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# Residential Mortgages Under Chapter 13 of the Bankruptcy Code: The Increasing Case Against Cramdown After "Dewsnup v. Timm"

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# Residential Mortgages Under Chapter 13 of the Bankruptcy Code: The Increasing Case Against Cramdown After *Dewsnup v. Timm*

## I. Introduction

Congress designed Chapter 13 to allow individuals an extended period of time to pay their debts so that they may support themselves and their dependents while repaying their creditors.[1] Chapter 13 bankruptcy is more favorable to debtors than a straight liquidation under Chapter 7 because Chapter 13 debtors may keep all of their assets while Chapter 7 debtors must surrender most of their assets to generate funds with which to pay their creditors.[2] A Chapter 13 debtor also benefits by avoiding the stigma and less favorable credit rating that accompanies a liquidating bankruptcy.[3] Chapter 13's benefit to creditors is also self-evident: their losses will be significantly less than if their debtors opt for straight bankruptcy.[4]

An emerging trend to interpret the Bankruptcy Code (the "Code")[5] as prohibiting cramdown of residential mortgages threatens Chapter 13's mission.[6] The term "cramdown" refers generally to any attempt by a debtor to pay a secured creditor less than the full amount of its claim.[7] For example, suppose a debtor previously borrowed $100,000 to purchase a home valued at $150,000. Assume further that the fair market value of that home falls to $60,000 while the amount of the debt remains $100,000.[8] The creditor now lacks security for the full amount of his loan. Cramdown allows the debtor to discharge the debt and retain the collateral by paying only the fair market value of the collateral

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1. See H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 118 (1977), in 3 USCCAN 5963, 6079.

2. Id. Section 522 allows an individual debtor to retain a limited amount of assets (exempt from property of the estate). 11 U.S.C. § 522 (1988).

3. See H.R. Rep. No. 98-595 at 118, in 3 USCCAN at 6079 (cited in note 1).

4. Id.

5. All references to code sections or the "Code" are to the Bankruptcy Reform Act of 1978 as amended and codified in 11 U.S.C. §§ 101 to 1330 (1988).

6. Debtors that cram down creditors' claims to the current value of the collateral securing the claim effectively undermine, by paying the Chapter 13 creditor no more than it would receive under a Chapter 7 liquidation, those aspects of Chapter 13 that are designed to provide creditors with recoveries on their debts greater than under Chapter 7.

7. Cramdown is, therefore, a broad term. Sections 506(a) and 1322(b)(2) of the Code allow a debtor to cramdown most undersecured claims by bifurcating the claim into two claims: one claim equal to the current value of the collateral and a second claim equal to the difference between the full claim and the current value of the collateral. The focus of this Note is whether an exception contained in Section 1322(b)(2) prevents such a cramdown of a claim secured only by the debtor's principal residence.

This Note does not address cramdown pursuant to Section 1325(b)(1), which allows a court to confirm a debtor's plan of reorganization over the objection of a creditor if the plan meets certain requirements.

8. Notice that the creditor is now "undersecured." Collateral worth only $60,000 secures the creditor's loan of $100,000, so the creditor lacks security for $40,000 of the loan. Generally, Section 506(a) would bifurcate the claim of $100,000 into a secured claim of $60,000 and an unsecured claim of $40,000.

plus a fraction[9] of the difference between the amount of the debt and the value of the collateral. In our example, the debtor may keep his home, free of any liens or encumbrances, by paying $60,000 plus a fraction, perhaps as little as ten percent,[10] of $40,000. Thus, the debtor might discharge a debt of $100,000, secured by a home that was once worth $150,000, by paying the creditor as little as $64,000.

Cramdown's value to debtors lies in the fact that they do not have to pay their debts in full, but instead may treat the liens on their homes as unsecured claims to the extent that the liens exceed the value of the collateral.[11] Chapter 13 requires debtors to pay unsecured creditors only what they would have received in a Chapter 7 liquidation case.[12] This may be nothing at all, and is often as little as five or ten cents on the dollar.[13]

Whether the Code permits cramdown of residential mortgages under Chapter 13 is an important question. Debtors choose to file under Chapter 13 principally to keep their homes.[14] If cramdown is found unavailable then debtors may be less likely to choose Chapter 13 rather than Chapter 7 with the ultimate result that Chapter 13's mission is left unaccomplished.

Despite the importance of the cramdown question, the issue remains unresolved.[15] Advocates of cramdown believe that cramdown is consistent with the basic structure and mechanics of Section 506(a), a

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9. The fraction a Chapter 13 debtor must pay is the amount the creditor would have received under a Chapter 7 liquidation. 11 U.S.C. § 1325(a)(4) (1988). Generally speaking, under Chapter 7 a trustee collects a debtor's property, sells it, then pays the debtor's debts. Id. § 704; David G. Epstein, Jonathan M. Landers, and Steve H. Nickles, *Debtors and Creditors* 707-09 (West, 3d ed. 1987). Unsecured creditors receive a pro rata share; that is, a share proportionate to their claim, of what is left of the debtor's property after secured creditors and priority expenses are paid in full. 11 U.S.C. § 726; Epstein, Landers, and Nickles, *Debtors and Creditors* at 709.

10. This fraction varies from case to case. It is determined by dividing what is left of the debtor's estate after paying secured claims and priorities in full by the aggregate amount of unsecured claims.

11. See *In re Nobleman*, 968 F.2d 483, 486 n.5 (5th Cir. 1992), cert. granted, 113 S. Ct. 654 (1992).

12. 11 U.S.C. § 1325(a)(4) (1988).

13. Unsecured creditors may receive as little as five or ten cents on the dollar in a Chapter 7 case because Section 726(b) allows pro rata payment to similarly situated claims if all similarly situated claims cannot be paid in full. See also Chaim J. Fortgang and Thomas Moers Mayer, *Valuation in Bankruptcy*, 32 UCLA L. Rev. 1061, 1065 n.16 (1985) (citing an empirical study in which unsecured creditors received an average of three cents on the dollar).

14. Regina L. Nassen, *Bankruptcy Code § 1322(b)(2)'s No-Modification Clause: Who Does It Protect?*, 33 Ariz. L. Rev. 979, 979 n.1 (1991).

15. The Supreme Court has recently granted certiorari in *In re Nobleman*. 113 S. Ct. 654. The Court's decision in *Nobleman* should provide a judicial answer to the question. The issue, however, may be the subject of congressional action even after the Supreme Court rules in *Nobleman* because cramdown or its prohibition significantly affects debtors, creditors, and borrowers in general.

section critical to the application of much of the Code.[16] Advocates of cramdown also contend that the plain language of the Code does not prohibit cramdown, while opponents of cramdown point to Section 1322(b)(2) as authority for the proposition that the Code does prohibit cramdown of mortgages that are secured only by the debtor's principal residence.[17]

Prior to *Dewsnup v. Timm*,[18] a majority of courts found that the Code permitted cramdown of residential mortgages. Indeed, the Third, Ninth, and Tenth Circuits all expressly adopted this view.[19] While no circuit court opinion prior to *Dewsnup* held that the Code prohibited cramdown, a number of lower courts took this position.[20] After the Supreme Court's decision in *Dewsnup*, which held that the Code prohibited the closely related practice of stripdown[21] in Chapter 7 cases, an increasing number of courts have begun to prohibit cramdown of residential mortgages under Chapter 13.[22]

Part II of this Note examines the cramdown debate prior to *Dewsnup*. Part III traces the Supreme Court's reasoning in *Dewsnup* and its impact on the cramdown question. Part IV begins by critiquing ex-

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16. Section 506 provides:

Determination of Secured Status

(a) An allowed claim of a creditor secured by a lien on property in which the estate has an interest, or that is subject to setoff under section 553 of this title, is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, or to the extent of the amount subject to setoff, as the case may he, and is an unsecured claim to the extent that the value of such creditor's interest or the amount so subject to setoff 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.

17. See text accompanying notes 55-96 for a discussion of arguments against cramdown. Section 1322(a) lists what a debtor's plan of reorganization must do, while Section 1322(b) lists what the plan may do. Section 1322(b)(2) 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.

18. 112 S. Ct. 773 (1992).

19. See *In re Houghland*, 886 F.2d 1182 (9th Cir. 1989); *Wilson v. Commonwealth Mortgage Corp.*, 895 F.2d 123 (3rd Cir. 1990); *In re Hart*, 923 F.2d 1410 (10th Cir. 1991) (per curiam).

20. See, for example, *In re Schum*, 112 Bankr. 159 (Bankr. N.D. Tex. 1990); *In re Sauber*, 115 Bankr. 197 (Bankr. D. Minn. 1990); *In re Mitchell*, 125 Bankr. 5 (Bankr. D.N.H. 1991); *In re Catlin*, 81 Bankr. 522 (Bankr. D. Minn. 1987); *In re Russell*, 93 Bankr. 703 (D.N.D. 1988); *In re Lee*, 137 Bankr. 285 (Bankr. E.D. Wis. 1991); *In re Etchin*, 128 Bankr. 662 (Bankr. W.D. Wis. 1991); *In re Chavez*, 117 Bankr. 733 (Bankr. S.D. Fla. 1990); *In re Kaczmarczyk*, 107 Bankr. 200 (Bankr. D. Neb. 1989).

21. Stripdown refers to liens while cramdown refers to claims. A debtor "strips down" a lien by avoiding, pursuant to Section 506(d), that portion of the lien not supported by value. A debtor crams down a claim held by a creditor by paying (in full satisfaction of the claim) less than the full amount of the claim. This is often accomplished by bifurcating the claim under Section 506(a), but may also be accomplished under Section 1325(b)(1).

22. See text accompanying notes 116-62.

isting interpretations of Section 1322(b)(2) and the cramdown debate. It then discusses the bankruptcy values implicated in the debate and analyzes the effect that valuation and misvaluation of collateral have on the issue. Part IV proposes an original solution, awarding appreciation in the value of the collateral during bankruptcy to the creditor. This solution largely satisfies the misvaluation concerns, respects stare decisis and the Supreme Court's decision in *Dewsnup*, and effectuates the congressional intent behind Section 1322(b)(2).

