empirical evidence exists concerning the costs and benefits of those different standards.

Part IV.A reviews some of the policy issues underlying the *Nobelman* case that the Supreme Court did not address, such as the tension between the federal policies of encouraging homeownership by keeping the price of mortgage finance low and granting consumer debtors a "fresh start" through bankruptcy. Part IV.B describes the state law alternative to lien stripping in bankruptcy, usually known as antideficiency laws. Part IV.C describes cramdown standards that apply to undersecured mortgage lenders in Chapter 12 and Chapter 11 proceedings, and then turns to the cramdown of secured creditors other than home mortgage lenders in Chapter 13 proceedings.

A. Policy Issues

Many of the most compelling arguments made on behalf of both the Nobelmans and mortgage lenders were based on public policy and the practical consequences of adopting a rule permitting lien stripping. Mortgage lenders have fought vociferously to protect their privileged status in Chapter 13 on the grounds that it is a necessary element of the federal government's policy to promote home ownership. The Nobelmans and consumer advocates argued with equal vigor that lien stripping offers a mortgage lender the equivalent of what it would receive upon foreclosure of a mortgage lien but also preserves the full economic benefit of a debtor's fresh start following bankruptcy. The Court did not address the policy issues implicit in the *Nobelman* case, although the outcome of the case gave lenders the result they were seeking. The case does not offer any explicit answers to questions such as whether the federal government should be promoting home ownership when to do so exposes homeowners like the Nobelmans to potentially devastating losses if there is a sudden collapse in home prices. Even assuming that the federal government chooses to encourage individuals to invest in housing, it is not clear that granting privileged status in bankruptcy to mortgage lenders at the expense of borrowers like the Nobelmans in order to keep mortgage interest rates low is the best way to achieve that policy.

("[D]ebates over whether to repeal mortgagor protection laws have been informed by remarkably little theory and even less empirical evidence.").

1. Credit availability

Mortgage lenders objected to lien stripping on various grounds, including (1) that it would disrupt secondary markets for mortgage-backed securities,[202] and (2) that it would restrict access to mortgage credit for the most risky applicants.[203] Lenders argued that lien stripping would force future home buyers to subsidize existing homeowners whose mortgages were priced on the assumption that lien stripping was not permitted: As lenders and mortgage insurance companies attempt to recoup their losses on outstanding loans, they will be forced to increase the prices of future loans.

In addition, lenders argued that allowing existing homeowners to use bankruptcy proceedings to strip down their mortgages to current market value at the bottom of the market in a recession gives those homeowners a windfall[204] or a "head start," not just the "fresh start" drafters of the Bankruptcy Code envisaged.[205] In contrast, state law foreclosure proceedings require debtors to surrender the collateral to lenders before a debtor's personal liability, if any, can be determined.[206] The lender then has the option to retain the asset if the lender believes the market price will recover or to sell the asset and realize the loss.[207] Lien stripping in bankruptcy, however, permits the debtor both to determine the amount of the lender's loss and to retain the asset, enjoying any subsequent appreciation if market conditions improve. Arguably, this creates a windfall for the debtor at the lender's expense.

All these arguments have a basis in fact, but the case for protecting mortgage lenders may not be as strong as some lenders assume. If the rate of bankruptcy filings is a function of many variables, then the decision to permit or deny lien stripping may not appreciably change the total number of consumer bankruptcy filings.[208] Even if lien stripping is not permitted, homeowners can still use Chapter 7 or Chapter 13 bank-

202. FHLMC Brief, *supra* note 14, at 25; MBA Brief, *supra* note 13, at 16.

203. FHLMC Brief, *supra* note 14, at 25.

204. *Cramdown Hearing, supra* note 11, at 45 (statement of Dean Cooper); Alaska Brief, *supra* note 18, at 10-13.

205. On the issue of "head start" versus "fresh start" and "when does a pig become a hog," see Norwest Bank Neb., N.A. v. Tveten, 848 F.2d 871 (8th Cir. 1988).

206. *See, e.g.*, U.C.C. §§ 9-502(2), 9-503 (1990) (providing that secured lender is entitled to take possession of collateral after default and to deficiency after commercially reasonable disposition of collateral unless otherwise agreed).

207. Dewsnup v. Timm (*In re* Dewsnup), 112 S. Ct. 773, 778 (1992).

208. Jagdeep S. Bhandari & Lawrence A. Weiss, *The Increasing Bankruptcy Filing Rate: An Historical Analysis*, 67 AM. BANKR. L.J. 131 (1993) (increase in consumer bankruptcies since 1978 is due more to decrease in debt servicing capacity of individuals than to change in law).

ruptcy proceedings to avoid personal liability for a deficiency if the mortgage debt greatly exceeds the market value of the property. Moreover, because regulated institutional lenders do not have the option of holding the property long enough to enjoy much, if any, rebound in values,[209] they will receive a lump sum payment when the property is liquidated that is equivalent in value to the stream of payments a debtor would have to offer in Chapter 13 in order to have a plan confirmed.[210] Additionally, transaction costs associated with holding and liquidating the foreclosed property would have to be offset against the lump sum proceeds of the sale, reducing the net benefit to the lender receiving immediate repossession instead of accepting deferred payments from the current homeowner. The "windfall to debtors" issue may also be a red herring because it is far from certain that home prices will always rebound after a collapse in market values. Furthermore, if lenders are more certain than homeowners or bankruptcy judges that current real property prices are artificially low, they can invest in additional properties in order to be in a position to enjoy future market appreciation.

2. Home ownership

In both the *Nobelman* litigation and in Congress, lenders have resisted lien stripping on the ground that the resulting economic dislocation would subvert the well known federal policy of promoting home ownership. The primary political justification advanced for the special treatment accorded home mortgage lenders in bankruptcy was the importance of making individual home ownership as broadly available as possible because home ownership is widely regarded as a cornerstone of both the free market economic system and the democratic political system.[211]

Since the 1930s the federal government has pursued a broad-based policy of encouraging home ownership in the United States. The policy has been pursued on many fronts, including tax incentives such as the home mortgage interest deduction for taxpayers,[212] deposit insurance for savings and loans and banks,[213] mortgage insurance to holders of mort-

209. *See, e.g.*, 12 U.S.C. § 29 (1989) (national banks should not invest in real estate as general rule with exception for properties obtained through foreclosure qualified by five-year limit).

210. 11 U.S.C. § 1325(a)(5)(B)(ii) (1988).

211. See *infra* part IV.A.2 for a discussion of the history of this policy and an analysis of its continued viability.

212. I.R.C. § 163(h)(2)(D) (1988).

213. 12 U.S.C. § 1815 (1988 & Supp. 1992).

gages that conform to federal guidelines,[214] and other programs designed to promote the growth of secondary mortgage markets.[215]

Various tax incentives encourage home ownership.[216] The home mortgage interest deduction is, in effect, a subsidy from the federal government to homeowners.[217] In addition, homeowners may deduct property taxes from taxable income.[218] Homeowners do not have to recognize as taxable income any imputed rent from living in the property or any appreciation in the value of a home unless and until the home is sold.[219] Even if the homeowner realizes a profit on the sale of a home, that gain is often excluded from income if a new home is purchased within two years of the sale.[220] For taxpayers aged fifty-five or over, up to $125,000 of that gain may not be recognized at all.[221]

The federal government has also supported the flow of low-cost funds to potential homeowners by various programs subsidizing home mortgage lenders, although the shift in the 1980s toward financial deregulation has ended many of these programs.[222] Prior to deregulation, the segmented structure of retail financial institutions in the United States provided the housing industry with a steady source of low-cost funds. Interest rate regulations permitted savings and loan associations to pay

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214. See *supra* part IV.B.1 for a discussion of federal home mortgage programs.

215. See *supra* part IV.B.1 for a description of secondary mortgage markets.

216. *See generally* Joseph A. Snoe, *My Home, My Debt: Remodeling the Home Mortgage Interest Deduction*, 80 KY. L.J. 431, 452 (1991) (listing several different tax incentives that foster home ownership).

217. The deduction for interest expenses did not originally distinguish between home mortgage interest and other personal interest expenses. The interest deduction was introduced as the federal income tax was established by the Tariff Act of 1913, ch. 16, § IIB, 63 Stat. 114, 167. The right to deduct interest generally from taxable income was preserved in the 1954 Internal Revenue Code. *See* I.R.C. § 163 (Supp. II 1993). It was not until the Tax Reform Act of 1986 disallowed the deduction for personal interest expenses that the political commitment to the home mortgage interest deduction in particular became obvious. The interest deduction for individual taxpayers remains for the primary residence and one secondary residence, with the requirement that the interest be paid on debt incurred to acquire the residence or for a limited number of other purposes such as education or medical expenses. *See* Tax Reform Act of 1986, Pub. L. No. 99-514, § 511(b), 100 Stat. 2085, 2246-58 (codified at I.R.C. § 163 (1988)); I.R.C. §§ 163(h)(2)(D), 163(h)(3)(A) (1988); *see also* 132 CONG. REC. 26,889, 26,690 (1986) (remarks of Sen. Dole).

218. I.R.C. § 164(a)(i) (1988).

219. *Id.* § 1221.

220. *Id.* § 1034(a).

221. *Id.* § 121.

222. ANTHONY DOWNS, THE REVOLUTION IN REAL ESTATE FINANCE 32-36 (1985). *But cf.* George H. Sellon, Jr., *The Role of Government in Promoting Homeownership: The U.S. Experience*, 75 ECON. REV. 37 (1990) (government policies that appear to promote homeownership do no more than offset obstacles to home ownership created through regulatory obstacles impeding operation of real estate finance markets).

interest to individual savers at rates that were below market rates but slightly higher than those commercial banks could offer, thus channeling household savings into institutions dedicated to investing in housing. This indirect mechanism of encouraging savers to subsidize the borrowing costs of homeowners broke down in the late 1970s and early 1980s. By then inflation had pushed interest rates to record highs, and the creation of money market funds had finally given individual savers alternatives to the thrift industry. Following deregulation, thrifts were forced to offer market interest rates to savers to secure sources of funding, mortgagors were forced to pay market interest rates to purchase homes, and thrifts were permitted to diversify out of an exclusive focus on home mortgage lending.

Federal programs supporting home ownership that were not curtailed in the 1980s include mortgage insurance and support of secondary mortgage markets. Mortgage insurance, provided by federal programs as well as by private mortgage insurance companies, simplifies the mortgage underwriting process and permits mortgage lenders to make riskier loans than they would otherwise undertake.[223] In addition, a mortgage originator in the United States has the option to hold an asset or sell it in the highly liquid secondary mortgage market, which was created in large part through the efforts of several federally chartered institutions. Lenders wishing to invest in home mortgages need not engage in actually underwriting the loans but may invest in a wide array of mortgage-backed securities tailored to suit their risk tolerance and other portfolio requirements.[224]

Just as there have been various mechanisms for implementing the federal policy favoring home ownership, there have been many justifications offered for the policy itself. The constitutional basis for government intervention in supporting home ownership is arguably derived from congressional authority to help provide a national system of credit that meets the needs of the economy.[225] The impetus for the National Housing Act of 1934 was the perception that (1) a lack of activity in the housing sector was stifling further economic recovery generally, (2) the lack of credit for mortgages and home improvements was contributing to the low level of new construction and maintenance of existing housing, and (3) more households desired and could reasonably afford mortgages than were able to obtain mortgages under then-current conditions in credit

223. *See infra* part IV.B.1.

224. *See infra* part IV.B.1.

225. That in turn is based on Article I, Section 8 of the Constitution. Validity of Certain Provisions of the National Housing Act, 38 OP. ATT'Y GEN. 258, 269 (1935).

markets.[226] In the words of one commentator, "The home is the foundation of our national existence and its safety is the country's safety."[227]

The commitment of the federal government to high-quality, affordable housing has been reiterated often. In the words of section 2 of the Housing Act of 1949,

> The Congress hereby declares that the general welfare and security of the Nation and the health and living standards of its people require housing production and related community development sufficient to remedy the serious housing shortage, through the clearance of slums and blighted areas, and the realization as soon as feasible of the goal of a decent home and a suitable living environment for every American family, thus contributing to the development and redevelopment of communities and to the advancement of the growth, wealth and security of the Nation.[228]

The contours and degree of the federal government's commitment to decent, affordable housing has changed in recent decades, apparently degenerating from a real policy to a mere shibboleth invoked on appropriate occasions.[229] Financial deregulation and a burgeoning federal deficit have reduced the flow of subsidized funds into owner-occupied housing.[230] The debate over the home mortgage interest deduction re-

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226. Ernest P. Jones, Jr., *National Housing Act*, 7 MISS. L.J. 270 (1935); James N. MacLean, *The National Housing Act Explained*, 20 A.B.A. J. 565 (1934).

227. J.H.C., *Emergency Mortgage Legislation*, 8 ST. JOHN'S L. REV. 204, 209 (1933). According to Representative Sirovich, speaking in support of the National Housing Act,

> [t]he home is the foundation of all society. Upon it the superstructure of all civilization rests. The home is the institution where the father is the king, mother the queen, and the children are the subjects . . . . The home is the cradle that nurtures our offspring. The home is the institution that shapes the destiny of our brood. As go the parents, so go the children; as go the children, so goes the home; as goes the home, so goes the Nation and the world. Destroy the home, and you destroy society, civilization, and everything that goes with it.
>
> Everyone is praying for happiness, for comfort, and prosperity to return to all who struggle for their daily bread in order that their home may be maintained. We are hoping for a new day to break in upon all of us. Today the mortgages upon the homes of millions of our people are being foreclosed. Hunger, penury, want, and destitution stare these millions in the face. Today the homes of these unfortunate people are being threatened as never before. Economic conditions threaten to achieve what fire, flood, wind and invasion have never done before. . . . And what is the cause of it all? It is the lack of money with which to preserve the home, rebuild the home, and build new homes.