## II. The Cramdown Debate Prior to *Dewsnup*

### A. *The Argument Supporting Cramdown*

At least since the Ninth Circuit's decision in *In re Houghland*,[23] courts addressing the issue of whether the Code permits cramdown of residential mortgages have focused on the interplay between Sections 506(a)[24] and 1322(b)(2). In contrast to Section 1322(a), which dictates what a debtor's plan *must* do, Section 1322(b) lists what a debtor's plan *may* do. Specifically, Section 1322(b)(2) permits a debtor's plan to "modify the rights of holders of secured claims, other than a claim secured only by . . . the debtor's principal residence, or [modify the rights of holders] of unsecured claims."[25] Section 101, the definitional section of the Code, defines "claim"[26] without reference to the value of any security. Section 506(a) then classifies claims as either secured or unsecured. Under Section 506(a), a claim is secured to the extent of the value of any collateral securing it, while a claim is unsecured to the extent the claim exceeds the value of any collateral securing it.

23. 886 F.2d at 1182. Prior to *Houghland*, a debtor's ability to cram down a residential mortgage was less clear. See, for example, *In re Glenn*, 760 F.2d 1428, 1442 (6th Cir. 1985) (assuming, without extensive discussion, that Section 1322(b)(2) prohibits cramdown of residential mortgages); *In re Catlin*, 81 Bankr. at 524 (stating that "in a Chapter 13 case, the allowed amount of a claim secured only by a security interest in the principal residence of a debtor is . . . the balance owing on the debt without regard to the value of the collateral—§ 506(a) notwithstanding"); *In re Kaczmarczyk*, 107 Bankr. at 200 (holding that Section 1322(b)(2) prohibits modification of even undersecured claims secured by only the debtor's principal residence); *In re Russell*, 93 Bankr. at 703 (refusing to confirm a debtor's plan that proposed to pay claims secured only by the debtor's principal residence less than the full balance owing at the time of filing).

24. For a discussion of Section 506(a), see text accompanying note 160.

25. 11 U.S.C. § 1322(b)(2) (1988).

26. Section 101(5) defines "claim" as a

(A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured; or

(B) right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured; . . .

In *Houghland*, the court began its analysis of whether the Code allows cramdown by first bifurcating the lien on the debtor's principal residence into a secured claim and an unsecured claim pursuant to Section 506(a).[27] The court then considered whether the Code permits modification of the claim's unsecured portion.[28] The court noted two divergent lines of cases addressing this issue.[29] First, some courts have held that Section 1322(b)(2) does not affect a determination under Section 506(a) that a debtor may divide an undersecured claim into a secured and an unsecured portion.[30] Furthermore, these courts have held that Section 1322 permits a debtor's plan to modify the unsecured portion of an unsecured claim.[31] In contrast, other courts have held that Section 1322(b)(2)'s "other than" clause[32] prohibits modification of a lender's rights and prevents separate treatment of what would otherwise be an unsecured claim.[33] That is, Section 1322(b)(2)'s "other than" clause prevents debtors from using Section 506(a) to bifurcate a single, undersecured claim into one fully secured claim and one undersecured claim in order to treat the unsecured claim differently than the secured claim.

The *Houghland* court chose to follow the first line of cases, and as a matter of statutory construction[34] found specifically that Sections 506(a) and 1322(b)(2) do not conflict.[35] The court also found that the phrase "secured claim" means the same in Section 1322(b)(2) as it does in Section 506(a). That is, the court used Section 506(a) to define a secured claim as only that portion of a claim supported by value, rather than the entire claim without respect to value. When the court used

27. *In re Houghland*, 886 F.2d at 1183. In *Houghland*, the secured claim was equal to the value of the collateral at the time of filing. The unsecured claim was equal to the extent that the balance owing on the lien exceeded the value of the collateral.

28. Id.

29. Id.

30. Id., citing *In re Harris*, 94 Bankr. 832 (D. N. J. 1989); *In re Frost*, 96 Bankr. 804 (Bankr. S.D. Ohio 1989); *In re Kehm*, 90 Bankr. 117 (Bankr. E.D. Pa. 1988); *In re Caster*, 77 Bankr. 8 (Bankr. E.D. Pa. 1987); *In re Bruce*, 40 Bankr. 884 (Bankr. W.D. Va. 1984).

31. *In re Houghland*, 886 F.2d at 1183.

32. Section 1322(b)(2) allows a debtor's plan to modify the rights of holders of secured claims other than claims secured only by the debtor's principal residence.

33. *In re Houghland*, 886 F.2d at 1183.

34. Id. (citing *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 241 (1989)). The *Houghland* court stated that "the quest for meaning should begin and end with the language of the statute itself." Id. But see Patricia Lindauer, *Optimizing the "Fresh Start": Mortgage Cramdown Under Chapter 13 of the Bankruptcy Code*, 11 J. L. & Commerce 257, 264 (1992) (arguing (i) that the court chose to allow cramdown hecause the loan at issue was a state benefit that allowed negative amortization, (ii) that "real" lenders would not allow themselves to hecome undersecured, since those who lend for profit do not make loans that allow negative amortization, and (iii) that the *Houghland* court failed to anticipate other situations in which lenders could become undersecured).

35. *In re Houghland*, 886 F.2d at 1183.

Section 506(a) to define the words "secured claim," it assumed the permissibility of bifurcation rather than addressing it as an issue.[36] Instead of phrasing the issue as whether the "other than" clause prohibits bifurcation, the court focused on whether the "other than" clause protects the entire claim or only its secured portion after the claim has been bifurcated.[37] The court concluded that the "other than" clause protects only the secured portion of the claim. The court then permitted the debtor's plan to modify the unsecured portion.[38]

In *Wilson v. Commonwealth Mortgage Corporation*,[39] the Third Circuit arrived at a similar conclusion. It, too, began by finding that Section 506(a) bifurcates undersecured mortgages.[40] The court began its analysis by recognizing that Chapter 13 allows debtors to reorganize their affairs in order to pay their debts through future earnings rather than having to liquidate their assets as under Chapter 7.[41] The court then concluded that Section 1322(b)(2)'s "other than" clause protects only the claim's secured portion.[42] The court also specifically held that Section 1322(b)(2) and Section 506(a) do not conflict[43] and that Section 1322(b)(2)'s specific exclusion does not control Section 506(a)'s general provision.[44] Further, the court refused to accept the argument that cramdown left Section 1322(b)(2) without a purpose since, under the court's interpretation, Section 1322(b)(2) still protects the secured portion of the claim.[45]

It was not until the Tenth Circuit's decision in *In re Hart*[46] that a court framed the issue as whether, pursuant to Section 506(a), a debtor may bifurcate an undersecured lien, secured only by his or her principal residence, into two claims such that the unsecured portion is left unprotected by Section 1322(b)(2).[47] Prior to *Hart*, most courts holding that the Code permits cramdown began their analysis by bifurcating the

36. Id.

37. Id. at 1183-84. In fact, the court felt that this issue was dispositive. The court conceded that if the "other than" clause refers to the entire secured claim, then the Code would prohibit cramdown. Id. at 1184.

38. Id.

39. 895 F.2d 123.

40. Id. at 125 (quoting *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 239 (1989)).

41. Id. Chapter 7 differs from Chapter 13 in that Chapter 7 requires debtors to liquidate their assets in order to pay their debts, while Chapter 13 debtors usually pay their debts from their future earnings. Compare Section 541 with Section 1306.

42. *Wilson*, 895 F.2d at 127.

43. Id. at 128.

44. Id. The court in *In re Lewis* had previously held Section 506(a) fully applicable to Chapter 13. 875 F.2d 53, 55 (3d Cir. 1989).

45. *Wilson*, 895 F.2d at 128.

46. 923 F.2d 1410 (10th Cir. 1991) (per curiam).

47. Id. at 1411.

claim without questioning whether Section 1322(b)(2) permits such a bifurcation. The *Hart* court, however, did not evade the issue. Rather, it began with a discussion of the legislative history of Section 1322(b)(2) and concluded that Congress drafted the "other than" clause to protect the lending industry.[48] The court found that cramdown, although not entirely consistent with the legislative history,[49] is consistent with the plain meaning of Section 1322(b)(2). The court further found nothing in Section 1322(b)(2) that authorizes courts to look beyond the Code to define "secured claim."[50] The court conceded that although the result was a modification of a secured claim-holder's rights, the modification was not impermissible.[51]

*Houghland*, *Wilson*, and *Hart* are significant because they interpret Sections 506(a) and 1322(b)(2) so as to avoid conflict between the two Code provisions. By avoiding conflict, these courts escape resort to the legislative history of Section 1322(b)(2), which clearly indicates an intent to protect the home mortgage lending industry.[52] Accordingly, these courts never have to decide whether the limited protection their interpretation of Section 1322(b)(2) provides mortgage lenders is consistent with Congress' intent. The strength of their approach, however, is that it results in an interpretation of Section 1322(b)(2) that is harmonious[53] with Section 506 and is also consistent with the entire statutory scheme of Chapter 13.[54]

### B. *Arguments Against Cramdown*

Prior to the Supreme Court's decision in *Dewsnup*, courts holding that the Code prohibits cramdown of residential mortgages under

48. Id. at 1412.

49. See text accompanying notes 176-82.

50. *In re Hart*, 923 F.2d at 1415. In doing so, the court relied on Section 506(a) to define the words "secured claim" found in Section 1322(b)(2).

51. Id. The dissent emphasizied that the majority's interpretation of Section 1322(b)(2) rendered Section 1322(b)(2)'s "other than" clause essentially meaningless. Id. at 1417 (Brorhy dissenting).

52. What is not clear from the legislative history is to what extent Congress intended to protect home mortgage lenders. See, for example, *In re Bellamy*, 962 F.2d 176, 181-82 (2d Cir. 1992) (stating that although Section 1322(b)(2) was designed to provide greater protection to home mortgage lenders than to other secured creditors, the extent of this greater protection cannot be determined from the legislative history).

53. The court in *In re Bellamy* endorsed the principle that, whenever possible, courts should construe statutory provisions so as to avoid a conflict. 962 F.2d at 181 (citing *Pittsburgh & Lake Erie R.R. v. Railway Labor Executives' Ass'n*, 491 U.S. 490, 510 (1989); *United States Sav. Ass'n of Texas v. Timbers of Inwood Forest Ass'n, Ltd.*, 484 U.S. 365, 371 (1988) (finding that statutory construction is an holistic endeavor, and that apparently ambiguous language may be clarified when viewed in context of a statutory scheme as a whole).