78 CONG. REC. 11,182 (1934) (statement of Rep. Sirovich).

228. Housing Act of 1949, ch. 338, 63 Stat. 413, *quoted in Future of FHA: Hearings Before the Senate Committee on Banking, Housing and Urban Affairs*, 95th Cong., 1st Sess. 406 (1977).

229. *See supra* notes 7-9.

230. DOWNS, *supra* note 222, at 14, 294.

vealed that it is now acknowledged to be little more than a selective subsidy to the middle class rather than a broad-based policy supporting affordable housing.[231] The tremendous success of government-sponsored initiatives in secondary mortgage markets has made it possible for the government to withdraw partially, permitting privatized agencies or private issuers to continue to expand participation in those markets.[232]

Even if the federal government remains committed to promoting private home ownership, it is unclear that encouraging mortgage lenders to offer mortgages at lower cost by prohibiting lien stripping in Chapter 13 is the best way to do this. Lenders perceive mortgagor protections as expensive and inefficient obstacles that needlessly increase interest rates to nondefaulting borrowers. Professor Schill has argued that state law mortgagor protections can be reconceptualized as creating an insurance system for consumers by adopting an *ex ante* perspective.[233] Treating the right to strip home mortgage liens in bankruptcy as a similar form of insurance system would indicate that permitting lien stripping might increase the overall efficiency of home mortgage markets, rather than merely add unnecessarily to the interest rates paid by nondefaulting borrowers.

3. Junior liens

In *Nobelman*, the Supreme Court did not directly confront the issue of junior liens: As Texas has the most restrictive law of any United States jurisdiction governing junior liens on homesteads, the facts did not squarely present the issue. In Texas a debtor's homestead is exempt from seizure through creditor process unless a creditor's lien is (1) a purchase money lien, (2) a property tax lien, or (3) a materialman's lien for improvements to the property.[234] Therefore, home equity loans and other forms of junior mortgages, very popular in many jurisdictions, are not permitted in Texas. Permitting stripping of junior liens but protecting purchase money liens would have little impact on mortgage lending in Texas,[235] but would have a large impact on consumer lending outside Texas.

In proposed bankruptcy legislation introduced in 1992 and 1993, legislators repeatedly evidenced a willingness to distinguish between

231. *See, e.g.*, 132 CONG. REC. 26,690 (1986) (remarks of Sen. Dole).

232. WILLIAM B. BRUEGGEMAN ET AL., REAL ESTATE FINANCE 648-53 (8th ed. 1989).

233. Schill, *supra* note 201, at 500.

234. TEX. CONST. art. XVI, § 50; TEX. PROP. CODE ANN. § 41.001 (West 1993).

235. Stripdown of junior homestead liens is not impossible, however, even in Texas. For example, a swimming pool contractor might have a valid junior lien that becomes unsecured following a general decline in home prices.

purchase money home mortgage lenders and junior lienors.[236] This distinction is reflected in the preferential status accorded purchase money financing in the Uniform Commercial Code[237] as well as elsewhere in the Bankruptcy Code.[238] Given that the antimodification provision of § 1322(b)(2) is an exception to the general rule that all secured creditors are subject to cramdown in rehabilitative bankruptcy proceedings, the tendency has been to construe the exception to cover only a narrow category of lenders and deny special treatment to credit providers who happen to take a security interest in the debtor's homestead rather than enabling the debtor to acquire the homestead itself. The proposed legislation therefore treats junior liens on the debtor's homestead as subject to the general rule permitting lien stripping rather than as qualifying for the special, narrow exception reserved for a privileged category of lenders.

In addition, several other policy justifications support denying antimodification protection to junior lienors. One has to do with predatory lending practices prevalent in communities that have traditionally been denied access to finance on conventional terms. Although the practice of granting home equity loans to permit homeowners to cash out their equity in houses that may have appreciated substantially since purchase may not raise significant policy issues in many instances, a real problem arises when low-income households—in which home equity may be the only significant asset—are pressured into granting multiple liens on their homesteads by unscrupulous lenders.[239] Predatory lenders may target members of minority communities threatened with foreclosure by refinancing their debt at astronomical interest rates.[240] The ability of such junior lienors to hide behind the antimodification provision of § 1322(b)(2) is particularly offensive to public policy.

236. *See supra* part III.A.

237. U.C.C. §§ 9-301(2), 9-312(4) (1990) (creating ten-day period for perfection of purchase money security interest); *id.* § 9-302(1)(d) (automatic perfection of purchase money security interest in consumer goods).

238. 11 U.S.C. § 362(b)(2) (1988) (exception to automatic stay to perfected purchase-money security interests); *id.* § 547(c)(3) (late perfection of purchase-money security interest not preferential transfer).

239. *See, e.g.*, Amicus Curiae Brief of Harold J. Barkley, Jr. in Support of Petitioner at 9, *Nobelman*, 113 S. Ct. 2106 (No. 92-641) (predatory lending practices not uncommon among consumer debtors and such lenders should not be given special protection under Bankruptcy Code); JULIA P. FORRESTER, MORTGAGING THE AMERICAN DREAM: A CRITICAL LOOK AT THE FEDERAL GOVERNMENT'S PROMOTION OF HOME EQUITY FINANCING (forthcoming).

240. In the words of a Federal Reserve Bank president in recent congressional testimony,

> Second mortgage abuses represent one of the most emotional issues facing Congress, regulators, lenders and the public. Some homeowners, usually the elderly or disadvantaged, have been literally "conned" out of their homes through abusive second-mortgage practices. Others who have not lost their homes have been so burdened by high payments that their lives have been severely disrupted.

The problem of taking junior liens as part of abusive credit practices is similar to the problem Congress faced when drafting the Bankruptcy Code in 1978 with regard to nonpossessory, nonpurchase money security interests in household goods. Section 522(f) prohibits this form of security interest in order to safeguard the economic reality of a debtor's fresh start and to remove incentives for creditors to engage in overreaching credit practices. Although all secured lending can be understood as an attempt by the lender to gain leverage over the borrower,[241] a particular problem arises when the lender's leverage becomes so great that it exceeds the bounds of reasonable commercial practices. Congress enacted § 522(f) because of concern that consumers would impair the value of their fresh starts by reaffirming debts secured by household items with little or no resale value but of great value to their owner.[242] To the extent that junior liens on the debtor's homestead have no economic value, the same concern applies to them.

B. State Law Antideficiency Regimes

Antideficiency statutes balance the competing principles of rehabilitation for debtors and preservation of creditors' rights under state law in a manner that roughly corresponds with the operation of cramdown standards under federal bankruptcy law. Antideficiency statutes provide some degree of relief from personal liability for mortgagors following foreclosure of their interest in the property when the proceeds of the sale of the property do not fully retire the outstanding mortgage debt. Antideficiency statutes parallel cramdown under bankruptcy in that they may permit a debtor to shift the cost of depreciation in the value of the mortgaged property to the lender. They differ from cramdown in that they protect a debtor only following repossession and foreclosure of the collateral by the lender.

Prior to the Supreme Court decision in *Nobelman*, it was unclear how much a debtor had to pay in order to confirm a plan stripping down a mortgage lien. This made it more difficult to determine whether the federal bankruptcy system was more generous to debtors retaining their homes in bankruptcy than state law regimes. The most extreme reading

The Federal Reserve President's Views on Monetary Policy and Economic Conditions: Hearings Before the Comm. on Banking, Housing & Urban Affairs, 103d Cong., 1st Sess. 22 (1993) (statement of Richard F. Syron, President and CEO, Federal Reserve Bank of Boston).

241. *See* Robert E. Scott, *A Relational Theory of Secured Financing*, 86 COLUM. L. REV. 901, 926-27 (1986).

242. *The Bankruptcy Reform Act: Hearings on S.235 and S.236 Before the Subcomm. on Improvements in Judicial Machinery of the Senate Comm. on the Judiciary*, 94th Cong., 1st Sess. 98 (1975).

of *Nobelman* would require that a debtor in bankruptcy wishing to retain his or her home may not confirm a Chapter 13 plan without offering to pay in full the debt of all mortgagees, including those whose security consists of unsecured junior liens on the debtor's home even though those liens were undersecured at the time they attached.[243] Such an interpretation of federal bankruptcy law grants junior lienors more leverage over a debtor than exists under state law regimes that provide some form of antideficiency protection for homeowners. On the other hand, the interpretation of § 1322(b)(2) adopted in the Second, Third, Ninth, and Tenth Circuits accorded a debtor considerably more leverage under federal bankruptcy law in dealing with a mortgage lender than even the most generous state law regimes.[244]

Notwithstanding the emergence over the last twenty years of real estate credit markets integrated into national and international capital markets, state law regimes regarding the rights and obligations of mortgagors and mortgagees vary tremendously.[245] The impact of this diversity in legal regimes on the efficient operation of the now highly developed national market for mortgage obligations is unclear.[246] With regard to estimating the costs of lien stripping under federal bankruptcy law, however, it might provide a valuable source of data for evaluating the probable impact of lien stripping on mortgage markets.

243. *Nobelman* is silent on this issue; thus, it remains unclear whether the Supreme Court has really adopted such an extreme position. Prior to the resolution of the split in the circuits by *Nobelman*, several lower courts rejecting bifurcation and lien stripping under § 1322(b)(2) held that debtors had to pay undersecured junior liens in full. *See, e.g.*, Landmark Fin. Servs. v. Hall, 918 F.2d 1150, 1153-54 (4th Cir. 1990); Grubbs v. Houston First Am. Sav. Ass'n, 718 F.2d 694, 697 (5th Cir. 1983); Vines v. Mid-State Homes (*In re* Vines), 153 B.R. 345, 347 (Bankr. M.D. Ala. 1993); *In re* Dyer, 142 B.R. 364 (Bankr. D. Ariz. 1992); Etchin v. Star Servs., Inc. (*In re* Etchin), 128 B.R. 662, 682 (Bankr. W.D. Wis. 1991); Boullion v. Sapp (*In re* Boullion), 123 B.R. 549, 551 (Bankr. W.D. Tex. 1990); *In re* Kaczmarczyk, 107 B.R. 200, 202 (Bankr. D. Neb. 1989); *In re* Hynson, 66 B.R. 246, 253 (Bankr. D.N.J. 1986).

244. Bellamy v. Federal Home Loan Mortgage Corp. (*In re* Bellamy), 962 F.2d 176 (2d Cir. 1992); Eastland Mortgage Co. v. Hart (*In re* Hart), 923 F.2d 1410 (10th Cir. 1991); Wilson v. Commonwealth Mortgage Corp., 895 F.2d 123 (3d Cir. 1990); Hougland v. Lomas & Nettleton Co. (*In re* Hougland), 886 F.2d 1182 (9th Cir. 1989), *aff'd sub nom.*, 980 F.2d 1279 (9th Cir. 1992).

245. *See* DOWNS, *supra* note 222; Schill, *supra* note 201, at 489; Michael H. Schill, *Uniformity or Diversity: Residential Real Estate Finance Law in the 1990s and the Implications of Changing Financial Markets*, 64 S. CAL. L. REV. 1261 (1991).

246. Schill, *supra* note 245, at 1300 (benefits of increased efficiency in secondary mortgage markets from federal preemption of local real estate law are unclear). *But see* Jo Anne Bradner, *The Secondary Mortgage Market and State Regulation of Real Estate Financing*, 36 EMORY L.J. 971 (1987) (regional variation in local real estate law creates market inefficiencies that market forces might correct over time but federal preemption is preferable because it would be more effective).

While there are certain similarities between lien stripping and antideficiency laws, it is not possible to draw direct parallels between the two systems. A generous antideficiency regime in some sense simply mirrors bankruptcy relief, whether or not lien stripping is allowed, because the homeowner can avoid personal liability for the mortgage debt under both systems. While personal liability for a deficiency is at issue under state law, permitting or forbidding lien stripping in bankruptcy primarily affects the parties' transaction costs. If lien stripping is permitted, the homeowner will pay the lender the equivalent of what would have been realized through a foreclosure sale, thus saving the homeowner from incurring relocation costs and the lender from incurring the warehousing and administrative costs of conducting a foreclosure sale. If lien stripping is not permitted, a debtor committed to retaining possession of his or her home may pay more than the current market value for the home, impairing the fresh start, or may surrender the property to the mortgagee and shoulder the costs of relocating. In addition, a bankrupt homeowner will be excluded from buying any other home for some time as a consequence of filing for bankruptcy. While some lenders may be in a position to hold a surrendered property to see if market values recover, regulated institutional lenders must liquidate foreclosed properties reasonably promptly, and are thus unlikely to enjoy much appreciation prior to sale.[247]

From the few empirical studies that have been done comparing the impact of different state law foreclosure regimes on the pricing or availability of mortgage credit, it remains unclear how much impact a nationwide policy of permitting lien stripping based on federal law would have on access to and the terms of mortgage credit.[248] While the economic literature on the issue does not provide ready answers, there does not seem to be much support for the repeated assertions of mortgage lenders that instituting a more generous lien stripping regime through the Bankruptcy Code will have calamitous effects on the availability of mortgage credit, although it may indeed have a measurable impact.[249]

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247. *See* 12 U.S.C. § 29 (1989).

248. There are no empirical studies directly on the issue of the impact of antideficiency laws or lien stripping in isolation from other risks associated with default by the borrower on the price of credit. *See infra* text accompanying notes 278-86 (reviewing economic literature).

249. *See Cramdown Hearing, supra* note 11, at 50-51, 66, 82, 85, 92 (prepared statements of John P. Davey, Larry Gilmore, Michael S. Polk, Robert E. McKew, Suzanne Hutchinson, and Frank M. Salinger); Realtors' Brief, *supra* note 12, at 14; MBA Brief, *supra* note 13, at 16; FHLMC Brief, *supra* note 14, at 25-26; Nationsbanc Brief, *supra* note 13, at 19-20. *But cf. Cramdown Hearing, supra* note 11, at 29 (statement of Henry J. Sommer); CEPA Brief, *supra* note 11, at 58-61.

1. Structure of mortgage markets

In order to assess the impact of antideficiency laws and lien stripping on the pricing and availability of mortgages to would-be homeowners, it is helpful to first outline briefly the principal features of mortgage markets in the United States before setting forth the basic mechanisms of default and foreclosure of mortgages under state law. The pricing of mortgage obligations occurs in what are known as primary and secondary markets.[250] While it was once the case that mortgage obligations were held in the investment portfolios of the institutions that originated them, mortgages are now packaged and sold in large numbers on the secondary mortgage market in the form of mortgage-backed securities.[251]

The pricing of mortgage obligations in primary markets is a function of the loan underwriting process. In underwriting a loan, a lender obtains an appraisal of the property and evaluates the creditworthiness of the borrower.[252] In assessing the borrower's ability to repay the loan, the lender will compare the borrower's income and net worth to the amount of the proposed mortgage payment, and will also consider the amount of the borrower's down payment.[253]

A major factor minimizing the risk of loss to the lender upon default by the borrower is mortgage insurance. Mortgage insurance may be provided by the Federal Housing Administration (FHA) or private mortgage insurance companies (PMIs). The FHA, unlike PMIs, insures the entire amount of the loan.[254] The Veterans Administration (VA) also offers qualified veterans a home loan guarantee program, which is similar to mortgage insurance.[255] Federal guidelines for real estate lending policies suggest that residential mortgages should not be made in excess of a

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250. This summary is based on 10 SECONDARY MORTGAGE MARKET GUIDE §§ 3-4 (Charles L. Edson ed., 1992).

251. BRUEGGEMAN ET AL., *supra* note 232, at 7.

252. *Id.* at 178.

253. Some traditional rules of thumb in mortgage underwriting include that total mortgage payments (principal and interest) should not exceed 25% of the borrower's total income, and total mortgage payments plus other housing expenses such as taxes, insurance, utilities, and that maintenance should not exceed 33% of the borrower's total income. Lenders usually require a down payment of between five and twenty-five percent of the purchase price. Frank J. Fabozzi & Dexter Senft, *Introduction to Mortgages*, *in* THE HANDBOOK OF MORTGAGE-BACKED SECURITIES 14 (Frank J. Fabozzi ed., 3d ed. 1992).

254. The National Housing Act of 1934 established the FHA which is currently a part of the Department of Housing and Urban Development. 12 U.S.C. §§ 1708-1710 (1993); *see also* BRUEGGEMAN ET AL., *supra* note 232, at 181-82.

255. 38 U.S.C. §§ 3702, 3703, 3710 (1991). The Veterans Administration also has authority to make direct loans under 38 U.S.C. § 1811 (currently 38 U.S.C. § 3711), but rarely does so. GRANT S. NELSON & DALE A. WHITMAN, REAL ESTATE FINANCE LAW 755 n.5 (2d ed. 1985).

ninety percent loan-to-value ratio without mortgage insurance or readily marketable collateral.[256] This creates an equity cushion that protects the lender against declines in property values.

Mortgage insurance programs have different eligibility criteria,[257] different methods of calculating and collecting premiums,[258] and different procedures following default by the borrower.[259] For example, FHA insurance is available for houses, condominiums, cooperatives, apartment buildings, and many other types of real property, but VA and PMI insurance is usually provided only for houses and condominiums.[260] Premiums may be collected at closing as a lump sum that the borrower may finance together with the purchase price of the property, or in monthly installments for the life of the mortgage.[261] In order to make a claim against the FHA under one of its single-family programs, a lender must acquire title to the property, either by foreclosure or deed in lieu of foreclosure, and transfer the property to the FHA.[262] The FHA then pays the lender the full loan balance and any expenses incurred by the lender in connection with the default.[263] The FHA generally sells the property after acquiring it and subrogates to the lender's rights, if any, to seek a deficiency judgment from the borrower.[264] Because VA and PMI programs do not insure the entire amount of the mortgage, upon default they generally pay lenders less than the full loan balance, and may or may not take title to the property.[265] From the point of view of a lender that accepted mortgage insurance in lieu of a larger down payment, the difference between foreclosure under state law and lien stripping under bankruptcy law is very significant because the FHA and VA have refused to compensate insured lenders following Chapter 13 cramdowns.[266]

256. *See* 12 C.F.R. § 545.32(d)(2) (1992) (Office of Thrift Supervision loan-to-value ratio for federal savings associations).

257. NELSON & WHITMAN, *supra* note 255, at 754-64.

258. *Id.* at 760.

259. *Id.* at 761-64.

260. *Id.* at 755-56.

261. *Id.* at 760.

262. *Id.* at 761.

263. 24 C.F.R. § 203.402 (1992).

264. NELSON & WHITMAN, *supra* note 255, at 762. The FHA has become more aggressive in recent years about pursuing borrowers liable for any deficiency. *See* 53 Fed. Reg. 4384-85 (Feb. 16, 1988).

265. NELSON & WHITMAN, *supra* note 255, at 762-63.

266. *Cramdown Hearing, supra* note 11, at 26; *see also* VA Office of General Counsel Precedent 1-91, 56 Fed. Reg. 25,156 (1991); U.S. DEP'T OF HOUS. AND URBAN DEV., Letter No. 91-27 (June 4, 1991).

The secondary mortgage market consists of the buying, selling, and trading of existing mortgage loans and of participations in such loans.[267] A secondary mortgage market of some description has always existed in the United States,[268] but since the 1930s the phenomenal growth in that market has been supported by various federal government programs. These programs include the standardization of mortgage contract terms and the provision of mortgage insurance, which supported the expansion of secondary market activity by reducing the risk of default and by standardizing the assets to be pooled. The original mortgage insurance program established by the FHA in the 1930s permitted the risk of default by individual borrowers to be spread across a large population of borrowers through the payment of small premiums virtually eliminated the risk of loss to the lender.[269] The original FHA insurance program also created incentives for the standardization of mortgage contract terms by conditioning eligibility to participate in the program on the use of standard contracts promulgated by the FHA, although the FHA now permits lenders to use their own forms if they meet FHA criteria.[270]

The growth of the secondary mortgage market has also been fueled by the operations of several federally chartered corporations established to engage in secondary market activities. These include the Federal National Mortgage Association (FNMA or Fannie Mae),[271] the Government National Mortgage Association (GNMA or Ginnie Mae),[272] and the Federal Home Loan Mortgage Corporation (FHLMC or Freddie Mac).[273] Additional congressional support for the secondary mortgage

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267. GNMA MORTGAGE-BACKED SEC. DEALERS ASS'N, THE GINNIE MAE MANUAL 98 (1978).

268. Prior to the mid-1950s, the secondary market consisted of life insurance companies buying mortgages originated by mortgage bankers and eastern thrifts buying mortgages originated by thrifts in other regions. BRUEGGEMAN ET AL., *supra* note 232, at 647.

269. *Id.* at 113.

270. 53 Fed. Reg. 34,279 (1988); NELSON & WHITMAN, *supra* note 255, at 755 n.4.

271. FNMA's original charter was contained in Title III of the National Housing Act, 48 Stat. 1246 (1938). FNMA was first wholly government owned and administered, but in 1954 it was partially privatized. Under the Housing and Urban Development Act of 1968, Pub. L. No. 90-448, 82 Stat. 476 (codified at 12 U.S.C. §§ 1701-1750 (1989)), FNMA's original functions were divided between the new Government National Mortgage Association and a reconstituted FNMA, which became a wholly private organization. *See* NELSON & WHITMAN, *supra* note 255, at 765.

272. The Housing and Urban Development Act of 1968, 82 Stat. 476. 12 U.S.C. § 1717(a)(2)(A) (1989) created the Government National Mortgage Association as a government agency within the Department of Housing and Urban Development.

273. Emergency Home Finance Act of 1970, Pub. L. No. 91-351, 84 Stat. 461 (codified at 12 U.S.C. §§ 1715z-3, 1715z-8, 1717, 1719, 1720, 1726, 1730, 1749 (1989)). Title III of the Emergency Home Finance Act of 1970 created the Federal Home Loan Mortgage Corporation to facilitate the interregional flow of mortgage money between different areas of the United

market has been provided with the Secondary Mortgage Market Enhancement Act of 1984,[274] and in the Tax Reform Act of 1986.[275]

Among the most important government programs facilitating the growth of the secondary mortgage market since the 1950s are the payment guarantee programs of GNMA. The first of these programs originated in 1968 when GNMA was authorized to guarantee the timely payment of principal and interest on securities backed or secured by pools of mortgages insured by the FHA or guaranteed by the VA.[276] A payment guarantee from a quasi-governmental organization effectively freed secondary market investors from concern over the risk of default on the individual mortgage obligations backing their securities. Many private and public institutional lenders now issue their own mortgage-backed securities guaranteed by the issuing institution or by a PMI.[277]

Various elements are taken into account in the pricing of mortgages in secondary markets. These include risk of default by the borrower,[278] risk of default by the guarantor,[279] interest rate risk,[280] prepayment risk,[281] and liquidity risk.[282] The risk of default by the borrower is thus only one of many factors taken into account by an investor in making the decision to invest in a mortgage-backed security. Evaluating risk of default by the borrower or guarantor is facilitated in secondary markets by

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States, and to facilitate the flow of financial resources into mortgage markets from other forms of capital investment. *See* NELSON & WHITMAN, *supra* note 255, at 764-66.

274. Pub. L. No. 98-440, 98 Stat. 1689. The Act granted an exemption to the restrictions on credit extension by securities dealers for a "mortgage related security."

275. Pub. L. No. 99-514, 100 Stat. 2085.

276. BRUEGGEMAN ET AL., *supra* note 232, at 651.

277. NELSON & WHITMAN, *supra* note 255, at 772.

278. Risk of loss due to default by the borrower is a function of the lender's ability to collect not only from the borrower but also from the mortgage insurer if one exists. FHA provides the most comprehensive coverage; VA and PMI programs provide less. *See* BRUEGGEMAN ET AL., *supra* note 232, at 672.

279. GNMA is backed by the full faith and credit of the United States government while FNMA and FHLMC have only indirect government guarantees. *See id.*

280. For example, if market interest rates rise, the market price of fixed-interest-rate, mortgage-backed securities will fall more than variable interest rate mortgage-backed securities. *See id.*

281. Greater than anticipated loan repayments will result in a lower than anticipated yield for a mortgage pool. Since 1983 a new form of bond known as "collateralized mortgage obligations" or CMOs has been developed and has grown in popularity as investors attempt to manage prepayment risks associated with mortgage-backed securities. CMOs are bonds collateralized by mortgage-backed securities. CMOs are divided into "tranches," which are scheduled to receive different cash flows from the underlying mortgage-backed securities, such as principal payments or interest payments. *See, e.g.*, Gregory J. Parseghian, *Introduction to Collateralized Mortgage Obligations*, *in* THE HANDBOOK OF MORTGAGE BACKED SECURITIES, *supra* note 253, at 287.

282. Fabozzi & Senft, *supra* note 253, at 25.

the existence of credit rating agencies.[283] Market risks such as interest rate risk, prepayment risk, and liquidity risk, however, are not included in credit rating analyses.

2. Foreclosure regimes

The standard modern American version of the foreclosure process is as follows: Following a default by the borrower, and after appropriate notice and opportunity for the borrower to proffer the outstanding balance to the lender, the lender may proceed to a public sale of the subject real estate.[284] The sale may be a judicial sale conducted under court supervision or may be conducted by an agent of the mortgagee under a power of sale granted in the deed of trust.[285] The purchaser at this sale generally takes title to the property free of any liens junior to the foreclosed lien and free of the borrower's interest. The price realized at the foreclosure sale is applied to the borrower's indebtedness. Any surplus over the debt is paid to any junior lienors party to the foreclosure action; the remaining funds, if any, are then paid to the borrower. Any deficiency between the sale price and the debt may become a personal liability of the borrower.

While in theory the mechanics of foreclosure following default are straightforward, in practice the process is subject to many formalities and requirements based on local law and practice.[286] A significant risk from the borrower's perspective is that the foreclosure sale conducted by the lender will realize an unreasonably low price, creating a large deficiency that constitutes a personal liability of the borrower. Without further regulation, this ability of the lender to impose the costs of an unfair or defective foreclosure sale on the borrower might remove much of the incentive the lender has to maximize the price realized at the foreclosure sale. Ab-

283. For a description of the procedures and standards applied by a credit rating agency, see, for example, STANDARD & POOR'S CORP., S&P'S STRUCTURED FINANCE CRITERIA (1988). In addition to risk of default by borrower or guarantor, credit rating agencies also evaluate the legal structure of the mortgage-backed-security transaction and the cash flow structure of the transaction. *Id.* at 80-81.

284. Only two states permit "strict foreclosure," which permits the lender to retain title to the property in satisfaction of the debt. Schill, *supra* note 201, at 492 n.6. (citing CONN. GEN. STAT. § 49-15 (1983); VT. STAT. ANN. tit. 12, § 4528 (1973)). Public foreclosure sales were substituted for strict foreclosure in an effort to produce the best possible price for the borrower or junior lienors. *See* Steven Wechsler, *Through the Looking Glass: Foreclosure by Sale as De Facto Strict Foreclosure—An Empirical Study of Mortgage Foreclosure and Subsequent Resale*, 70 CORNELL L. REV. 850, 852 (1985).