54. Peter H. Carrol III, *Cramdown of Residential Mortgages in Chapter 13 Cases*, 20 Colo. Law 881, 882 (1991).

Chapter 13 relied on at least six distinct rationales to support their conclusions.

### 1. Section 1322(b)(2) Supersedes Section 506(a)

As noted in the previous section, proponents of cramdown use Section 506(a) to bifurcate an undersecured claim in order to render the claim's unsecured portion beyond the protection of Section 1322(b)(2).[55] However, generally accepted tenets of statutory construction provide an argument that Section 1322(b)(2) alters Section 506(a)'s bifurcation scheme. When two statutes conflict, one statute does not apply or prevail over matters specifically dealt with in another part of the same enactment, notwithstanding the apparent inclusiveness of the statute's general language.[56] In other words, the specific protection that Section 1322(b)(2) affords to home mortgagees should prevail over the general language of Section 506(a).[57]

A precondition to the validity of this argument is actual conflict between Sections 1322(b)(2) and 506(a).[58] For example, the court in *In re Mitchell* found conflict in that Section 506(a) invades the protection of Section 1322(b)(2).[59] Of course, courts that accept this argument always find the required conflict.[60] Courts that allow bifurcation and cramdown, however, typically speak of the virtue of reading Code provisions harmoniously or may even speak of the absence of conflict between Section 1322(b)(2) and Section 506(a).[61] Curiously, these courts that allow bifurcation and cramdown apply Section 506(a) in the same manner as the *Mitchell* court, even though it determined the provisions are in conflict.[62]

Once a court decides that Section 506(a) conflicts with Section 1322(b)(2), the court must decide which section prevails. In *In re Sauber*, the court chose Section 1322(b)(2) to prevail. In reaching this decision, the court noted that the issue involved both general and spe-

55. See text accompanying notes 23-54.

56. *In re Russell*, 93 Bankr. at 705 (citing *Maiatico v. United States*, 302 F.2d 880, 886 (D.C. Cir. 1962)).

57. See, for example, *In re Lee*, 137 Bankr. at 286; *In re Etchin*, 128 Bankr. at 665; *In re Mitchell*, 125 Bankr. at 6; *In re Sauber*, 115 Bankr. at 199; *In re Chavez*, 117 Bankr. at 734-35; *In re Kaczmarczyk*, 107 Bankr. at 202; *In re Russell*, 93 Bankr. at 705; *In re Catlin*, 81 Bankr. at 524.

58. *In re Mitchell*, 125 Bankr. at 6.

59. See note 43.

60. Id. Compare *Wilson*, 895 F.2d at 128.

61. See, for example, *Wilson*, 895 F.2d at 128, and text accompanying note 43.

62. See text accompanying note 43. Doubt is cast upon the supposed virtue of a harmonious interpretation by the fact that some courts call the interpretation harmonious while other courts call the same interpretation conflict. The real disagreement between these courts is not the proper application of Section 506(a), but rather, the proper effect to be given to Section 1322(b)(2). Courts that allow cramdown rarely address the issue in these terms.

cific concepts intended to govern the rights of debtors and creditors in varying situations and with different applications depending upon the particular Code purpose to be served.[63] The court discounted Section 506(a)'s importance and almost universal application throughout the rest of the Code by arguing that the application of concepts is not universal in the scheme of the Code, but rather is subject to limitation and even total disregard in some instances.[64] The court even went so far as to criticize the *Houghland* court's analysis as "overly technocratic."[65]

### 2. Protection of Home Mortgage Lenders

Opponents of residential mortgage cramdown also argue that disallowance of cramdown is consistent with Section 1322(b)(2)'s goal of protecting mortgage lenders.[66] Many courts rely on Section 1322(b)(2)'s legislative history to arrive at this conclusion.[67] Other courts have found that this purpose is obvious from the statute's text.[68]

Some courts have focused on the issue of whether an examination of Section 1322(b)(2)'s legislative history is appropriate. For example, in *In re Schum*[69] the court held that a court should accept an interpretation taken from the legislative history that is different from that drawn from the face of the statute only if the evidence from the legislative history is very strong. This test usually requires explicit language in the legislative history.[70] Despite the apparent strictness of this test, the *Schum* court found the word "modify" in Section 1322(b)(2) ambig-

63. *In re Sauber*, 115 Bankr. at 199.

64. Id.

65. Id.

66. Even the *Houghland* court conceded that the legislative history of Section 1322(b)(2) indicated congressional intent to protect the mortgage lending industry. *In re Houghland* 886 F.2d at 1185. For cases in which this argument is made, see, for example, *In re Sauber*, 115 Bankr. at 199; *In re Chavez*, 117 Bankr. at 736; *In re Russell*, 93 Bankr. at 705; *In re Schum*, 112 Bankr. at 161-62.

67. *In re Schum*, 112 Bankr. at 161; *In re Chavez*, 117 Bankr. at 736. See generally Lindauer, 11 J. L. & Commerce at 267-71 (cited in note 34) (arguing that congressional intent to protect a mortgagee's entire claim is reflected in Section 1322(b)(2)'s legislative history). For a thorough discussion of Section 1322(b)(2)'s legislative history, see *In re Strober*, 136 Bankr. 614, 620-22 (E.D.N.Y. 1992).

68. One court stated that cramdown of a residential mortgage in Chapter 13 is at odds with the "clear intent of Congress to protect a lender's security when a lender is secured only by a security interest in the debtor's home." *In re Russell*, 93 Bankr. at 706. Accord *In re Sauber*, 115 Bankr. at 199.

69. 112 Bankr. 159 (Bankr. N.D. Tex. 1990).

70. Id. at 161 (quoting *Tulalip Tribes of Washington v. FERC*, 732 F.2d 1451 (9th Cir. 1984)).

uous[71] and relied on that section's legislative history to interpret the term in a way that prohibits cramdown.[72]

### 3. Pre-Code Law Prohibited Cramdown

A third argument against cramdown addresses the issue from an historical context. Advocates of this view argue that the Code prohibits cramdown of residential mortgages because under its predecessor, the Bankruptcy Act of 1898, a Chapter 13 plan could not include claims secured by real property.[73] This was because, although a Chapter 8 plan could address secured claims, the statutory definition of the term "claim" expressly excluded "claims secured by estates in real property or chattels real."[74] Some courts have found that Congress' silence regarding whether it intended the Code's enactment to change the treatment of residential mortgages strongly suggests that it did not intend to change the law.[75] This silence has led more than one court to conclude that Section 1322(b)(2) continues the prohibition on modification of claimholders rights that are secured by real estate.[76]

### 4. Reference to Section 101(5) Rather Than Section 506(a) to Define "Claim"

A fourth argument that opponents of residential mortgage cramdown employ relies on the language of Section 1322(b)(2) and attempts to nail down a precise definition of the word "claim" found in Section 1322(b)(2). Recall that Section 1322(b)(2) allows a debtor's plan of reorganization to "modify the rights of holders of secured claims, other than a claim secured only by . . . the debtor's principal residence."[77] Some opponents of cramdown argue that the word "claim" should be defined by Section 101(5)[78] rather than by Section 506(a).[79]

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71. The *Schum* court found ambiguity in the word "modify" since Section 1322(b)(5) permits a debtor to cure a default or decelerate a note even though these actions technically modify the rights of holders of secured claims. *In re Schum*, 112 Bankr. at 161.

72. Id. But compare *In re Bellamy*, 962 F.2d at 181-82.

73. *In re Kaczmarczyk*, 107 Bankr. at 202. Accord *In re Mitchell*, 125 Bankr. at 8.

74. *In re Kaczmarczyk*, 107 Bankr. at 202-03. See Bankruptcy Act of 1898 §§ 1006(2), 1046(1). The current definition of "claim" is much broader and includes any right to payment without regard to how or if the claim is secured. 11 U.S.C. § 101(5) (1988).

75. The legislative history of Section 1322(b)(2) does not specify whether Congress intended the Code to change the treatment of residential mortgages. Nor does Congress address this issue elsewhere in the Code. For courts finding this silence meaningful, see *In re Kaczmarczyk*, 107 Bankr. at 202. Accord *In re Mitchell*, 125 Bankr. at 8.

76. *In re Kaczmarczyk*, 107 Bankr. at 203; *In re Mitchell*, 125 Bankr. at 8. But note that Congress did change the law regarding the definition of "claim." 11 U.S.C. § 101(5) (1988). See also note 177.

77. 11 U.S.C. § 1322(b)(2) (1988).

78. Pub. L. 101-647 (1990) redesignated Section 101(4) as Section 101(5).

The difference is that Section 101(5) defines "claim" without reference to security or lack of security, and, therefore, refers to the entire claim in the context of a Section 1322(b)(2) cramdown. Advocates of using Section 101(5) to define the meaning of "claim" within Section 1322(b)(2) point out that the definition of a term in the definitional section of a statute should control the construction of that term wherever it appears throughout the statute.[80] On the other hand, proponents of cramdown argue that the phrase "secured claims" immediately before the phrase "other than" requires reference to Section 506(a) to define "secured claims" and limits the word "claim" to only the secured portion of the claim as determined by Section 506(a).[81]

### 5. "The Rights of Holders of Secured Claims" is the Subject of Section 1322(b)(2)'s "Other Than" Clause

A fifth argument that opponents of cramdown employ notes that cramdown utilizes an interpretative scheme that renders the words "secured claims" the subject of Section 1322(b)(2)'s "other than" clause. Although proponents of cramdown concede that the "other than" clause prohibits modification, they contend that this prohibition only extends to a claim's secured portion because they assume that the subject of Section 1322(b)(2) is "secured claims." Opponents of cramdown directly challenge this assumption by contending that the true subject of Section 1322(b)(2)'s anti-modification clause is not "secured claims" but rather "the rights" of those holding secured claims.[82] If "the rights" of those holding secured claims is the subject of Section 1322(b)(2), then it is those rights, and not merely the secured claim, that may not be modified. Once it is established that "the rights" and not "secured claims" are the subject of Section 1322(b)(2)'s no-modification clause, it follows easily that cramdown of residential mortgages modifies these "rights" and, therefore, violates Section 1322(b)(2)'s prohibition against modification.[83]

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79. *In re Etchin*, 128 Bankr. at 668; *In re Kaczmarczyk*, 107 Bankr. at 202; *In re Russell*, 93 Bankr. at 705.