285. Schill, *supra* note 201, at 493.

286. "These requirements include, for example, commencing an action to foreclose on the property, posting and publishing the notices, and holding the public sale." Wechsler, *supra* note 284, at 851 n.2.

sent any form of mortgagor protection, a lender might buy the property itself at the foreclosure sale for an artificially low price, realize a profit on the resale of the property, and still have the right to pursue the borrower for the deficiency set by the purchase price at the sale. Most states have therefore enacted some form of mortgagor protection designed to prevent the more egregious forms of mortgagee manipulation of the foreclosure process.

One important form of mortgagor protection is protection from unlimited personal liability for any deficiency produced by the foreclosure sale.[287] While many states[288] have some form of protection for borrowers against gross defects in the conduct of foreclosure sales, the degree of protection and the mechanism for providing that protection vary tremendously from state to state. Some of the most minimal forms of protection include a "single action" requirement—that is, that no deficiency can be recovered unless it is sought in the same proceeding as the foreclosure sale itself[289]—or that a deficiency be recovered within a specified period of time such as three months or two years.[290] A more significant form of protection uses some value other than the price received at the foreclosure sale as the benchmark to determine the amount of the deficiency, thus insulating the debtor from liability arising out of a defective or

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287. Schill, *supra* note 201, at 495. Another common form of mortgagor protection is a statutory right of redemption that permits the borrower to redeem the property *after* the foreclosure sale from the purchaser at the sale. Postforeclosure right of redemption will not be discussed in this Article.

288. Based on the Author's own informal survey, 11 states—Delaware, Kansas, Kentucky, New Hampshire, New Mexico, Rhode Island, South Carolina, Tennessee, Virginia, West Virginia, and Wyoming—appear to have no form of mortgagor protection that could be described as an antideficiency law, whereas six states appear to have a limited form of antideficiency protection based on an interpretation of case law precedent: Alabama, ALA. CODE § 35-10-6 (1991); Colorado, Smith v. Juhan, 311 F.2d 670, 672 (10th Cir. 1962), United Bank, N.A. v. One Center Joint Venture, 773 P.2d 637, 639 (Colo. Ct. App. 1989); Hawaii, Wodehouse v. Hawaiian Trust Co., 32 Haw. 835, 852 (1933), International Trust Co. v. Suzui, 31 Haw. 34, 41-42 (1929); Maryland, Hersh v. Allnutt, 250 A.2d 629, 632 (Md. Ct. App. 1969); Mississippi, OMP v. Security Pac. Business Fin., 716 F. Supp. 251, 258 (N.D. Miss. 1989); and Pennsylvania, Robison v. Sumner Brick & Tile Co., 11 Pa. Super. 48, 53 (1899).

289. States with a form of this rule include: California, CAL. CIV. PROC. CODE § 726 (West 1993); District of Columbia, D.C. CODE ANN. § 45-716 (1990); Idaho, IDAHO CODE § 6-101 (Supp. 1993); Iowa, IOWA CODE ANN. § 654.5-.6 (West Supp. 1993); Montana, MONT. CODE ANN. § 71-1-222 (1991); Nevada, NEV. REV. STAT. ANN. § 40.430 (Michie Supp. 1991); New York, N.Y. REAL PROP. LAW §§ 1301(3), 1371(3) (McKinney 1979); Oklahoma, OKLA. STAT. ANN. tit. 12, § 686 (West 1988); Utah, UTAH CODE ANN. § 78-37-1 (1990); and Wisconsin, WIS. STAT. ANN. § 846.04 (West 1977).

290. *See, e.g.*, MASS. GEN. LAWS ANN. ch. 244, § 17A (West 1988) (two years); NEB. REV. STAT. § 76-1013 (1986) (three months); N.J. STAT. ANN. § 2A:50-2.1 (West 1987) (three months); OKLA. STAT. ANN. tit. 12, § 686 (90 days).

fraudulently conducted foreclosure sale.[291] The benchmark value might be fair market value as determined by a judge[292] or a jury,[293] an appraised value,[294] or a judicially determined upset price.[295] Finally, some jurisdictions excuse the borrower from any personal liability for the deficiency. Some of these states focus on the situation where the risk of self-interested behavior by lenders is greatest and protect borrowers only if the sale is a nonjudicial sale conducted by the lender or a trustee under a deed of trust.[296] Some states excuse borrowers from liability for any deficiency on purchase money mortgages.[297] Arizona alone protects borrow-

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291. Twenty-four states provide this protection in some form, including: Arkansas, ARK. CODE ANN. § 18-50-112 (Michie Supp. 1991); California, CAL. CIV. PROC. CODE § 726; Connecticut, CONN. GEN. STAT. ANN. § 49-28 (West Supp. 1993); Florida, FLA. STAT. ANN. § 702.06 (West Supp. 1993); Georgia, GA. CODE ANN. § 44-14-161(a) (Harrison 1990); Idaho, IDAHO CODE § 6-108 (Supp. 1990); Louisiana, LA. CODE CIV. PROC. ANN. arts. 2336-37 (West 1961); Maine, ME. REV. STAT. ANN. tit. 14, § 6324 (West Supp. 1992); Nebraska, NEB. REV. STAT. § 76-1013; Nevada, NEV. REV. STAT. ANN. § 40.457 (Michie 1986); New Jersey, N.J. STAT. ANN. § 2A:50-3 (West 1987); New York, N.Y. REAL PROP. LAW § 1371 (McKinney 1979); North Carolina, N.C. GEN. STAT. § 45-21.38 (1992); North Dakota, N.D. CENT. CODE § 32-19-06 (Supp. 1993); Ohio, OHIO REV. CODE ANN. § 2329.20 (Anderson 1991); Oklahoma, OKLA. STAT. ANN. tit. 12, § 386 (West 1988); Pennsylvania, 42 PA. CONS. STAT. ANN. § 8103(a) (1982); South Carolina, S.C. CODE ANN. §§ 29-3-660 to 760 (Law. Co-op. 1977); Texas, TEX. PROP. CODE ANN. § 51.003 (West Supp. 1993); Utah, UTAH CODE ANN. § 57-1-32 (1990); Vermont, VT. R. CIV. P. § 80.1(j) (1988); Washington, WASH. REV. CODE ANN. § 61.12.060 (West 1990); and Wisconsin, WIS. STAT. ANN. § 846.165 (West 1977). Some states, such as Maryland and Minnesota, provide that even though the deficiency is measured by the difference between the debt and the foreclosure sale price, the debtor may avoid liability for the deficiency if he or she can prove that the foreclosure sale was unfair or defective. MD. REAL PROP. CODE ANN. § 7-105 (1988); MINN. STAT. ANN. § 582 (West Supp. 1993).

292. CAL. CIV. PROC. CODE § 726; GA. CODE ANN. § 44-14-161(a); IDAHO CODE § 6-108 (1990); NEB. REV. STAT. § 76-1013; OKLA. STAT. ANN. tit. 12, § 386; 42 PA. CONS. STAT. ANN. § 8103(a); VT. R. CIV. P. § 80.1 (1988); WASH. REV. CODE ANN. § 61.12.060.

293. N.D. CENT. CODE § 32-19-06.

294. CONN. GEN. STAT. ANN. § 49-28; LA. CODE CIV. PROC. ANN. arts. 2336-37; NEV. REV. STAT. § 40.457; S.C. CODE ANN. § 29-3-680.

295. OHIO REV. CODE ANN. § 2329 (Anderson 1991); WIS. STAT. ANN. § 1-17-316 (West 1977).

296. ALASKA STAT. § 34.20.100 (1990); CAL. CIV. CODE § 580(d) (West Supp. 1992); MINN. STAT. ANN. §§ 580.23(1), 582.30(2) (West 1993); N.D. CENT. CODE § 32-19-07 (Supp. 1991); OKLA. STAT. ANN. tit. 46, § 43 (1988); WASH. REV. CODE ANN. §§ 61.24.010, 61.24.040 (West 1990).

297. ARIZ. REV. STAT. ANN. § 33-729(A) (1990); CAL. CIV. CODE § 580(b) (West Supp. 1992); FLA. STAT. ANN. § 702.06 (West 1992); IOWA CODE ANN. § 654.26 (West Supp. 1993); KAN. STAT. ANN. § 58-2342 (Supp. 1991); MONT. CODE ANN. § 71-1-232 (1991); N.C. GEN. STAT. § 45-21.38 (1991); N.D. CENT. CODE § 32-19-07; OR. REV. STAT. §§ 88.070-.075 (1988); S.D. CODIFIED LAWS ANN. § 44-8-20-24 (1983); UTAH JUDICIAL CODE § 78-37-1 (1992).

ers from any deficiency arising out of a decline in the market value of the real estate not attributable to factors within the borrower's control.[298]

Given the large variations among states regarding lenders' rights to pursue borrowers for personal liability for any deficiency produced by a foreclosure sale, it would not be surprising to find that this diversity in creditors' rights produces significant variations in the pricing of mortgage credit between states. Such a finding could be used to buttress the claims of mortgage lenders that making lien stripping generally available would restrict access to credit and disrupt mortgage markets. While credit rating agencies take information regarding state law creditors' rights into account when analyzing the probable frequency and severity of default of mortgage-backed securities in secondary markets, and while economic analysis supports the general proposition that state law entitlements have some impact on mortgage interest rates, the precise nature of the relationship is far from clear. Interest rates reflect not only the risk of loss following default, but also such factors as the risk of loss associated with fluctuating market interest rates and the possibility of prepayment by the borrower. Very little systematic research has been done to determine what impact differences in state foreclosure laws have had on losses incurred by lenders or mortgage insurers, and whether mortgage interest rates and terms accurately reflect the economic consequences of those differences.[299]

Although the relationship between state law foreclosure regimes and the price and terms for which mortgage credit is made available has not been quantified, certain aspects of the relationship between the costs of default by the borrower and the pricing of mortgages by lenders have been established. An early study found that regional differences in mortgage interest rates were due largely to regional variations in supply and demand for mortgage capital rather than variations in the institutional structure of mortgage markets.[300] A later study found that low foreclosure costs may not indicate lower default risk but may instead reflect losses incurred in informal negotiations.[301] Another study found that

298. ARIZ. REV. STAT. ANN. § 33-729(A).

299. Schill, *supra* note 201, at 490 n.3; *see also* SULLIVAN ET AL., *supra* note 48, at 143, 146 n.19; Terrence M. Clauretie & Thomas Herzog, *The Effect of State Foreclosure Laws on Loan Losses: Evidence from the Mortgage Insurance Industry*, 22 J. MONEY, CREDIT & BANKING 234 (1990) (noting that mortgage insurance companies have historically charged uniform premiums that do not reflect variations in costs associated with state foreclosure laws, and that this may change).

300. A.H. Schaaf, *Regional Differences in Mortgage Financing Costs*, 21 J. FIN. 85 (1966).

301. Terrence M. Clauretie, *The Impact of Interstate Foreclosure Cost Differences and the Value of Mortgages on Default Rates*, 15 J. AM. REAL EST. & URBAN ECON. ASS'N 152 (1987).

mortgage interest rates have both a regional and a national component: Differences in loan-to-value ratios, state usury laws, and state foreclosure laws accounted for much of the regional variations in mortgage rates, but interregional differences in interest rates appeared generally to decline with the growth of the secondary mortgage market in the 1970s. The study found that cumbersome foreclosure procedures resulted in higher interest rates.[302] A more recent study of losses incurred by private mortgage insurers similarly found that antideficiency laws and a right of redemption increased the cost of mortgage finance.[303]

The validity of studies finding that mortgagor protection laws significantly increased interest rates were called into question by a later study showing that they had seriously overstated the impact of those protections on mortgage pricing.[304] A recent study of mortgage pricing and its relationship to default risks found that where loan-to-value ratios were low[305] and house prices stable, the contribution of default risk to price could be ignored without serious consequences, but that where loan-to-value ratios and price volatility were high, risk of default had a significant impact on interest rates.[306] The economic literature thus suggests that there are significant relationships between incentives created by the legal environment and the behavior of both lenders and borrowers, but the importance of different state law foreclosure regimes in determining interest rates remains unclear. The lack of any empirical studies demonstrating that generous antideficiency regimes—considered in isolation from other factors contributing to default risks—drive up the cost of mortgage credit, or that mortgage rates or terms have changed in regions where lien stripping has been permitted, however, undermines the credibility of the more extreme claims of lenders.[307]

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302. Mark Meador, *The Effects of Mortgage Laws on Home Mortgage Rates*, 34 J. ECON. & BUS. 143 (1982).

303. Terrence M. Clauretie, *State Foreclosure Laws, Risk Shifting, and the Private Mortgage Insurance Industry*, 56 J. RISK & INS. 544, 551 (1989).

304. Schill, *supra* note 201, at 514.

305. The loan-to-value ratio is the amount of the loan divided by the value of the property. Loan-to-value ratios are low where lenders have an ample equity cushion and high where the amount loaned approaches or exceeds the value of the property.

306. James B. Kau et al., *A Generalized Valuation Model for Fixed-Rate Residential Mortgages*, 24 J. MONEY, CREDIT & BANKING 279 (1992).

307. Schill found that the economic literature overstated the costs of mortgagor protection, but that it was still difficult to evaluate the impact of mortgagor protection laws on economic efficiency because the benefits from such laws were difficult to quantify. Schill, *supra* note 201, at 501, 515.