80. This is an elementary principle of statutory construction. See *In re Etchin*, 128 Bankr. at 668.

81. *In re Bellamy*, 962 F.2d at 180-81 (citing *In re Hart*, 923 F.2d at 1413).

82. Id. at 667-78. Accord *In re Lee*, 137 Bankr. at 287; *In re Nobleman*, 968 F.2d at 488.

83. *In re Etchin*, 128 Bankr. at 668.

### 6. Appreciation in the Value of Collateral Should Accrue to the Creditor and not the Debtor

The court in *In re Etchin* made a rather unique argument against cramdown.[84] The *Etchin* court prohibited cramdown after concluding that cramdown would deprive the creditor of the right to appreciation in the value of the collateral, implying that this right belonged to the creditor and not the debtor.[85]

The court began by comparing the Code's treatment of debtors filing under Chapter 13 with debtors that file under other chapters in the Code.[86] The court noted that many creditor protection provisions found elsewhere in the Code are absent in Chapter 13 because Congress designed Chapter 13 to offer simplified and expedited relief to consumers and other small debtors.[87] Noticeably absent in Chapter 13 is a counterpart to Section 1111(b), a section that provides for the protection of undersecured creditors by giving them the right to any appreciation in the value of their collateral up to the full amount of their claim.[88] Under Section 1111(b), creditors may elect to have the debt owed to them become secured to the full amount of the debt, rather than being secured only up to the value of their collateral,[89] even if the value of the collateral at the time of the election is substantially less than the amount of the debt.[90] By so electing, any appreciation up to the amount of the debt accrues to the creditor and not the debtor.[91] These rights and others[92] effectively protect secured creditors from a forced cramdown in Chapter 11.[93]

The *Etchin* court noted that the need for creditor protection in Chapter 13 is far less compelling than in Chapter 11.[94] This is because loans to Chapter 13 debtors, except for residential mortgages, are typically secured by rapidly depreciating personal property and are made in a highly competitive consumer finance market.[95] The less compelling need for creditor protection in Chapter 13 supports a rule that gener-

84. Id.
85. Id.
86. Id.
87. Id.
88. Id.
89. Jefferey A. Stein, *Section 1111(b): Providing Undersecured Creditors with Post-Confirmation Appreciation in the Value of the Collateral*, 56 Am. Bankr. L. J. 195, 195 (1982).
90. *In re Etchin*, 128 Bankr. at 666.
91. Id.
92. Chapter 11 creditors are also given the right to "credit bid" if there is a sale of the collateral during the case's administration. See 11 U.S.C. § 363(k) (1988).
93. *In re Etchin*, 128 Bankr. at 667.
94. Id. at 687.
95. Id.

ally allows cramdown in Chapter 13 cases. However, the fact that Section 1322(b)(2)'s "other than" clause is an exception to the general rule of Section 1322(b)(2) supports a rule prohibiting cramdown of residential mortgages. Thus, the *Etchin* court found that Section 1322(b)(2)'s narrowly drawn exception from modification for home mortgages is consistent with a specific need for creditor protection. Therefore, courts should not diminish the exception's effect by attempting to protect a debtor's "fresh start" through an overly technical reading of the Code.[96]

## III. *Dewsnup* and Its Impact on the Cramdown Debate

In *Dewsnup*, the Supreme Court held that Chapter 7 debtors cannot stripdown residential mortgages.[97] The precise issue in *Dewsnup* differs from the cramdown issue in two important ways. First, *Dewsnup* was a Chapter 7 case, and Chapter 7 and Chapter 13 at times promote different goals.[98] Second, the debtor in *Dewsnup* attempted to reduce his mortgage obligation under Section 506(d) rather than Section 1322(b)(2). Therefore, the *Dewsnup* holding is not readily applicable to the Chapter 13 cramdown debate. Furthermore, the court in *Dewsnup* made a valiant effort to limit its holding to the specific facts of the case.[99] Nevertheless, much of the Supreme Court's reasoning is applicable to Chapter 13. The following section discusses how *Dewsnup* has impacted the Chapter 13 cramdown debate.

### A. *The Supreme Court's Decision in* Dewsnup

In *Dewsnup*,[100] the Supreme Court had to decide whether a Chapter 7 debtor could bifurcate an undersecured lien on real property and

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96. Id.

97. See *Dewsnup v. Timm*, 112 S. Ct. 773 (1992).

98. There is at least one reason why a holding in a Chapter 7 case such as *Dewsnup* may not be applicable under Chapter 13. Under Chapter 7, a trustee collects the debtor's non-exempt assets, sells them, and distributes the proceeds to creditors in proportion to their claims. Under Chapter 13, however, the debtor generally does not liquidate his assets but pays his creditors through his future earnings over the next three or five years. Because creditors are paid more gradually under Chapter 13 than under Chapter 7, the debtor's successful rehabilitation is arguably more important under Chapter 13 than under Chapter 7.

99. 112 S. Ct. at 778 & n.3. The court stated:

> 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. at 778. It is likely that despite the Court's attempts, its decision will have significant effects in a broad range of issues.

100. Id. at 773.

then avoid the unsecured portion of the claim under Section 506(d).[101] The debtor, relying on Section 506(a), argued that the creditor had an "allowed secured claim" for purposes of Section 506(d) only to the extent that the claim was secured.[102]

The bankruptcy court was not convinced by this argument and did not allow stripdown.[103] The court first accepted the assumption that the property securing the lien was abandoned by the trustee pursuant to Section 554.[104] Because the debtor's estate no longer held an interest in the abandoned property, the court disallowed the debtor's use of Section 506(a) to define terms in Section 506(d) since Section 506(a) does not apply to property in which the debtor's estate has no interest.[105]

Before the Supreme Court, the creditor[106] argued that "allowed secured claim" in Section 506(d) is not an indivisible term of art defined by Section 506(a), but rather creates a two-pronged test for lien avoidance.[107] According to the creditor, a claim first must be allowed under Section 502, and second, secured, to escape avoidance under Section 506(d).[108] Since it was clear on the facts of the case that the claim was both allowed and at least partially secured, the creditor argued that stripdown was inappropriate.[109] The creditor also noted that pre-Code bankruptcy law preserved such liens and that nothing in the Code's legislative history reflects an intent to alter the law.[110]

The Supreme Court held that, on the facts of the case, Section 506(d) does not permit stripdown because the claim was both allowed and secured.[111] The Court also stated that it was not convinced Congress intended a departure from pre-Code law that allowed liens to pass

101. Id. Generally, Section 506(d) voids every lien to the extent that it secures a claim against the debtor that is not an allowed secured claim.

102. 112 S. Ct. at 776-77.

103. *In re Dewsnup*, 87 Bankr. 676 (Bankr. D. Utah 1988). See also note 20.

104. Id. Section 554 authorizes the court to authorize the trustee to abandon any property of the estate tbat is burdensome or of inconsequential value to the estate. Although the trustee in *Dewsnup* never actually abandoned the property, the court appropriately treated the property as if it had been abandoned since the property was of no value to the estate. A bankruptcy estate is created for the benefit of unsecured creditors upon the filing of a bankruptcy petition. 111 U.S.C. § 541(a) (1988). The property at issue in *Dewsnup* was of no benefit to the estate (i.e., unsecured creditors) because the amount of liens on the property exceeded its value.

105. Id. The district court affirmed without opinion. The Tenth Circuit also affirmed. *In re Dewsnup*, 908 F.2d 588 (10th Cir. 1990).

106. *Dewsnup*, 112 S. Ct. at 777. The creditor was joined by the United States as amicus curiae.

107. Id.

108. Id. This is because Section 506(d) is phrased in the negative.

109. Id.

110. Id.

111. Id. at 778.

through bankruptcy unaffected.[112] The Court, however, was careful to limit its decision to the facts before it.[113]

The Court was comforted in its decision because, unlike the debtor's interpretation, its interpretation resulted in a rule under which any appreciation in the collateral's value during bankruptcy accrues to the benefit of the secured creditor, rather than the debtor or other unsecured creditors.[114] The Court noted that this result was consistent with what the creditor would have received had it not participated in bankruptcy: *in rem* property rights in the collateral along with the attendant rights to appreciation, up to the full value of his claim, in that property.[115]

### B. *Analysis of Residential Cramdown Since* Dewsnup

The first major case interpreting *Dewsnup*'s impact on the residential cramdown debate was the Second Circuit's decision in *In re Bellamy*.[116] In *Bellamy*, the Second Circuit permitted the debtor to cramdown the mortgage on their principal residence and concluded that *Dewsnup*'s analysis of Section 506(d) was "inapposite."[117]

The court began by stating that Congress was aware of debtors' difficulties in avoiding liquidation when it enacted the claim-splitting provision, Section 506(a).[118] The *Bellamy* court thus felt that Congress intended Section 506(a) to allow debtors to keep their homes.[119] The *Bellamy* court then employed the analysis pro-bifurcation courts typically use: an allowed claim secured by a lien is a secured claim only to the extent of the value of the collateral,[120] and Section 1322(b)(2) pro-

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112. Id.

113. Id. at 778 & n.3.

114. Id. at 778.

115. Id. The dissent felt that the case turned on the definition of the phrase "allowed secured claim" in Section 506(d), and turned to Section 506(a) to define "allowed secured claim." The dissent argued that its interpretation was consistent with a "clear and unmistakable" pattern of usage: elsewhere in the Code the phrase "allowed secured claim" refers to only the secured portion of the claim as defined by Section 506(a), but when the Code refers to the entire claim it uses the words "allowed claim." *Dewsnup*, 112 S. Ct. at 777 (Scalia dissenting).

Scalia's dissent condemns the majority's "one-subsection-at-a-time" interpretative approach because it violates the normal rule of statutory construction which holds that identical words used in different parts of the same act are intended to have the same meaning. Scalia also found the majority's reliance on pre-Code law inappropriate when dealing with contradictory statutory text. Id. (Scalia dissenting).