C. *Treatment of Secured Creditors in Bankruptcy*

In order to estimate whether the costs of permitting lien stripping for home mortgages in Chapter 13 exceed the benefits, the Chapter 13 cramdown standard for home mortgages can also be compared with cramdown of mortgage lenders under other bankruptcy chapters, and with Chapter 13 cramdown of other types of secured creditors. As with antideficiency laws, published empirical studies of the impact of bankruptcy law on economic activity provide only incomplete and indirect evidence of the costs and benefits of such cramdown standards. Any inferences drawn with regard to the likely impact of stripping down home mortgages based on these studies must likewise be tentative. Yet as with antideficiency laws, such evidence as is available does not support the most dire predictions of mortgage lenders in the *Nobelman* litigation and before Congress.[308]

In all three major reorganization chapters of the Bankruptcy Code, the following considerations apply to any attempt by a debtor to cramdown a secured lender. Section 506(a) determines the extent to which an "allowed" claim is a "secured" claim.[309] The bankruptcy court can only confirm a plan that, inter alia, provides to the nonconsenting secured lender the "value" of its "allowed secured claim."[310] Value in this context means "present value," or that if the amount is not paid in cash upon confirmation it must be paid with interest over the life of the plan.[311] The Bankruptcy Code gives little concrete guidance as to the precise mechanics of valuation,[312] leaving the courts to resolve questions of value on a fact-specific, case-by-case basis.[313] Courts have adopted several different standards, including fair market value,[314] replacement value to the debtor,[315] going concern value,[316] or forced sale or liquida-

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308. *See supra* notes 7-9.

309. For a discussion of § 506(a), see *supra* part II.

310. 11 U.S.C. §§ 1129(a)(7)(A)(ii), 1225(a)(4), 1325(a)(4) (1988).

311. 2 EPSTEIN ET AL., *supra* note 82, at 639.

312. Section 506(a) provides in part: "Such value shall be determined in light of the purposes of the valuation and of the proposed disposition or use of the property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest." 11 U.S.C. § 506(a). Bankruptcy Rule 3012 provides: "The court may determine the value of a claim secured by a lien on property in which the estate has an interest on motion of any party in interest and after a hearing on notice to the holder of the secured claim and any other entity as the court may direct." FED. R. BANKR. P. 3012.

313. *See* 3 COLLIER 15, *supra* note 123, ¶ 506.04.

314. *See, e.g.*, Lopez v. Beneficial Mut. Sav. Bank (*In re* Lopez), 75 B.R. 961 (Bankr. E.D. Pa. 1987), *aff'd*, 82 B.R. 712 (E.D. Pa. 1988).

315. *See, e.g.*, *In re* Courtright, 57 B.R. 495 (Bankr. D. Or. 1986).

316. *See, e.g.*, *In re* Wabash Valley Power Ass'n, 77 B.R. 991 (Bankr. S.D. Ind. 1987), *rev'd*, 111 B.R. 752 (1990).

tion value.[317] Likewise, there is little consensus with regard to what interest rate must be used to calculate present value.[318]

The outer limits of congressional authority to permit a debtor to modify a secured creditor's rights in any bankruptcy proceeding are set by the Fifth Amendment of the Constitution.[319] The fine line between an unconstitutional impairment of a creditor's property right and a constitutional exercise by Congress of the bankruptcy power emerges from a line of cases interpreting the Frazier-Lemke Act, a Depression-era, debtor-relief statute that authorized a form of lien stripping. In 1934 Congress passed the Frazier-Lemke Act,[320] which provided that a farmer unable to reach a voluntary restructuring of his or her debt with creditors could be adjudicated a bankrupt and then, under court supervision, retain possession of the property for five years if the debtor paid a reasonable rental value and complied with any court orders.[321] A farmer could also purchase the property outright at any time before the end of the five years by tendering to the court an amount equal to the appraised value of the property.[322] Prior to the Frazier-Lemke Act, bankruptcy proceedings did not generally affect secured creditors at all.[323] The new provi-

317. *See* H.R. REP. No. 595, 95th Cong., 1st Sess. 339 (1977); S. REP. No. 989, 95th Cong., 2d Sess. 54 (1978); 2 COLLIER 15, *supra* note 123, ¶ 361.02.

318. Possible rates include the creditor's cost of funds, the market rate for a similarly situated borrower, a markup over the Treasury Bill rate, the contract rate, the Internal Revenue Service rate for delinquent tax payments, or the legal rate. *See* 2 EPSTEIN ET AL., *supra* note 82, at 640-45; *see also* 5 COLLIER 15, *supra* note 123, ¶ 1129.03[4][f][i] (stating creditor's claim is in effect coerced loan so interest should be at market rate).

319. "The bankruptcy power is subject to the Fifth Amendment's prohibition against taking private property without compensation." United States v. Security Indus. Bank, 459 U.S. 70, 74 (1982) (citing Louisville Joint Stock Land Bank v. Radford, 295 U.S. 555 (1935)). At issue is the relationship between the Bankruptcy Clause, which grants Congress the power to "establish . . . uniform Laws on the subject of Bankruptcies throughout the United States," U.S. CONST. art. I, § 8, cl. 4, and the Fifth Amendment, which states that "no person shall . . . be deprived of . . . property, without due process of law . . . nor shall private property be taken for public use, without just compensation," U.S. CONST. amend. V. *But see* James S. Rogers, *The Impairment of Secured Creditors' Rights in Reorganization: A Study of the Relationship Between the Fifth Amendment and the Bankruptcy Clause*, 96 HARV. L. REV. 973 (1983) (arguing Bankruptcy Clause itself, not Fifth Amendment, limits congressional bankruptcy power with regard to rights of secured creditors).

320. Pub. L. No. 73-486, 48 Stat. 1289 (1934) (codified as amended at 11 U.S.C. § 203(s) (1988)). The Frazier-Lemke Act amended the Bankruptcy Act by adding subsection 75(s). *Id.*

321. Pub. L. No. 73-486, § 75(s)(7), 48 Stat. 1289, 1291 (codified as amended at 11 U.S.C. § 203(s) (1934)).

322. *Id.*

323. John C. Anderson & Rex D. Rainach, *Farmer Reorganizations Under the New Bankruptcy Code*, 28 LOY. L. REV. 439, 447 (1982).

sions for the first time granted debtors the ability to shift the costs of falling farm values onto secured lenders.

The Supreme Court struck down the Frazier-Lemke Act as an unconstitutional impairment of the mortgagee's property rights.[324] In response Congress passed minor amendments to the provisions of the Frazier-Lemke Act,[325] which in its revised form was upheld by the Supreme Court.[326] Although the correct interpretation of the Supreme Court opinions dealing with the relationship between the Fifth Amendment and the bankruptcy power is far from clear,[327] it is generally assumed that a secured creditor is only entitled to have the value of its secured position protected in a rehabilitative bankruptcy proceeding.[328] Subject to these general principles, however, the treatment of secured creditors in reorganizations under Chapters 12, 11, and 13 vary considerably in the particulars.

1. Chapter 12: Adjustment of debts; family farmer

In response to a perceived economic crisis in the American farming community and to the apparent inadequacy of existing Bankruptcy Code provisions for dealing with the reorganization of family farm indebtedness,[329] Congress enacted Chapter 12 as part of the Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986.[330]

324. Louisville Joint Stock Land Bank v. Radford, 295 U.S. 555 (1935).

325. Act of Aug. 28, 1935, Pub. L. No. 74-384, 49 Stat. 942. The most notable change was the shortening of the period for the stay of foreclosure proceedings and debtor's right of redemption from five to three years. *See* 2 COLLIER 15, *supra* note 123, ¶ 362.01.

326. Wright v. Vinton Branch of the Mountain Trust Bank, 300 U.S. 440 (1937). The Frazier-Lemke Act remained in effect only until March 1, 1949 when it expired. *See* Act of April 21, 1948, Pub. L. No. 80-495, 62 Stat. 198.

327. Although the most plausible interpretation is that *Vinton* and other subsequent cases such as Wright v. Union Central Insurance Co., 311 U.S. 273 (1940), overrule *Radford,* most commentators and courts assume that later cases merely refine the teachings of *Radford. See* Rogers, *supra* note 319, at 981.

328. 2 COLLIER 15, *supra* note 123, ¶ 362.01.

329. *See Farm Bankruptcy: Hearings Before the Subcomm. on Admin. Prac. and Proc., and Courts of the Senate Comm. on the Judiciary,* 99th Cong., 1st Sess. (1985) [hereinafter *Farm Hearings 1*]; *Farm Bankruptcy Amendments: Hearings on H.R. 1397 and H.R. 1399 Before the Subcomm. on Monopolies and Comm. Law of the House Comm. on the Judiciary,* 99th Cong., 1st Sess. (1985) [hereinafter *Farm Hearings 2*]; *America's Farm Crisis: Who's to Blame, Government or Farmer?: Hearing Before a Subcomm. of the House Comm. on Gov't Operations,* 99th Cong., 1st Sess. (1985); *Crisis in the Rural Economy and its Effect on Small Businesses: Hearings Before the Subcomm. on Export Opportunities and Special Small Business Problems of the Comm. on Small Business,* 99th Cong., 1st Sess. (1985) [hereinafter *Farm Hearings 4*]; *The Economic Evolution of Rural America: Hearings Before the Subcomm. on Agric. and Transp. of the Joint Econ. Comm.,* 99th Cong., 1st Sess. (1985).

330. Pub. L. No. 99-554, § 255, 100 Stat. 3088, 3105 (codified as amended at 11 U.S.C. §§ 1201-1231 (1986)).

The cramdown standards of Chapter 12, and the costs they have imposed on farm credit, are highly relevant to the question of whether a similar form of cramdown should be permitted homeowners in Chapter 13 for the following reasons: A deliberate decision was made by Congress to provide a generous form of debtor relief with the provisions of Chapter 12; the decision to provide a liberal cramdown standard to family farmers is a recent one, taken in the face of policy arguments by farm lenders very similar to those made by mortgage lenders regarding Chapter 13 lien stripping; and there have been some attempts to quantify the economic impact of the permissive cramdown standards in Chapter 12.

Chapter 12 has been controversial since its inception and remains so.[331] The provisions of Chapter 12 were due to expire on October 1, 1993.[332] In 1992 and 1993 Congress received testimony on whether to extend the expiration date to 1995.[333] Provisions extending the life of Chapter 12 have been included in all versions of proposed bankruptcy reform legislation introduced in 1992 and 1993.[334] Legislation to extend Chapter 12 until at least October 1995 was passed by Congress, and signed into law by President Clinton on August 6, 1993.[335]

Following a long period of rapidly rising prices for agricultural land, low interest rates, and steady, high prices for agricultural produce, a large number of farmers who had taken on substantial debt during the 1970s were caught in the 1980s by a sudden downturn in land values, rising interest rates, and falling prices for their output.[336] Prior to the creation of Chapter 12, family farmers in default on their obligations had the following options: (1) attempting an informal workout with creditors; (2) surrendering their farms to creditors and liquidating their farm operations under Chapter 7; (3) attempting to reorganize under Chapter 13 although its debt ceilings were generally too low to help most family

331. *See* Patrick B. Bauer, *Where You Stand Depends on Where You Sit: A Response to Professor White's Sortie Against Chapter 12*, 13 J. CORP. L. 33 (1987); James J. White, *Taking From Farm Lenders and Farm Debtors: Chapter 12 of the Bankruptcy Code*, 13 J. CORP. L. 1, 2-4 (1987).

332. Pub. L. 99-554, § 302(f), 100 Stat. 3124 (1986).

333. *Extension of the Family Farmer Bankruptcy Act: Hearing on H.R. 5322 Before the Subcomm. on Economic and Commercial Law of the House Comm. on the Judiciary*, 102d Cong., 2d Sess. 21 (1992) [hereinafter *1992 Farm Hearings*].

334. The Senate bill passed in June 1992 would have extended Chapter 12 from 1993 to 1995. S. 1985, 102d Cong., 2d Sess. 401 (1992). Legislation introduced in 1993 would extend Chapter 12 to 1998. Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1993, sec. 1, § 302(f), 107 Stat. 311, 311 (1993).

335. Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1993 § 1.

336. Steven Shapiro, *An Analysis of the Family Farmer Bankruptcy Act of 1986*, 15 HOFSTRA L. REV. 353, 360-61 (1987).

farmers;[337] or (4) attempting to reorganize under Chapter 11. For a significant number of farmers, none of these alternatives was adequate to prevent foreclosure of their farms by lenders.[338] In Congress legislators were willing to rally to the populist cause of the embattled family farmer[339] and pass temporary legislation designed to stave off disaster until the causes of the crisis, perceived to be beyond the control of individual farmers, abated.[340] Agricultural lenders objected to Chapter 12 vociferously on the grounds that relatively few farmers had taken on unmanageable levels of debt, most farmers and lenders were able to achieve informal workouts, and granting debt relief to that profligate few would effectively impose a tax on the prudent majority.[341]

Most provisions of Chapter 12 were modeled after corresponding provisions of Chapter 13 for individual debtors rather than the more cumbersome Chapter 11 for business reorganizations.[342] Farmers in Chapter 12, as a result, did not have to contend with certain onerous requirements of Chapter 11, such as the "absolute priority" rule as it applies to unsecured claims,[343] the disclosure and voting requirements,[344]

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337. The debt ceilings for debtors under Chapter 13 are $350,000 for secured debts and $100,000 for unsecured debts. 11 U.S.C. § 109(e) (1988).

338. *See, e.g.*, 132 CONG. REC. S15,076 (1986) (statement of Sen. Grassley).

> We must stop the bleeding on the farm. Mr. President, I harbor no illusions about the ability of the Federal Bankruptcy Code to redress farmers' grievances. I know as well as anyone that the economic causes of the crisis in agriculture lie well beyond the realm of bankruptcy. But hearings in the House and Senate led to the unmistakable conclusion that the Bankruptcy Code doesn't work for farmers.

Id.

339. White, *supra* note 331, at 2-4.

340. Although there is a consensus among economists that farmers face economic challenges of a unique nature, there is no consensus as to what precisely constitutes the "farm problem." *See generally* Bruce L. Gardner, *Changing Economic Perspectives on the Farm Problem*, 30 J. ECON. LITERATURE 62 (1992) (stating that economists variously describe "farm problem" as function of low farm incomes despite rising productivity and instability in supply due to technological factors, low farm prices, or volatile prices).

341. *Farm Hearings 1, supra* note 329, at 124-39 (statement of Oliver Hansen, representing Independent Bankers Association); *Farm Hearings 2, supra* note 329, at 23-24 (testimony of James Eatherly, on behalf of American Bankers Association).

342. Whether Chapter 12 should be more closely modeled after Chapter 11, recognizing the business nature of family farming, or after Chapter 13, giving farmers the advantages of simplified procedures and greater leverage over secured creditors, was debated at the time the legislation was enacted. *See Farm Hearings 2, supra* note 329, at 56-59 (statements of Professor Frank Kennedy and Gary Jewel, Midland Bankers Trust, Memphis, Tennessee); *Farm Hearings 4, supra* note 329, at 289 (statement of Sen. Grassley).

343. The "absolute priority" rule requires that a plan provide that any nonconsenting class of unsecured claims be paid in full or that the plan pay nothing to any junior classes of claims and interests (such as equity interests). *See* 11 U.S.C. § 1129(a)(8), (b)(2)(B)(ii) (1988). In the farm reorganization context, this meant that the farmer could not keep the farm unless unsecured creditors consented or were paid in full.

344. 11 U.S.C. § 1125.

the adequate protection standards imposed in Chapter 11,[345] and the special protection of undersecured mortgage lenders provided by § 1111(b)(2).[346] As with Chapter 13, Chapter 12 protects creditors' interests by providing for a standing trustee and by requiring the debtor to file a plan promptly.[347]

The benefits conferred on debtors by Chapter 12, however, exceeded those of Chapter 13 with regard to lien stripping.[348] Farmers in Chapter 12 were granted the right to strip down the mortgage on the debtor's principal residence, which for a farmer might also be the principal place of business.[349] In addition, under Chapter 12, a court could confirm a farmer's plan even if it included long-term debts not fully repaid within the plan period.[350] Thus, a farmer could strip down an undersecured mortgage to the current value of the real property, pay the balance due on the mortgage over a period exceeding the term of the plan, receive a discharge on the undersecured portion of the debt, and retain possession of the property. After *Nobelman*, Chapter 13 does not permit this for home mortgages. Additionally, even an undersecured claim outside the protection of the antimodification provision of § 1322(b)(2) cannot be stripped down unless the debtor proposes to pay off the current value of the collateral under the plan.[351] Although a Chapter 12 plan may provide for repayment of the mortgage beyond the term of the plan, the court still cannot grant the debtor a discharge of the unpaid balance due on the modified mortgage debt when the debtor has completed payments under the plan.[352] If the farmer defaults on the modified obligation, a creditor could take steps to foreclose the modified mortgage in state court.[353]

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345. 11 U.S.C. § 1205 (providing for market rent, not interest cost; *Timbers* later obviated this issue even in Chapter 11).

346. For a discussion of 11 U.S.C. § 1111, see *infra* notes 367-400.

347. 11 U.S.C. § 1221.

348. A major distinction between Chapters 12 and 13 was the increased debt ceilings that determined eligibility for Chapter 12; however, eligibility for Chapter 12 is not relevant to the discussion of cramdown standards.

349. *Compare* 11 U.S.C. §§ 1222(b)(2), (b)(9), 1228(a)(1) (1988) *with* 11 U.S.C. §§ 1322(b)(2), 1328(a)(1) (1988).

350. 11 U.S.C. § 1222(b)(9).

351. This is due to the confirmation standard in 11 U.S.C. § 1325(a)(5)(B)(ii) requiring payment of the present value of the collateral under the plan.

352. *See* 11 U.S.C. § 1228(a)(1). This is equivalent to the Chapter 13 discharge standard in § 1328(a)(1), which provides that the court cannot grant a discharge of indebtedness for which the last payment is due after the plan is completed.

353. *See Farm Hearings 2*, *supra* note 329, at 131 (statement of Professor Kennedy).

Creditors and some legislators objected strenuously to the lien stripping provisions of Chapter 12.[354] The fears of legislators and lenders concerning lien stripping in Chapter 12 mirror concerns regarding lien stripping in Chapter 13. Since the enactment of Chapter 12 in 1986, there have been at least two attempts to quantify the impact of the liberal cramdown standards on farm credit[355] as well as further congressional hearings on the desirability of delaying the expiration of Chapter 12.[356] One serious obstacle to quantifying the impact of Chapter 12 on the availability and terms of farm credit, however, is the fact that the additional leverage it grants to debtors has been used by some family farmers to negotiate informal debt restructurings, eliminating the need for a formal bankruptcy filing.[357]

In 1989 the Government Accounting Office (GAO) studied statistics and case information on Chapter 12 activity and conducted surveys of participant attitudes on various issues, including credit availability and the cost of credit to farmers.[358] With regard to the availability and terms of farm credit, the GAO study relied exclusively on an attitudinal survey of a small number of creditors and did not attempt any independent verification of the information as reported. A majority of creditors reported that they were less willing to lend to farmers who had filed for Chapter 12, and that they had raised interest rates charged to all farm borrowers as a result of Chapter 12, or had lowered individual loan amounts or

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354. *Farm Hearings 2, supra* note 329, at 40 (statement of James Eatherly, First National Bank, Tonkawa, Oklahoma); *id.* at 116, 188 (statement of Thomas J. Stanton); 132 CONG. REC. 28,592 (1986) (statement of Sen. Thurmond). In the words of Senator DeConcini,

> The provision of this bill that troubles me the most is the provision that will permit a family farmer to go into bankruptcy, write down the secured debt to the current value of the land, and then begin to pay the creditor based on what amounts to a new mortgage based on the value of the farm. The thought that a person cannot pay their debt and yet may retain their property and only continue payments based on the value of the property as of the filing of the bankruptcy is entirely new—and dangerous. Why won't every farmer with a substantially undercollateralized loan against his farm declare bankruptcy? . . . I fear that we have created a legal atmosphere that may well encourage farm bankruptcies and that farmers who can now manage to work things out with their creditors in some satisfactory manner to both will no longer have that incentive to reach mutual agreement. . . . This bill . . . has precluded a creditor from any hope of participating in an upswing in the value of its collateral.

132 CONG. REC. 28,609-10 (1986) (statement of Sen. DeConcini).

355. ROBERT N. COLLENDER, U.S. DEPT. OF AGRIC., BANKRUPTCY COSTS UNDER CHAPTER 12 (Staff Rep. No. AGES 9210) (1992); U.S. GEN. ACCOUNTING OFFICE, FARM FINANCE: PARTICIPANTS' VIEWS ON ISSUES SURROUNDING CHAPTER 12 BANKRUPTCY (1989) [hereinafter GAO STUDY].

356. *1992 Farm Hearings, supra* note 333, at 1-2.

357. GAO STUDY, *supra* note 355, at 11; *see also 1992 Farm Hearings, supra* note 333, at 4 (testimony of Bankruptcy Judge A. Thomas Small).

358. The GAO interviewed 59 participants, including six judges, five trustees, 11 debtor attorneys, eight creditor attorneys, and 29 creditors. GAO STUDY, *supra* note 355, at 4-5.

raised collateral requirements.[359] However, the reliability of such self-reporting by lenders should be open to question, as evidenced by the admission of one banker in the congressional hearings in 1992 that his bank had actually increased its agricultural lending since 1986.[360] In those same hearings, one bankruptcy judge testified that he had seen little evidence of farmers taking advantage of the more generous cramdown provisions of Chapter 12.[361] Other observers have also noted that the initial reaction of some lenders to reduce their exposure to farmers following enactment of Chapter 12 was modified when their worst fears were not realized.[362]

The Collender Study treats the family farmer as a form of business enterprise equivalent to a corporation and relates the data on economic costs created by Chapter 12 to corporate finance theories of agent-principal incentives and estimates of the costs of business bankruptcy. Collender distinguishes direct bankruptcy costs (such as legal and administrative costs) and indirect costs (resulting from economic distortions associated with bankruptcy or the threat of bankruptcy that cause inefficient resource allocations).[363] He found that the direct costs of Chapter 12 bankruptcies seem to be relatively low—as little as three percent of asset value—which is consistent with the legislative objective of simplifying bankruptcy proceedings for family farmers.[364] With regard to indirect costs, however, he found that they ranged from 90% to 100% of asset value for cases in his sample; these were much higher than the estimates of indirect costs for business bankruptcy filings under Chapter 11.[365] This was interpreted to mean that the more liberal provisions of Chapter 12, including the cramdown standard, were causing more debtors to file for bankruptcy, even when no economic benefit was produced, than was the case under Chapter 11. Collender estimated this larger number of unproductive filings would cause farmers to pay 0.25% to 1% more for credit than they would in the absence of Chapter 12.[366]

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359. *Id.* at 14-20.

360. *1992 Farm Hearings*, *supra* note 333, at 47-48 (statement of Phil Burns, President and CEO, Farmers & Merchants National Bank, West Point, Nebraska).

361. *Id.* at 21 (statement of Bankruptcy Judge A. Thomas Small). Judge Small was one of the principal drafters of Chapter 12.

362. Andrea Bennett, *Chapter 12 Changes Ways Lenders Serve Farmers*, AM. BANKER, Feb. 16, 1988, at 26.

363. COLLENDER, *supra* note 355, at 1.

364. *Id.* at 6.

365. *Id.* at 12-13.

366. *Id.* at 15.

2. Chapter 11: Reorganization

Cramdown standards in Chapter 11 are relevant in evaluating the impact of cramdown standards in Chapter 13 not only because Chapters 11 and 13 are both procedures aimed at rehabilitating a distressed debtor, but also because many individual debtors are now forced to file under Chapter 11 by the eligibility limits for Chapter 13.[367] Chapter 11 is generally thought of as governing business reorganizations whereas Chapter 13 governs individuals. However, there is no requirement that a Chapter 11 debtor be engaged in business,[368] and many unincorporated businesses are handled through Chapter 13 when the owner of the business files.[369] Many homeowners no longer qualify for Chapter 13 because the value of their homes, even after allowing for declining market values, exceeds the Chapter 13 ceiling of $350,000 on secured debts.[370] Debtors in jurisdictions with house prices well above the national average, such as Southern California, still have the option of stripping down their home mortgages because Chapter 11 does not contain the same antimodification provision at issue in *Nobelman*, although creditors have the option to make a § 1111(b)(2) election[371] to try to protect their interests in a Chapter 11 proceeding.

Chapter 11, like Chapter 13, is based in large part on the reorganization provisions of the Chandler Act of 1938.[372] The Chandler Act introduced four forms of reorganization: Chapter X for publicly held companies, Chapter XI for closely held companies, Chapter XII for real estate owned by partnerships or individuals, and Chapter XIII wage-earner plans for individuals.[373] Chapter 11 is an amalgam of (1) Chapter X, modeled on nineteenth-century equity receivership, which provided a mechanism for cramming down creditors, including secured creditors, but also included the absolute priority rule designed to protect unsecured creditors from overreaching by management and shareholders; (2) Chapter XI, modeled on common-law composition, which required the consent of all interested parties to confirm a plan and which could not affect

367. Lisa H. Fenning, *The Future of Chapter 11: One View from the Bench*, 1993-1994 ANN. SURV. BANKR. L. 113, 125 (stating that consumers are forced to file Chapter 11 in high-priced housing markets, such as Los Angeles, to save homes because of debt ceilings in Chapter 13).

368. Toibb v. Radloff, 111 S. Ct. 2197, 2202 (1991).

369. *See, e.g.*, 11 U.S.C. § 1302(c) (1988) (providing for special duties of trustee if Chapter 13 debtor is engaged in business).

370. 11 U.S.C. § 109(e) (1988).

371. *See supra* text accompanying notes 346-62 for a discussion of 11 U.S.C. § 1111(b)(2) elections.

372. Act of June 22, 1938, ch. 575, 52 Stat. 878.

373. COLLIER 15, *supra* note 123, app., at 1.

the rights of secured creditors without their consent;[374] and (3) Chapter XII, which permitted the cramdown of secured creditors but provided none of the elaborate safeguards of Chapter X, such as the absolute priority rule.[375]

The basic protection granted creditors in a Chapter 11 proceeding is that a court will not confirm a plan of reorganization unless the creditors have either voluntarily accepted the plan, or the creditor's rights were not impaired under the plan.[376] This protection is not absolute, however, because the Bankruptcy Code also grants debtors, subject to certain limitations, broad powers to modify the rights of creditors without their consent.[377] If an impaired class of creditors does not accept the plan, the court cannot confirm the plan unless it meets the cramdown standard contained in § 1129(b). While the operation of Chapter 11 cramdown is very complex with regard to secured creditors, generally a plan must provide that the secured creditor both retains the collateral and is paid in full over the life of the plan, that the collateral will be sold and the claim paid in full from the proceeds, or that the debtor retain possession of the collateral, but provide the creditor with the equivalent of its property.[378]

With regard to undersecured creditors in particular, § 1111(b)(2) of the Bankruptcy Code contains an important qualification to the power of debtors to cramdown nonconsenting creditors.[379] Under § 1111(b)(2) secured creditors may elect special treatment designed to prevent Chapter 11 debtors from stripping down an undersecured claim to the current value of the collateral, thus denying secured creditors the ability to participate in any future appreciation in the value of the collateral. In essence § 1111(b)(2) provides that nonrecourse loans are treated as

374. DOUGLAS G. BAIRD & THOMAS H. JACKSON, CASES, PROBLEMS AND MATERIALS ON BANKRUPTCY 959 (2d ed. 1990).

375. John C. Anderson & Eric S. Ziegler, *Real Property Arrangements Under the Old and New Bankruptcy Acts*, 25 LOY. L. REV. 713, 714-15 (1979).

376. 11 U.S.C. § 1129(a)(8) (1988).