116. 962 F.2d 176 (2d Cir. 1992).

117. Id. at 183.

118. Id. at 177-78.

119. Id.

120. Id. at 178-79.

hibits modification of only the "secured claim" as determined by Section 506(a).[121]

The lender, however, argued that the court need not consult Section 506(a) before applying Section 1322(b)(2)'s prohibition on modification because Section 506(a) deals with whether a claim is secured rather than purporting to affect a creditor's rights.[122] The *Bellamy* court, however, framed the issue in terms of whether Section 1322(b)(2)'s prohibition on modification extends to the entire claim or merely to the secured portion.[123] The court's decision that the prohibition extends only to the secured portion resulted from its finding that the Code made a fundamental change in pre-Code law: treatment under the Code turns on whether a claim is secured rather than whether the creditor is secured.[124] The court held that bifurcation of a claim into a secured claim and an unsecured claim does not modify but rather determines a creditor's rights.[125]

The court rejected the lender's argument that Section 101(5) defines "claim" as the entire claim and that the "other than" clause prohibits modification of the entire claim.[126] Although the court found that the "other than" clause refers to "secured claim," the court felt bound to construe Code provisions so as to avoid conflict whenever possible.[127] The court thus held that Section 506(a) rather than Section 101(5) defines "secured claim" within Section 1322(b)(2).[128]

An examination of Section 1322(b)(2)'s legislative history also did not lend support to the creditor's argument.[129] Although the court acknowledged that the legislative history demonstrated Congress' intent to give greater protection to home mortgage lenders than to other secured lenders, the court felt that it could not determine to what extent

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121. Id.

122. Id. at 179.

123. Id. Compare *In re Hart*, 923 F.2d at 1410, which framed the issue as whether Section 1322(b)(2)'s "other than" clause prohibits bifurcation so as to leave the unsecured portion of the claim unprotected.

124. 962 F.2d at 179.

125. The court stated that "bifurcating [the lender's] claim into unsecured and secured portions does not, for purposes of § 1322(b)(2), modify its "rights," but rather simply determines how, under the Code, its right to payment must be satisfied." Id. at 180. See also *In re Hart*, 923 F.2d at 1413 (stating that bifurcation is a recognition of the legal status of a creditor's interest in the debtor's property and not a modification of the mortgage); Laurence P. King, ed., 3 *Collier on Bankruptcy* § 506.04[1] at 506-15 (stating that Section 506(a) provides a measure of the entitlements of holders of secured claims).

126. *In re Bellamy*, 962 F.2d at 180.

127. Id. (citing *Pittsburgh & Lake Erie R.R. v. Railway Labor Executives' Ass'n*, 491 U.S. 490, 510 (1989)). See also *United Savings Ass'n of Tex. v. Timbers of Inwood Forest Assoc., Ltd.*, 484 U.S. 365, 371 (1988).

128. *In re Bellamy*, 962 F.2d at 180.

129. Id. at 181-82.

Congress intended this greater protection.[130] Since the legislative history did not expressly state that the intended protection extended to the entire claim, the court concluded that cramdown does not conflict with Section 1322(b)(2)'s legislative history.[131]

The court interpreted *Dewsnup* as preventing it from presuming that the meaning of "secured claim" in Section 1322(b)(2) was the same as in Section 506(a).[132] But *Dewsnup* did not control the definition of "secured claim" under Section 1322(b)(2).[133] The court felt it reasonable to assume that Section 506(a) defines "secured claim" unless doing so would be contrary to basic bankruptcy principles.[134]

In *In re Nobleman*,[135] the Fifth Circuit recently held that bifurcation of a lien secured only by the debtor's principle residence violates Section 1322(b)(2). In *Nobleman*, the creditor objected to the debtor's proposed plan to bifurcate a mortgage into secured and unsecured portions.[136] The creditor argued that bifurcation resulted in an impermissible modification of the creditor's rights that are protected under Section 1322(b)(2). The creditor bolstered its argument by pointing out that the general language of Section 506(a) should not prevail over the specific language of Section 1322(b)(2). Further, the creditor suggested that bifurcation frustrates Congress' intended protection of the mortgage lending industry—an industry that Congress has recognized as serving a valuable social function.[137] The creditor's *amici* argued further that bifurcation provides a windfall to the debtor and that cramdown's supposed promotion of the debtor's fresh start is illusory.[138]

The court noted two contradictory lines of cases, one favoring the debtor's position and the other the creditor's.[139] Stating that *Dewsnup* lent support to its decision, the court eventually ruled that Section 1322(b)(2) prohibits cramdown.[140] The court relied on language in *Dewsnup* that Congress would not create a broad new remedy without men-

130. Id.
131. Id.
132. Id. at 182.
133. Id. at 130.
134. Id. (citing *Dewsnup*, 112 S. Ct. at 779). The court did not find that using Section 506(a) to define "secured claim" in Section 1322(b)(2) was contrary to basic bankruptcy principles.
135. 968 F.2d 483 (5th Cir. 1992), cert. granted, 113 S. Ct. 654 (1992).
136. Id. at 485-86.
137. Id.
138. Id.
139. Id. at 486. For cases holding that bifurcation and cramdown violate Section 1322(b)(2), see *In re Chavez*, 117 Bankr. at 733; *In re Kaczmarczyk*, 107 Bankr. 200 (Bankr. D. Neb. 1989); *In re Boullion*, 123 Bankr. at 549; and *In re Schum*, 112 Bankr. at 159. For cases allowing bifurcation, see *In re Bellamy*, 962 F.2d at 176; *In re Hart*, 923 F.2d at 1410; *Wilson*, 895 F.2d at 123; *In re Houghland*, 886 F.2d at 1182.
140. 968 F.2d at 487.

tioning it in the Code's text or legislative history.[141] The court also relied on language in *Dewsnup* to hold that a creditor's lien stays with the real property, that this was what the parties bargained for, and that the lienholder should receive any benefit from appreciation in the value of the collateral.[142]

Relying on its own independent analysis, the Fifth Circuit held that the plain meaning of Section 1322(b)(2) prohibits cramdown.[143] Further, the Fifth Circuit found that the specific language of Section 1322(b)(2) prevails over the general language of Section 506(a). The two sections conflict and a specific provision must take precedence over general language when two Code provisions conflict.[144] Additionally, the court endorsed the argument that the subject of Section 1322(b)(2) are the rights of the holders of the secured claims and not the claims themselves.[145] Finally, the court concluded after examining the legislative history of Section 1322(b)(2), that Congress intended to prohibit cramdown.[146]

A court that took a rather novel approach to the cramdown debate is the Arizona bankruptcy court in *In re Dyer*.[147] The *Dyer* court held that, although Section 1322(b)(2) does not prohibit bifurcation, a debtor's inability to discharge the *in rem* liability aspect of a lien prevents cramdown.[148]

The court, bound by the Ninth Circuit's pre-*Dewsnup* decision in *Houghland*,[149] framed the issue as whether *Dewsnup* prohibits bifurcation and avoidance of a lien encumbering the debtor's principal residence.[150] The court began by examining the Supreme Court's decision in *Johnson v. Home State Bank*,[151] which held that even though a Chapter 7 discharge may remove a debtor's personal liability, *in rem* liability survives bankruptcy and may be paid under a Chapter 13 plan.[152] The *Dyer* court interpreted *Dewsnup* as a logical extension of the principle set forth in *Johnson* that *in rem*, or nonrecourse, claims survive at the end of bankruptcy.[153]

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141. Id.
142. Id.
143. Id. at 487-88.
144. Id. at 488.
145. Id.
146. Id. at 488-89. For an excellent discussion of Section 1322(b)(2)'s legislative history, see *In re Strober*, 136 Bankr. 614, 620-22 (Bankr. E.D.N.Y. 1992).
147. 142 Bankr. 364 (Bankr. D. Ariz. 1992).
148. Id. at 373-74.
149. *In re Houghland*, 886 F.2d 1182 (9th Cir. 1989).
150. *In re Dyer*, 142 Bankr. at 366.
151. 111 S. Ct. 2150 (1991).
152. *In re Dyer*, 142 Bankr. at 366-68.
153. Id. at 368.

The *Dyer* court identified three approaches that had evolved in the lower courts after *Dewsnup*.[154] "The first approach permits bifurcation of a creditor's claim into a secured and unsecured claims, but prohibits the debtor from avoiding the lien if the debtor's reorganization plan does not propose paying off the entire secured claim."[155] The second approach strictly follows Section 1322(b)(2) by prohibiting bifurcation of the creditor's claim as well as avoidance of the creditor's lien.[156] The third approach permits both bifurcation of the claim and avoidance of the unsecured portion of the lien.[157]

The *Dyer* court chose to permit the bifurcation of the creditor's claim into a secured claim and an unsecured claim, but to prohibit the avoidance of the lien unless the debtor proposes to pay off the entire secured claim in the reorganization plan.[158] At the conclusion of the payments under the plan, the debtor receives a discharge of personal liability but not of *in rem* liability: any liens encumbering the debtor's property will survive bankruptcy and will not be discharged until paid in full.[159]

This result is consistent with *Dewsnup* and *Johnson* to the extent that these cases give the benefit of appreciation to the lienholder.[160] Although the debtor may not cram down, a benefit of the *Dyer* approach to debtors is that it may treat undersecured portions of claims less favorably during the life of their plans.[161] The benefit of the *Dyer* approach to creditors is that they retain a property interest in their collateral and may foreclose under state law if the debtor defaults.[162]

## IV. Critique, Analysis, and Recommendation

The previous two sections of this note have examined the current state of the law. This section discusses what the law should be. It begins by analyzing the strengths and weaknesses of both the pro-cramdown and anti-cramdown arguments. It then attempts to reduce the controversy to the basic bankruptcy values implicated in the debate. Finally, it fashions an original solution to the issue that respects these values by

154. Id. at 369.

155. Id. See also *In re Zeigler*, No. 91-126205, 91-10145, 1992 WL 50006 (Bankr. E.D. Pa. 1992); *In re Taras*, 136 Bankr. 941 (Bankr. E.D. Pa. 1992).

156. See text accompanying notes 135-46. See also *In re Davidoff*, 136 Bankr. 567 (Bankr. M.D. Fla. 1992); *In re Ireland*, 137 Bankr. 65 (Bankr. M.D. Fla. 1992).

157. *In re Bellamy*, 962 F.2d at 176.

158. *In re Dyer*, 142 Bankr. at 369.

159. Id. at 370.

160. Id.

161. Id. at 372.

162. Id.

awarding to the creditor appreciation in the value of the collateral up to the amount of the debt still owing at the end of the plan.

### *A. Critique*

#### 1. Critique of the Pro-Cramdown Interpretation

At its most basic level, the cramdown debate is merely a question of how much of a fresh start[163] a debtor should receive. In other words, should a debtor be able to modify the rights of the lender who lent the debtor money to purchase a home? Protecting lenders' rights makes home mortgage lending more attractive and arguably promotes the American dream of home ownership. On the other hand, allowing debtors to cram down their mortgages may discourage home mortgage lending and create a barrier to others seeking to own their own homes.[164] A pro-cramdown rule would create a barrier to home ownership because lenders would bear the cost of the debtors' fresh start and would ultimately pass this cost on to those who borrow to purchase a home.[165]

One might view cramdown simply as a question of who should bear the cost of the debtor's troubled financial condition: the debtor himself or everyone who borrows money to purchase a home? Shifting the cost to all borrowers spreads the cost over a large number of people and, therefore, makes the cost any one person bears small. Except for a desire to provide a debtor with a fresh start,[166] however, no justification exists for requiring many financially responsible borrowers to pay for one debtor's financial irresponsibility.

Thus, whether the Code should allow cramdown, and thereby allow debtors to shift the cost of their financial irresponsibility to financially responsible borrowers, begs the question of why our legal system pro-

163. The term "fresh start" denotes the improved position of the debtor at the end of bankruptcy after the debtor's debts have been discharged. A debtor's return to productive society is facilitated by his retention of essential assets such as a homestead, minimum furnishings, and his tools of the trade. See generally 11 U.S.C. § 522 (1988) (listing property the debtor may retain under a Chapter 7 liquidating bankruptcy). The author of this Note uses the term "fresh start" broadly to connote both the benefit of the discharge of indebtedness and the facilitation of the debtor's return to productive society that the retention of certain essential assets provides.

164. See generally Michael S. Polk, *The Chapter 13 Cramdown: New Nightmare for the Lender*, 19 Real Estate L. J. 279 (1991).

165. Indeed, Polk argues that an interpretation of the Code that permits cramdown may even impact the availability of housing. Polk, 19 Real Estate L. J. at 297 (arguing that residential lenders might be forced to dismantle low down payment loan programs if such lenders are not completely protected by Section 1322(b)(2)).

166. See, for example, *Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934); *Wetmore v. Markoe*, 196 U.S. 68, 77 (1904) (stating that "[s]ystems of bankruptcy are designed to relieve the honest debtor from the weight of indebtedness which has become oppressive and to permit him to have a fresh start in business or commercial life, freed from the obligations and responsibilities which may have resulted from business misfortunes").

vides debtors with a fresh start.[167] If one sees value in providing debtors with a fresh start, the question then becomes how extensive should the debtor's fresh start be.[168] Either way, the pro-cramdown interpretation offers a debtor a larger fresh start than does the anti-cramdown interpretation.

Another benefit of cramdown is that it allows debtors to keep their homes. Debtors often file under Chapter 13 for the principal reason of keeping their homes.[169] This is consistent with the rehabilitative goal of Chapter 13. Chapter 13 is designed to reorganize the debtor's debts and pay the debts through the debtor's future earnings rather than by liquidating the debtor's assets as under Chapter 7.[170] It follows, then, that debtors filing under a reorganization chapter, such as Chapter 13, should be able to retain their property rather than having it liquidated.[171] In addition, a Chapter 13 cramdown may make Chapter 13 more attractive to debtors than Chapter 7, thus encouraging them to reorganize instead of liquidating. This is advantageous because it is consistent with Congress's intent to encourage debtors to reorganize rather than liquidate.

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167. The fresh start is at the heart of bankruptcy policy. See Thomas H. Jackson, *The Fresh Start Policy in Bankruptcy Law*, 98 Harv. L. Rev. 1393, 1393 (1985) (explaining that the fresh start offers some protection from unwise credit decisions and "eliminates disincentives that cause debtors to become less productive once a large portion of their wages begins flowing to their creditors").

168. To the extent that this question should be answered by the legislature, it is beyond the scope of this Note. But to the extent that the legislature has already decided the question and expressed its answer in Section 1322(b)(2)'s "other than" clause, the question is properly addressed below.

169. Nassen, 33 Ariz. L. Rev. at 979 n.1 (cited in note 14).

170. This is evidenced by the varying titles of the chapters; Chapter 13 is entitled "Adjustment of Debts of an Individual With Regular Income," while Chapter 7 is entitled "Liquidation."

The rationale behind bankruptcy reorganizations (as in Chapter 13) as opposed to straight liquidations (as in Chapter 7) is that the debtor's property has a greater value to the debtor as a going concern than the value of the property if liquidated. See *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 203 (1982). See also note 194. This attempt to maximize value was designed to benefit both creditors and the debtor. See Harvey M. Lebowitz, *Bankruptcy Deskbook* 1 (Practicing Law Inst., 2d ed. 1990) (stating that bankruptcy laws were devised to relieve honest debtors of their overwhelming debts while maximizing the amount creditors would receive on their debts). See also H.R. Rep. No. 95-595 at 220, in 3 USCCAN at 6179 (cited in note 1) (stating that Congress, by permitting reorganization, anticipated that businesses could produce a return for debtor-owners as well as continuing to provide jobs and satisfy the claims of creditors). Yet, if retention of assets by the debtor is designed to maximize the value of the assets, and value maximization is designed to protect creditors, then the debtor cannot justifiably exclude the creditor from the benefit of subsequent appreciation in the value of the collateral.

171. A prohibition against cramdown can be seen as a forced liquidation. If the debtor is unable to pay the secured claim in full under the plan, then he or she will have to sell the collateral (that is, liquidate). Cramdown increases the likelihood that the debtor will be able to pay the secured claim in full by reducing what is considered the full claim.

A final but dubious benefit of cramdown is a statutory interpretation scheme that results in harmony between Sections 1322(b)(2) and 506(a). It seems sensible to fashion an interpretation of the Code that does not render the instant provision in conflict with other provisions of the Code.[172] Some courts even claim that this is a general principle of statutory construction.[173] No court addressing the issue of cramdown of residential mortgages under Chapter 13, however, has adequately explained why one should favor interpretations that avoid statutory conflict over those that expose statutory conflict.[174]

Perhaps the rule favoring interpretations that result in statutory harmony is built on the assumption that a code is a system of interrelated provisions designed to work together[175] and, therefore, code provisions generally do not conflict. Thus, it is logical to assume that the legislature did not intend the instant code provision to conflict with another code provision because, as a general rule, the legislature does not enact code provisions that conflict. The limits of this assumption are transgressed and this rule of statutory construction rendered inapplicable when the legislature intended the instant code provision to conflict with another code provision. This might be the case when the legislature intended the instant provision as an exception to an existing rule, or when the instant provision is designed to deal specifically with a matter dealt with only generally elsewhere in the code.

Not surprisingly, Section 1322(b)(2)'s "other than" clause falls within these exceptions. Congress intended the "other than" clause as an exception to the general rule of Section 1322(b)(2) which permits modification of secured claims. Furthermore, it deals specifically with the modification of certain secured claims that are dealt with in Section 506(a). Either of these two reasons alone is sufficient to upset the assumption underlying the rule preferring interpretations that avoid statutory conflict. Thus, the value of a harmonious interpretation in the instant case is illusory.

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172. Textualism, one of several schools of statutory interpretation, rejects interpretations that render other parts of the same statute inoperative. William N. Eskridge, Jr., *The New Textualism*, 37 UCLA L. Rev. 621, 661 (1990).

173. See, for example, *In re Houghland*, 886 F.2d at 1183 (citing *Ron Pair Enterprises*, 489 U.S. at 1030).

174. But see *In re Bellamy*, 962 F.2d at 181 (citing *Pittsburgh & Lake Erie R.R. v. Railway Labor Executives' Ass'n*, 491 U.S. 490, 510 (1989)). See also *United Saving Ass'n of Tex. v. Timbers of Inwood Forest Assoc., Ltd.*, 484 U.S. 365, 371 (1988) (stating that "statutory construction is [a] holistic endeavor," and that "apparently ambiguous language may be clarified when viewed in [the] context of the statutory scheme as a whole").

175. *Black's Law Dictionary* 257 (West, 6th ed. 1990) (defining "code" as "[a] systematic collection . . . of laws").

Whether debtors should be able to cram down the mortgages on their principal residences should also be viewed from a legislative viewpoint. In Chapter 13, cramdown of undersecured claims is the rule, and prohibition of cramdown is the exception. Section 1322(a) lists what a plan must include, while Section 1322(b) lists what a plan may include. Section 1322(b)(2) specifically allows a debtor's plan to modify the rights of holders of secured claims other than claims secured only by the debtor's principal residence. It is only Section 1322(b)(2)'s "other than" clause that calls into question the legality of cramdown when the claim is secured by the debtor's principal residence.

Perhaps, therefore, the most significant shortcoming of the pro-cramdown argument is that it fails to give effect to Congress' intent behind Section 1322(b)(2)'s "other than" clause. Although the extent to which Congress intended to protect home mortgage lenders cannot be determined easily[176] from Section 1322(b)(2)'s legislative history, it is worth noting that even pro-cramdown courts concede that Congress intended some protection of the home mortgage lending industry.[177] Yet, an interpretation of Section 1322 that allows cramdown of claims secured only by the debtor's principal residence fails to protect home mortgage lenders to the extent Congress intended. This is because a pro-cramdown interpretation of Section 1322(b)(2) offers protection from modification to the holders of claims secured only by the debtor's principal residence. This interpretation protects only the secured claim and, therefore, extends only to the value of the property. This provides little protection because the holders of claims secured by any type of property, whether it is the debtor's principal residence or not, receive nearly equal protection under the Code. That is, Section 1325(a)(5)(B) protects all secured claims by requiring a debtor's plan to pay secured creditors the present value of the creditor's claim. Thus, Section 1322(b)(2)'s approval of modification allows a debtor to do little of any value[178] except bifurcate the claim into a secured and unsecured claim.