377. These limitations include, for example, the requirements that creditors receive at least as much under a plan of reorganization as they would in a liquidating Chapter 7 bankruptcy, that at least one class of creditors whose rights have been modified accept the plan voluntarily, and that the debtor make full and fair disclosure of the details of the plan before creditors are required to vote on it. The absolute priority rule, designed to protect unsecured creditors from manipulation of the reorganization system by junior interests such as shareholders, is beyond the scope of this Article. For a summary of the cramdown process in general, see 3 EPSTEIN ET AL., *supra* note 82, at §§ 10-15 to -22; Kenneth N. Klee, *All You Ever Wanted to Know About Cram Down Under the New Bankruptcy Code*, 53 AM. BANKR. L.J. 133 (1979).

378. 11 U.S.C. § 1129(b)(2)(A)(i)-(iii) (1988).

379. Section 1111(b)(2) provides in part: "[N]otwithstanding section 506(a) of this title, [an electing undersecured creditor's] claim is a secured claim to the extent that such claim is allowed." 11 U.S.C. § 1111(b)(2) (1988).

recourse loans in determining the amount of a secured creditor's claim in Chapter 11, and that an undersecured creditor may prevent the bifurcation of its claim into secured and unsecured portions by electing to have the entire claim deemed a secured claim. If the § 1111(b)(2) election provisions worked as Congress intended, many of the criticisms of home mortgage lenders could be answered by introducing corresponding provisions into Chapter 13. This solution to the problems associated with lien stripping is probably not feasible, however, because the standard terms of home mortgage loans differ so greatly from those of commercial real property loans. Furthermore, it is unclear whether § 1111(b)(2) affords even Chapter 11 undersecured creditors the protections it was intended to provide.

Section 1111(b) was enacted in response to a bankruptcy case,[380] *In re Pine Gate Associates, Ltd.*,[381] decided under Chapter XII of the Bankruptcy Act. In *Pine Gate*, the bankruptcy court allowed investors in a real estate limited partnership to pay only the appraised value of the property in order to purchase the property from the undersecured nonrecourse lenders. The lenders had accepted nonrecourse notes from the partnership, agreeing to look only to the collateral for satisfaction of the debt and waiving the right to pursue the investors for any deficiency.[382]

From the secured creditors' perspective, they had waived the right to a deficiency in exchange for the right to foreclose on the property after default, giving the lender the option to hold the property and wait for any subsequent recovery in the value of the collateral. Nevertheless, lenders were dismayed when the bankruptcy court in *Pine Gate* held that the investors were protected from any personal liability for the deficiency—because the original loan to the partnership had been nonrecourse—but deprived the secured creditors of their right to participate in any future recovery in the value of the property.[383] Notwithstanding the

380. S. REP. NO. 989, 95th Cong., 2d Sess. 65 (1978); *see* 124 CONG. REC. H32,406-08 (Sept. 28, 1978) (statement of Rep. Edwards); 124 CONG. REC. S17,420 (Sept. 7, 1978) (statement of Sen. DeConcini).

381. *In re* Pine Gate Assocs., Ltd., 2 Bankr. Ct. Dec. 1478 (Bankr. N.D. Ga. 1976).

382. Nonrecourse lending is common in commercial real estate because the right to collect a deficiency may be prohibited by contract or state law. For example, limited partnership structure effectively creates a nonrecourse loan for the borrower because of limited liability for the limited partners. James A. Pusateri et al., *Section 1111(b) of the Bankruptcy Code: How Much Does the Debtor Have to Pay and When Should the Creditor Elect?*, 58 AM. BANKR. L.J. 129, 131 (1984).

383. The court relied on § 461(11)(c) of the Bankruptcy Act (formerly codified at 11 U.S.C. § 761(11)(c)) (repealed 1978). Section 461(11)(c) of the Bankruptcy Act provided that a plan of arrangement shall provide any nonconsenting class "adequate protection for the realization by them of the value of their debts" by "appraisal and payment in cash of the value of such debts."

common perception among commercial real estate lenders that the *Pine Gate* case was harsh in its treatment of secured creditors,[384] the court did attempt to balance the debtor's and the lenders' interests by requiring the debtor to pay cash for the property.[385] Thus, while lenders may have been deprived of the opportunity to participate in any recovery of the particular apartment complex at issue in *Pine Gate*, the court ensured they had cash to reinvest in a similar property if they were convinced that real property prices were artificially low and wanted to be positioned to take advantage of any future upswing in prices.

Real estate lenders were sufficiently shocked by the outcome in *Pine Gate* to lobby Congress for a provision in the Bankruptcy Reform Act of 1978 to overrule the case.[386] The provisions of the § 1111(b)(2) election reflect lenders' concerns with the facts of *Pine Gate*. First, § 1111(b)(1)(A) provides that, for the purposes of making a § 1111(b)(2) election, nonrecourse debt shall be treated as recourse debt. In addition, under § 1111(b)(2), an undersecured creditor may waive its unsecured claim in exchange for having its entire allowed claim deemed secured.[387] The creditor making a § 1111(b)(2) election is then entitled to demand that total payments under the plan equal the total amount of the deemed secured claim, in addition to being entitled to a stream of payments with a present value equal to the value of the collateral.[388]

To give a simplified example, consider the case of a creditor with a nonrecourse debt of $100 and collateral worth $60. The creditor can foreclose on the property outside of bankruptcy. If the creditor forgoes the option to hold the property following foreclosure, it is limited in its recovery to the proceeds of any foreclosure sale. In Chapter 11, in the

384. *See, e.g.*, *In re* Mesa Business Park Partnership, 127 B.R. 144, 148 (Bankr. W.D. Tex. 1991).

385. *Pine Gate*, 2 Bankr. Ct. Dec. at 1484. In a subsequent valuation hearing, the court held that the property had to be appraised at the higher going concern value, not the lower forced sale, and added a premium of 20% onto the appraised value to allow for the possibility of future appreciation. *In re* Pine Gate, 3 Bankr. Ct. Dec. 301, 315-16 (Bankr. N.D. Ga. 1977).

386. A senior vice president of the real estate division of a life insurance company stated during congressional testimony, "Mr. Chairman, I would have to speak for the life insurance industry. [If the existing law is not reformed,] I think we would channel more of our funds into direct placements and bond purchases and stay away from mortgages, particularly where limited partnerships are the borrowers." *Bankruptcy Reform Act of 1978: Hearings Before the Subcomm. on Improvements in the Judicial Machinery of the Comm. on the Judiciary of the United States Senate*, 95th Cong., 1st Sess. 715 (1977) (testimony of Edward J. Kulik, Massachusetts Mutual Life Insurance Co.).

387. Although the language of § 1111(b)(2) is unclear, the election is available to both recourse and nonrecourse undersecured lenders. *See* Klee, *supra* note 377, at 161.

388. 11 U.S.C. § 1129(b)(2)(A)(i)(II) (1988).

absence of a § 1111(b)(2) election, the creditor holds a secured claim of $60 and an unsecured claim of $40. In the event of cramdown under § 1129(b), with regard to the secured claim, this creditor would be entitled to a stream of payments with a present value of $60, but with regard to the unsecured claim, might receive very little.[389] If the undersecured creditor made a § 1111(b)(2) election, that creditor waives the unsecured claim of $40—and the right to vote on confirmation of the plan together with the other unsecured claim holders—in return for the right to a deemed secured claim of $100. The creditor is now entitled to a stream of payments under the plan totalling $100; however, the present value of those claims still must equal only the value of collateral, $60.

The § 1111(b)(2) election has been criticized as ineffective or misguided on several grounds.[390] It has been called misguided because it is based on the flawed premise that the *Pine Gate* case presented a special problem requiring a unique resolution.[391] This premise is flawed if *Pine Gate* merely represented a problem of judicial valuation of economic resources, a problem of the timing of the appraisal, or a problem of prodebtor bias among bankruptcy judges.[392] If the risk of undervaluation of real property collateral when debtors seek to cash out undersecured creditors is really one of these problems, then the attempt to provide a special remedy for nonrecourse undersecured mortgage lenders undermines other, arguably more important, bankruptcy policies such as equal treatment of similarly situated creditors.[393]

A major reason that a § 1111(b)(2) election may be ineffective in protecting undersecured creditors is that, no matter what the dollar amount of the payments an undersecured creditor is entitled to demand, the present value of what the debtor must offer is still limited to the value of the collateral. Therefore, the right to demand that the unsecured portion of a creditor's claim be paid in full may have little economic value if the stream of payments is made over the long term and the rate of interest used to calculate present value is relatively low. To continue with the above example, if the debtor proposes a five-year plan and uses a ten

389. A class of unsecured claims may receive less than payment in full provided that any junior claims or interests (such as equity interests) received nothing. This is one possible outcome under the application of the "fair and equitable" standard of § 1129(b)(2)(A)(i)(II) for the secured claim and § 1129(b)(2)(B)(i) for the unsecured. *See* 3 EPSTEIN ET AL., *supra* note 82, at §§ 10-15 to 10-20.

390. Theodore Eisenberg, *The Undersecured Creditor in Reorganizations and the Nature of Security*, 38 VAND. L. REV. 931, 943 (1985).

391. *Id.*

392. *Id.* at 943-50.

393. *Id.* at 967.

percent interest rate to calculate present values, a creditor not making a § 1111(b)(2) election with a debt of $100 and collateral worth $60 will only be entitled to annual payments of $15.83 a year. If that creditor makes a § 1111(b)(2) election, then that creditor is entitled to payments totalling $100 over the five-year plan with a present value of $60. Assuming the plan provides for equal annual installments of $20 over the life of the plan and a discount rate of ten percent, then the present value of the payments is $75.82. The creditor will only be receiving $15.82 more in the present value of the stream of payments for having made the § 1111(b)(2) election. If the debtor is able to confirm a plan that pays out the secured creditor over ten years instead of five, the real economic benefit of the § 1111(b)(2) election is even less. In the absence of the election, the creditor is entitled to annual payments of $9.76 on a secured claim of $60 with a discount rate of ten percent. Assuming the plan provides for equal annual installments of $10 over the life of the plan and a discount rate of ten percent, then the present value of the payments is $61.45, an increase of only $1.45 in the present value of the stream of payments for having made the § 1111(b)(2) election.

Assuming, however, that the § 1111(b)(2) election has been successful in providing some additional protection to nonconsenting, undersecured creditors in Chapter 11 and that nonconsenting home mortgage lenders have at least as much equitable claim to special treatment as nonrecourse commercial real estate lenders, should lien stripping be permitted in Chapter 13 if combined with a provision modeled after § 1111(b)(2)? The answer would seem to be "no" because the different structures of standard commercial real estate mortgages and standard home mortgages would make any provision similar to § 1111(b)(2) unworkable in Chapter 13. If Chapter 13 debtors were permitted to strip down undersecured home mortgages and pay off the deemed secured claim over a term of years exceeding the three-to-five-year maximum for a Chapter 13 plan,[394] then a § 1111(b)(2)-style election would produce little or no real economic benefit to the mortgage lender. If Chapter 13 debtors were required to pay off the deemed secured claim within the term of the Chapter 13 plan, few Chapter 13 debtors would be able to generate the cash flow to pay off the deficiency within the term of the plan to take advantage of the lien stripping option.[395]

394. That is, in the same manner as farmers are allowed to strip down undersecured mortgages on their family farms. *See supra* part IV.B for a discussion of Chapter 12 lien stripping.

395. *See, e.g.*, Zeigler v. Lomas & Nettleton Co. (*In re* Zeigler), 1992 WL 50006 (Bankr. E.D. Pa. Mar. 2, 1992); Taras v. Commonwealth Mortgage Corp. (*In re* Taras), 136 B.R. 941 (Bankr. E.D. Pa. 1992).

The standard home mortgage is a self-amortizing,[396] long-term loan, often with a maturity of fifteen, twenty, twenty-five, or thirty years. By contrast, a commercial real estate mortgage is usually of much shorter duration—often as little as three to five years, and may be self-amortizing or may be a "bullet" or "balloon" loan with little or no principal repaid during the term of the loan.[397] If a lien stripping provision were introduced into Chapter 13 following *Nobelman*, it would have little impact on debtors facing substantial declines in the appraised values of their homes unless debtors were given the same option to repay the modified mortgage over a period in excess of the three-to-five-year term of the plan that farmers enjoy under Chapter 12. From the lender's perspective, however, a § 1111(b)(2)-style election would produce little economic benefit if the homeowner were permitted to pay off a substantial deficiency over a period of twenty or more years because the present value of payments made ten years or more in the future rapidly decreases to nominal levels. For example, assuming a discount rate of ten percent, a dollar to be paid in twenty years has a present value of about fifteen cents today. On the other hand, forcing the debtor to repay the deficiency within the three-to-five-year term of the plan, while guaranteeing that the lender receives something of value from making a § 1111(b)(2)-style election, would put lien stripping beyond the means of many homeowners with undersecured mortgages. Thus, even assuming the effectiveness of a § 1111(b)(2)-style election in Chapter 11, the different economic characteristics of commercial and home mortgage lending make the provision unworkable in Chapter 13.[398]

While in recent years there has been a virtual flood of publications attempting to quantify the costs and benefits of the Chapter 11 corporate reorganization process generally,[399] a search of the relevant literature has

396. Self-amortizing loans are repaid in constant increments composed of both principal and interest payments, although the proportions of principal and interest vary for each payment.

397. A loan may combine both self-amortizing and balloon payment features, such as a loan with a term of five years that follows an amortization schedule such that, if the note were renewed each five years, the principal would be repaid in full in 30 years.

398. *See infra* part IV.C.3 for a discussion of other possible ways to structure lien stripping under Chapter 13 to address the concerns of both lenders and borrowers.