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176. But see *In re Strober*, 136 Bankr. at 614 (finding that the legislative history shows clearly congressional intent to prohibit cramdown of residential mortgages). Note that the Second Circuit's decision in *In re Bellamy*, 962 F.2d 176 (2d Cir. 1992), effectively overrules *Strober*. Regarding Section 1322(b)(2)'s legislative history, the *Bellamy* court held that the extent to which mortgage lenders were to he accorded greater protection, that is, whether Section 1322(b)(2) prohibits bifurcation of residential mortgages, may not be gleaned from the legislative history. 962 F.2d at 182.

177. *In re Hart*, 923 F.2d at 1415.

178. Modification of secured claims allowed by Section 1322(b)(2) and not prohibited by Section 1325(a)(5)(B) is limited to changes in the timing, scheduling, or manner of payment, but may not modify the amount of payment. See also *In re Bellamy*, 962 F.2d at 182 (citing Bankruptcy Laws Commissions' Report, H.R. Doc. 93-137, pt.2, 93rd Cong., 1st Sess. at 205 (1973).

The debtor then can pay the unsecured claim less than its full amount,[179] or modify the timing or method of payment.

As a result, many pro-cramdown courts have been the target of criticism that cramdown leaves Section 1322(b)(2) without a purpose.[180] They have responded by pointing to Section 1322(b)(2)'s protection of the secured portion of the claim.[181] But a pro-cramdown interpretation gives the words "other than" in Section 1322(b)(2) only the function of prohibiting a debtor from modifying the timing or manner of payment or some other right the claimholder might have. It seems implausible that Congress would entertain testimony[182] concerning the dangers cramdown poses to the home mortgage lending industry and respond with such minimal protection. Thus, the pro-cramdown interpretation violates the rule of statutory interpretation that mandates an interpretation that gives meaning to each word in a statute.[183]

To review, the primary benefits of the pro-cramdown interpretation are that it provides a debtor with a greater fresh start and facilitates the debtor's retention of his home. The prime drawback is that the pro-cramdown interpretation does little to effectuate Congress' intent.

### 2. Critique of the Anti-Cramdown Interpretation.

The most positive result stemming from an interpretation of Section 1322(b)(2) that prohibits cramdown is that it effectuates Congressional intent. Claims secured only by the debtor's principal residence are protected in full. This protection is significant and goes beyond the

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179. The treatment of secured and unsecured claims is greatly different. Section 1325(a)(5)(B) requires that a debtor's plan pay secured claims not less than the allowed amount of the claim, while Section 1325(a)(4) requires the plan to pay unsecured claims only "not less than the amount that would be paid on such claim if the estate of the debtor were liquidated under chapter 7 of this title."

180. *In re Houghland*, 886 F.2d at 128.

181. Id. In bolstering the argument that a specific provision should control a general provision, many courts note that, in the context of residential mortgage cramdown, allowing the general provisions of Section 506(a) to prevail over Section 1322(b)(2) largely vitiates Section 1322(b)(2)'s protection of home mortgage lenders. *In re Russell*, 93 Bankr. at 706; *In re Mitchell*, 125 Bankr. at 6. But compare *Wilson*, 895 F.2d at 123.

182. Edward J. Kulik, Senior Vice President of the Real Estate Division of the Massachusetts Mutual Life Insurance Co., testified that the flow of funds into new residential mortgages would be greatly reduced if the threat of bankruptcy cramdowns was not ameliorated. See Hearings Before the Subcommittee on Improvements of the Judiciary Machinery of the Senate Committee on the Judiciary, 95th Cong., 1st Sess. 709 (1977) (statement of Edward J. Kulik). An excellent discussion of Section 1322(b)(2)'s "other than" clause may be found in *In re Strober*, 136 Bankr. at 620-22. Although the decision was effectively overruled by *Bellamy*, the court's discussion of Section 1322(b)(2)'s legislative history is still insightful.

183. See, for example, *United States v. Menasche*, 348 U.S. 528, 538-39 (1955) (stating that "[i]t is our duty 'to give effect, if possible, to every clause and word of a statute' ") (quoting *Montclair v. Ramsdell*, 107 U.S. 147, 152 (1882)). Accord Norman J. Singer, 2A *Statutes and Statutory Construction* § 46.06 at 119 (Clark, Boardman, 5th ed. 1992).

protections offered any other type of claim, thereby furthering Congress's intent to protect the home mortgage industry.

A related benefit of an anti-cramdown interpretation is that any appreciation in the value of the collateral during bankruptcy accrues to the benefit of the creditor. If cramdown is permitted, the debtor would take the property for its current value. If the value of the property later increases, the debtor receives a windfall.[184] The appreciation would accrue solely to the benefit of the debtor and the debtor would have no obligation to repay the creditor. An anti-cramdown interpretation largely eliminates this undesirable incentive inherent in the cramdown approach.

When cramdown is prohibited, one of three things might happen. One, the creditor is paid in full under the plan and, therefore, is not harmed. Two, the debtor surrenders the collateral to the creditor in lieu of paying the claim under the plan. In this scenario, the creditor remains unharmed, for even though the value of the collateral may not fully satisfy the creditor's claim and the creditor may suffer economic loss as a result, the creditor is not harmed in a legal sense because it receives the full benefit of its bargain. Third, the plan covers the claim but the debtor subsequently defaults on the plan. When the creditor eventually forecloses on the security, the creditor's recovery will be capped[185] at the full amount of the creditor's claim rather than the crammed down amount of the debt. In this way, the creditor benefits from appreciation in the value of the collateral that occurs subsequent to the confirmation of the plan.

The anti-cramdown interpretation also has the ostensible advantage of being consistent with pre-Code law. Under pre-Code law, a debtor's Chapter XIII plan could not deal with a claim secured only by the debtor's principle residence because the statutory definition of "claim" expressly excluded claims secured by real property.[186] Thus, an interpretation that prohibits cramdown is consistent with the result pre-Code law would have produced.

Whether an interpretation that produces such consistency is truly desirable depends on whether Congress intended the Code to produce

184. The debtor benefits by the amount of appreciation. Had cramdown not been allowed, the debtor would have been unable to realize the benefit of any appreciation to the extent that the creditor's lien remained unpaid. Yet, the word "windfall" connotes that the debtor receives something that he should not. Those who contend that the debtor receives a windfall when he is able to cram down feel that any subsequent appreciation in the value of the collateral should accrue to the benefit of the creditor who has been harmed by the debtor's bankruptcy. Compare *Dewsnup*, 112 S. Ct. at 778.

185. The debtor receives any proceeds from a foreclosure sale that exceed the amount of the creditor's claim. Such recovery by the debtor is rare, however.

186. *In re Kaczmarczyk*, 107 Bankr. at 202-03.

the same result as pre-Code law. Some anti-cramdown courts rely on the fact that Congress failed to mention the broad new cramdown "remedy" in both the text of Section 1322(b)(2) and its legislative history as conclusive proof that Congress intended a result consistent with pre-Code law.[187] Proponents of an interpretation that allows cramdown, however, maintain that the Code made numerous and sweeping changes from pre-Code law and that silence in the legislative history is not in and of itself dispositive.[188] They point to specific changes made by the Code in the instant area of the law. It changed the practice of classifying claimants or claim holders under pre-Code law to classification of the claims themselves under the Code.[189] Also, the Code purposely changed the definition of "claim" to be all-encompassing.[190] For these reasons, how Congress intended the Code to treat residential mortgages relative to how pre-Code law treated residential mortgages is largely indeterminate and any consistency that an anti-cramdown interpretation has with pre-Code law is of dubious value. Such consistency, therefore, cannot be touted accurately as either a benefit or a drawback.

On the other hand, what may be touted accurately as a drawback of the anti-cramdown interpretation is its award to the creditor of the collateral rather than the value of the collateral. Although the anti-cramdown interpretation technically does not award the collateral to the creditor, this is the practical result when either the debtor is forced to abandon the property or the creditor is forced to foreclose upon the property. An interpretation that has both the debtor and the creditor preferring the collateral rather than the judicially determined value of the collateral is logically flawed.[191]

### 3. Critique of the *Dyer* Compromise

Recall that the *Dyer* court, bound by the Ninth Circuit's decision in *Houghland*, allowed the debtor to bifurcate a claim secured only by his principle residence, but did not allow the debtor to avoid the lien nor discharge any *in rem* liability.[192] This approach offers some of the

187. *In re Mitchell*, 125 Bankr. at 8. See also *Dewsnup*, 112 S. Ct. at 773.

188. See, for example, *In re Bellamy*, 962 F.2d at 176.

189. Id. at 179.

190. Compare the definition under pre-Code law, Bankruptcy Act of 1898 §§ 1006(2) and 1046(1), with the Code's broad definition, found at 11 U.S.C. § 101(5) (1988).

191. Logic would dictate that both the creditor and the debtor should be indifferent to either the collateral or its value. This phenomenon is discussed in detail in Part III.B.2.

192. *In re Dyer*, 142 Bankr. at 364. See also text accompanying notes 147-62. In rem liability refers to a creditor's claim against specific property as opposed to a claim against the debtor personally. A debtor typically receives at the end of bankruptcy a discharge of all debts, but this discharge is usually limited to a discharge of only personal liability. So although personal liability may be extinguished, *in rem* liability might still exist. Generally, *in rem* liability can be extin-

advantages of both the pro-cramdown and anti-cramdown interpretations. The *Dyer* interpretation gives the debtor a broader fresh start than that allowed by the anti-cramdown interpretation, although not quite as broad as the pro-cramdown interpretation. Debtors are able to cram down personal liability on their homes under the *Dyer* interpretation, but may not cram down their *in rem* liability. Thus, during the plan, creditors may not seek satisfaction of their debts from debtors except to the extent that the plan provides. As a result, debtors will likely be able to keep their homes by making payments under the plan. However, the creditor's full claim is protected because the lien on the property is never reduced. That is, should the debtor sell the property, the creditor must be paid the full amount of his claim. In this way, the creditor retains the right to appreciation in the value of the collateral. The *Dyer* rule, thus, expands debtors' fresh starts and ability to retain their homes without allowing debtors to profit unjustly from an upturn in the value of the collateral.