399. *See, e.g.*, Douglas G. Baird, *The Uneasy Case for Corporate Reorganizations*, 15 J. LEGAL STUD. 127 (1986); Lucian Arye Bebchuk, *A New Approach to Corporate Reorganizations*, 101 HARV. L. REV. 775 (1988); Michael Bradley & Michael Rosenzweig, *The Untenable Case for Chapter 11*, 101 YALE L.J. 1043 (1992); *cf.* Charles W. Adams, *An Economic Justification for Corporate Reorganizations*, 20 HOFSTRA L. REV. 117 (1991); Lynn M. LoPucki, *Strange Visions in a Strange World: A Reply to Professors Bradley and Rosenzweig*, 91 MICH. L. REV. 79 (1992); Lynn M. LoPucki, *The Trouble with Chapter 11*, 1993 WIS. L. REV. 729; Elizabeth Warren, *The Untenable Case for Repeal of Chapter 11*, 102 YALE L.J. 437 (1992).

failed to turn up any studies on the narrower question of what impact, if any, § 1111(b) has had on the cost of credit to business borrowers. This may be due to the greater concern in the corporate finance literature with the relative claims against the corporate enterprise of different classes of investors and of management, with the negotiating strategies of those participants and with modeling the highly nuanced financial structure of major corporations than with studying the impact on a single class of debt of a single provision of Chapter 11. Furthermore, given the complexity of corporate finance compared with the relative simplicity of the personal finances of individual debtors, it is unclear how relevant information taken from the corporate reorganization context would be in attempting to assess the impact of lien stripping on the market for home mortgage credit.[400]

3. Chapter 13: Secured creditors other than home mortgage lenders

In its report to Congress in 1973,[401] the Commission on Bankruptcy Laws recommended introducing significant new limitations on the power of secured creditors in consumer bankruptcy cases.[402] The recommendations had two objectives: (1) to clarify and make uniform the treatment of secured creditors in Chapter 13 proceedings;[403] and (2) to reduce the leverage a secured party enjoyed over the debtor when the personal value of the collateral to the debtor greatly exceeds the resale value of the asset, as is often the case with property such as household furnishings.[404] The Commission's recommendations remained substantially intact throughout the legislative process, producing a significant shift in negotiating power away from secured creditors and in favor of Chapter 13 debtors.[405] Consequently, a Chapter 13 debtor may strip down any lien, other than a mortgage on the debtor's principal residence, subject only to the obligation to pay the value of the collateral under the plan and to

Among corporate finance articles, *see, e.g.*, Julian R. Franks & Walter W. Torous, *An Empirical Investigation of U.S. Firms in Reorganization*, 44 J. FIN. 747 (1989); Robert Gertner & David Scharfstein, *A Theory of Workouts and the Effects of Reorganization Law*, 46 J. FIN. 1189 (1991).

400. WARREN & WESTBROOK, *supra* note 124, at 195-97 (arguing that consumer and business bankruptcy should be understood as parallel systems rather than unified system).

401. H.R. DOC. NO. 137, 93d Cong., 1st Sess. 130 (1973) (part II).

402. *See supra* part II.C for a discussion of the legislative history of Chapter 13.

403. EPSTEIN ET AL., *supra* note 82, at 601.

404. Aaron, *supra* note 128, at 25.

405. Some limitations on the power of secured creditors in consumer bankruptcy cases apply in Chapter 7 as well as Chapter 13, such as § 522(f), which provides that the debtor may ignore a nonpurchase-money security interest in otherwise exempt household goods, or only in Chapter 7, such as 11 U.S.C. § 722 (1988), which permits the debtor to redeem collateral by paying its value in cash.

meet the other cramdown standards in § 1325. Hence, a debtor may strip down a lien on a house if it is a rental property or a second home, or if it is also secured by other collateral, as well as strip down liens on chattels such as automobiles.

As in Chapter 12—but unlike Chapter 11—a plan can be confirmed in Chapter 13 without a vote of the creditors and without reference to the "absolute priority" rule. A Chapter 13 plan dealing with secured creditors cannot be confirmed unless the secured creditor has voluntarily accepted the plan, the secured creditor retains its lien and is paid over the term of the plan an amount equal to the present value of the judicially appraised value of the collateral, or the debtor surrenders the collateral to the secured creditor.[406] To illustrate the operation of this cramdown standard with a simplified example, take the case of a Chapter 13 debtor who purchased a car for $11,000 one year prior to filing for bankruptcy with a $1000 downpayment and financed the balance with a five-year loan for $10,000, with an annual interest rate of eighteen percent and a monthly payment amount of $253.93. Assume that when the debtor files for bankruptcy, the car is worth only $7000, but is still subject to a debt of $8,644.57 payable over the remaining term of four years. The debtor's plan may deal with the auto loan by reducing the amount of the secured debt to $7000, and if permitted by local precedent and practice, reducing the interest rate to the then current market rate of twelve percent. Furthermore, if local precedent and practice permit, the debtor may propose paying little or even nothing at all on the secured lender's unsecured balance of $1644.57. Assuming the debtor is proposing a three-year plan, the debtor may now purchase the car for thirty-six monthly payments of only $232.50, resulting in a total savings of $3818.64 compared with the total scheduled payments due under the original loan.

The relatively generous cramdown standard for all secured creditors in Chapter 13 other than home mortgage lenders has been in effect since 1979, so interest rates and the terms on which credit is available in affected consumer credit markets should fully reflect the costs imposed on lenders of this cramdown standard. The operation of consumer credit markets affected by this cramdown standard should be relevant in estimating the impact of a more generous lien-stripping rule for home mortgages in Chapter 13.

In comparing the cost and availability of home mortgage credit and consumer credit generally, one important common feature to note is the growth of "securitization" for both types of credit. The term "securitiza-

406. 11 U.S.C. § 1325(a)(5) (1988).

tion" is often used to refer to the trend toward financial assets being securities rather than loans, or to any borrowing transaction that takes the form of a securities issuance.[407] The first loans to be securitized on a large scale were home mortgages, and the growth of the market for such securities was pioneered by the governmental or quasi-governmental agencies starting in the 1970s.[408] Although the first securitization transactions involved home mortgages, the process has been reproduced in a wide variety of contexts, such as automobile loans, credit card receivables, manufactured housing contracts, unsecured consumer loans, junk bonds, education loans, commercial real estate mortgages, and boat loans.[409] Securitized consumer debt in bankruptcy includes not only se-

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407. Joseph C. Shenker & Anthony J. Colletta, *Asset Securitization: Evolution, Current Issues and New Frontiers*, 69 TEX. L. REV. 1369, 1374 (1991). Shenker and Colletta propose the following, more precise definition of securitization:

> the sale of equity or debt instruments, representing ownership interests in, or secured by, a segregated, income-producing asset or pool of assets, in a transaction structure to reduce or reallocate certain risks inherent in owning or lending against the underlying assets and to ensure that such interests are more readily marketable and, thus, more liquid than ownership interests in and loans against the underlying assets.

Id. at 1374-75. Securitization transactions generally involve the following parties: the originator, or the original lender of the assets to be securitized; the issuer of the asset-backed security, who may or may not be the same as the originator depending on whether the originator has already sold the assets in the secondary market to a second party; the underwriter, usually an investment bank that structures the transaction; a credit enhancer such as a bank, surety, or insurance company who provides credit support through a letter of credit or guarantee that payments will be made as they become due according to the terms of the securitized obligation; a trustee, who deals with the issuer, credit enhancer, and servicer on behalf of holders of the asset-backed securities; a servicer, who might be related to the originator or might be a bank, who is paid a fee to collect payments due on the underlying assets and pass them on to the trustee; credit rating agencies, who assess the credit quality of the underlying asset, the structure of the transaction, and the ability of the issuer to segregate the assets backing the securities from its own assets and thus secure an independent (usually higher) credit rating; and traders, who market the securities to investors and make a secondary market in them. A securitization transaction involves collecting income-producing assets into a pool and using the cash flow from the pool to make payments to investors in the asset-backed security. Lowell L. Bryan, *Structured Securitized Credit: A Superior Technology for Lending*, 1 J. APPLIED CORP. FIN. 9 (1988); Shenker & Colletta, *supra*, at 1376.

408. *See supra* part IV.A.1 for a discussion of the development of the secondary market for mortgage-backed securities.

409. Craig J. Goldberg & Karen Rogers, *An Introduction to Asset Backed Securities*, 1 J. APPLIED CORP. FIN. 20 (1988). Representative John J. LaFalce, a democrat from New York state has repeatedly sponsored legislation that would create a "Venture Enhancement and Loan Development Administration for Small, Undercapitalized Enterprises," to be known as Velda Sue, that would securitize small business loans. Such legislation may have a better chance of succeeding under the Clinton Administration than it had under the Bush Administration. *See* John H. Cushman, Jr., *Secondary Market Is Sought*, N.Y. TIMES, Mar. 29, 1993, at D1.

cured claims, such as automobile loans or home mortgages, but also unsecured claims such as credit card debt.[410]

Securitization of automobile loans and credit card receivables developed in the early 1980s,[411] after the development of the market for mortgage-backed securities and after the revision of the bankruptcy law and enactment of the more generous cramdown provisions of Chapter 13. Thus, the possibility that consumers will file for a Chapter 13 bankruptcy proceeding has been a component of default risk that issuers and investors in securitized consumer debts have been forced to deal with since these markets developed. In most cases securitized debt is composed of large numbers of small, standardized assets, so that the credit risk of such a security can be estimated by statistical analysis of the assets in the pool. As long as the impact of any given legal rule regarding the allocation of losses following default by borrowers in the underlying pool of assets is statistically predictable, the credit-rating service or guarantor can predict the impact of such a rule on the overall credit risk of the securitized asset, and investors can adjust the price of the securitized asset accordingly.

Techniques developed in the market for asset-backed securities for dealing with higher levels of default risk—whether due to bankruptcy law, state law debtor protections, or any other factor, such as a regional economic downturn—include permitting issuers to increase reserves against possible default and requiring the participation of a credit enhancer in the transaction. An issuer from a jurisdiction or a region experiencing higher-than-average losses on the securitized assets can set aside larger-than-average reserves in order to overcollateralize the security, and also can pay for the credit enhancement of a bank, surety, or insurance company in order to assure the marketability of its asset-backed securities. Thus the greater risk of loss through more generous debtor protection under bankruptcy law or state law need not foreclose potential borrowers or lenders from participation in national credit mar-

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410. Although securitization has grown explosively in recent decades, it has by no means displaced other forms of consumer lending. The amount of securitized consumer credit as a percentage of all consumer credit varies from as much as 35% for home mortgage lending to as little as 10-12% for automobile loans or credit card receivables. Bryan, *supra* note 407, at 6. The following discussion will focus on securitized consumer debt rather than traditional lending by financial intermediaries, however, because of the growing importance of this type of debt and also because structural parallels between asset-backed securities and mortgage-backed securities facilitate the comparison of the two forms of consumer credit.

411. STANDARD & POOR'S CORP., *supra* note 283, at 61.

kets. Access to national markets for credit, however, is conditioned on payment of an appropriate risk premium.[412]

V. CONCLUSION

In *Nobelman*, the Supreme Court resolved the question of how much special protection Chapter 13's antimodification provision granted to mortgage lenders with a lien on the debtor's primary residence. The narrow reasoning of the Court's opinion focused on "rights of holders" rather than "secured claim" in determining what interest was protected from modification. This interpretation is problematic because it undermines the function of § 506(a) in forcing lenders to face changed economic circumstances, and it undermines the benefit of the bankruptcy discharge for consumer debtors. Not only is the holding in *Nobelman* not dictated by the plain meaning of the Bankruptcy Code provisions at issue, it is not clearly mandated by the legislative history of the relevant provisions.

While the issue was not framed by the Supreme Court in these terms, the dispute in *Nobelman* is ultimately one of balancing the competing federal policies of granting consumer debtors a fresh start following bankruptcy and of encouraging home ownership through federal support for mortgage lenders. Lenders contended that permitting home mortgages to be stripped down would interfere with the operation of mortgage markets and choke off the free flow of credit to borrowers. Consumer advocates countered that there was no evidence that lien stripping had those effects. This Article has demonstrated that lenders other than home mortgage lenders routinely cope with lien stripping, and many home mortgage lenders cope with antideficiency statutes, so primary and secondary markets for mortgages should also be capable of adjusting to a regime that is more accommodating to debtors.[413]

The compromise reached in Chapter 11 between the interests of secured creditors and borrowers reflected in the § 1111(b) election is not available to home mortgage lenders and homeowners in Chapter 13 because of the different structure of a typical home mortgage compared with a typical commercial real property mortgage. Generalizing from

412. If retail markets for consumer credit are imperfect, however, the terms on which consumers are offered credit may not take account of small gradations in risk. If retail markets offer credit only on certain standardized terms, and potential borrowers who do not qualify under those terms cannot individually bargain for credit on terms that reflect their riskier credit status, then those more risky borrowers may in fact be cut off from conventional sources of credit as a result of standardization of credit terms.

413. Of course, the costs associated with the transition to such a system might be greater than the costs of routine administration once the change in liability has been accomplished.

the evidence of the impact of cramdown in Chapters 12 and 13 on secured lenders, however, it is apparent that permitting lien stripping on a uniform national basis through federal bankruptcy law would have some impact on price and terms of home mortgage credit, but is not likely to have the profound impact lenders alleged. Therefore, the holding in *Nobelman* was not dictated by economic necessity any more than it was dictated by the canons of statutory interpretation.

The holding in *Nobelman* tacitly supports both a particular interpretation of how best to achieve the federal policy of promoting home ownership, and a particular interpretation of how to balance the in rem rights of creditors in bankruptcy with the economic benefits of a bankruptcy discharge for consumer debtors. In considering revisions to the relevant Bankruptcy Code provisions, however, Congress may decide to strike a different balance between the rights of mortgage lenders and consumer debtors in bankruptcy.