A weakness of the *Dyer* interpretation is that it does not effectuate Congress' intent. It allows bifurcation even though Congress intended to protect the rights of home mortgage lenders from modification. The lender's rights are harmed because its right to satisfaction from the debtor personally is crammed down, even though its right to satisfaction from its collateral is not. Further, it treats the symptoms of the problem rather than its cause. The following section attempts to explain the bankruptcy values that actually cause the cramdown problem.

### B. *Analysis*

#### 1. Bankruptcy Values That Underlie the Cramdown Debate

The question whether the Code permits cramdown of mortgages secured only by the debtor's principal residence exists because a number of important judicial values are implicated in the debate. One of these values is the debtor's fresh start. A major purpose of bankruptcy is to give debtors relief from their creditors.[193] Society has an interest in rehabilitating its citizens so that they may once again be productive members of society. Bankruptcy gives debtors a fresh start and relieves

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guished only by paying the entire debt. Thus, a bankruptcy discharge will not prevent the debtor from bringing an action *in rem* or against a specific piece of property; but the recovery of a creditor limited to an action *in rem* is limited to the value of the thing he brings the action against. See generally George M. Treister, et al., *Fundamentals of Bankruptcy Law* 295 (ALI, 1986) (stating that "[a] lien on the estate's property is not affected by a discharge of the underlying obligation that it secures, although any unsecured deficiency would be barred").

193. See Lebowitz, *Bankruptcy Deskbook* at 1 (cited in note 170) (stating that the fresh start was designed to allow debtors to return to their place as productive members of society). See generally Jackson, 98 Harv. L. Rev. 1393 (cited in note 167).

them considerably of financial burden by discharging much of their debt. The real concern here is how large the debtor's fresh start should be and who should pay for it.

A debtor's rehabilitation arguably should be facilitated by the retention of the debtor's home under a reorganization chapter such as Chapter 13 for two reasons. First, society has an interest in encouraging debtors to reorganize rather than liquidate because the debtor's property has a greater value in the debtor's hands than it does when it is sold to third persons.[194] Second, mandating Chapter 13 for consumer debtors is not likely to work because the success of a Chapter 13 reorganization is inversely related to the extent that the debtor is forced to work for the benefit of his creditors.[195]

That the debtor's assets have a greater value to the debtor than to third persons upon liquidation is one of the major underlying premises of Chapter 13 reorganization. This premise is similar to that found in a Chapter 11 reorganization, most often used by businesses, which holds that business assets have a greater value when they are retained by the debtor business as a going concern than if those assets were liquidated.[196] Cramdown is consistent with this premise in that cramdown facilitates a debtor's ability to retain his or her home, and the debtor's home is likely significantly more valuable to the debtor than to a stranger.

Others, however, would argue that even though reorganization chapters are premised upon maximizing the value of the debtor's assets by keeping those assets in the hands of a debtor who remains a going concern, this value maximization was intended to benefit creditors rather than the debtors. This is a convincing argument because it is the creditors who are harmed by the debtor's bankruptcy. Debtors should be content with the sufficiently large discharge they receive under Chapter 7. Such arguments suggest that cramdown is inconsistent with what is arguably the goal of Chapter 13 reorganization: increasing the amount that creditors receive.[197]

A second reason why a debtor's fresh start should be generously construed under Chapter 13 is that the courts and the Code exhibit reluctance to force debtors to work for the benefit of their creditors.

194. See Fortgang and Mayer, 32 UCLA L. Rev. at 1065 n.16 (cited in note 13).

195. See Margaret Howard, *A Theory of Discharge In Consumer Bankruptcy*, 48 Ohio St. L. J. 1047, 1084 n.251, 1085 & n.259 (1987).

196. Id. See also note 152. But see Robert K. Rasmussen, *The Efficiency of Chapter 11*, 9 Bankr. Dev. J. 319, 322 (1991) (arguing tbat creditors receive less under Cbapter 11 tban under Cbapter 7, despite conventional wisdom).

197. Compare Chapter 7, where stripdown is not allowed. *Dewsnup v. Timm*, 112 S. Ct. 773 (1992). Also, Section 1325(a)(4) expressly requires debtors to pay unsecured claims as much in Chapter 13 as they would in Chapter 7.

Recall that, under Chapter 13, debtors pay their debts through their future income rather than by liquidating their assets.[198] Further, debtors are often required to devote all of their disposable income to their plan for up to five years following its confirmation.[199] It can be argued that the likelihood of a successful reorganization, success being defined as the debtor becoming a productive and financially responsible member of society, is inversely proportional to the degree the debtor's plan is burdensome, for debtors have little incentive to work hard if the fruits of their labors are to be enjoyed by their creditors rather than themselves.

Another important concern underlying the cramdown debate is to whom any appreciation in the value of collateral should accrue. The right to subsequent appreciation in the value of the collateral is significant in Chapter 13 cases for two reasons. First, Chapter 13 cases usually last from three to five years,[200] and the value of the collateral may fluctuate during this time. Second, a Chapter 13 debtor's estate is often dominated by a single piece of real estate,[201] and real estate is a commodity subject to routine price fluctuations. The subject of subsequent appreciation in the value of the collateral is presented rarely as an issue but rather as a reason to prohibit cramdown.[202] The reason is that the debtor receives a windfall if he or she is able to garner all of the benefits of appreciation in the value of the collateral by cramming down the creditor's interest in the collateral.[203] Opponents of cramdown contend that the creditor has a right to any appreciation in the value of the collateral up to the full amount of the creditor's claim.[204]

This leads to what is perhaps the most significant concern underlying the cramdown debate: the proper valuation of collateral. If the collateral could be valued properly, that is, assigned a value that reflects the likelihood and magnitude of any subsequent appreciation, then the debtor and creditor would be economically indifferent to cramdown. This indifference is an equilibrium point at which neither the debtor nor the creditor have incentives to liquidate the debtor's assets. This

198. What might seem an exception to this rule is the liquidation of assets encumbered by liens. But here the debtor truly "owns" only the unencumbered portion of the asset.

199. A court may not approve a debtor's plan over the objection of an unsecured creditor unless the debtor devotes all of his disposable income received over the next three years to the plan. 11 U.S.C. § 1325(b)(1)(B) (1988). Further, a court may approve a plan of up to five years in length. Id. § 1322(c).

200. Id. § 1322(c).

201. Section 109(e) limits those who may be a debtor under Chapter 13 to an individual or an individual and his spouse whose aggregate, noncontingent, liquidated, secured debts are less than $350,000. For this reason, a single piece of real estate often dominates the debtor's estate.

202. See notes 84-96.

203. Id.

204. Id.

effectuates Chapter 13's goal of reorganization since the assets have a greater value to the debtor and to society in the debtor's hands.

2. Valuation of Collateral and Its Role in the Cramdown Debate

The root cause of the cramdown problem is misvaluation of the debtor's collateral. To illustrate this, consider the following hypothetical. A debtor purchases a home worth 4x by using 1x of the debtor's own money and by borrowing 3x from a creditor. The value of the property later falls to 2x. If the debtor files bankruptcy and crams down the mortgage, the creditor's original claim of 3x will be bifurcated into a secured claim of 2x and an unsecured claim of 1x. If the true economic value of the home were 2x, the creditor would be willing to accept 2x dollars plus a pro rata share of 1x in satisfaction of its entire claim, because this is equal to or more than what it could realize by foreclosing on the home.[205] If the judicially determined value of the property, 2x, accurately reflects the property's value, a creditor should be indifferent to foreclosing on the property or having its claim crammed down to the value of the property in bankruptcy. The fact that creditors routinely oppose cramdown is evidence that property is often valued improperly.

Proponents of cramdown might attempt to explain why creditors oppose cramdown by contending that the creditor, by opposing cramdown, retains an interest in the debtor's property and is able to benefit at the expense of the debtor from any increase in value of the property. The creditor is theoretically just as likely to benefit from subsequent appreciation in the property as it is to be harmed by subsequent depreciation in the property. Thus, the explanation is fallacious and does not explain why a creditor prefers the return of the collateral rather than the judicially determined value of the collateral.

Nor can opposition to cramdown that manifests itself as advocacy of the anti-cramdown approach be explained as opportunism on the part of the creditor. That is, a creditor might advocate an anti-cramdown rule in order to receive 100% of its 3x claim rather than the cramdown result: 100% of the current value, 2x, plus a fraction of 1x. However, mere opportunism on the part of the creditor can be defeated easily by the debtor simply by surrendering the collateral and paying a fraction of the remaining 1x. Thus, mere opportunism on the part of creditors does not satisfactorily explain why creditors oppose cramdown.

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205. If the creditor forecloses, it will receive the home worth 2x and an unsecured claim of 1x. The creditor's act of foreclosure effectively converts its 1x claim from secured to unsecured status: the claim cannot be secured if no security exists any longer.

Similarly, a creditor's preference for a return of the collateral rather than the judicially determined value of the collateral cannot be explained as an attempt to avoid the risk of depreciation in the value of the collateral, that is, a desire to cash out its position, since the risk of depreciation should be accounted for in the value of the collateral. Further, any increased risk due to the fact that the debtor is a poor credit risk is a risk that was assumed by the creditor when the credit was originally extended.[206]

The elimination of all other rational explanations leads to the conclusion that creditors do not believe that the judicially determined value of the collateral equals its true economic value. If they did, creditors would be indifferent between a return of the collateral and its judicially determined value. Additionally, the debtor would be willing to pay the current value of the property in a lump sum for some other equivalent house. The reason why neither the debtor's nor the creditor's actions are consistent with the judicially determined value of the collateral can only be that the judicially determined value understates the true value of the property by the amount that the property is expected to appreciate.

The valuation offered to bankruptcy courts is usually supplied by an appraiser. The flaw in this valuation is that the appraisal is based on the supply and demand mechanics of the real estate market. In the single family real estate market, the overwhelming majority of people demanding the commodity view real estate as a consumer good and not an investment. That is, they intend to live in the house and do not expect to sell it within three to five years. Because these consumers do not intend to sell the house, expected appreciation is largely irrelevant to these purchasers, and they do not account for it when they bid for the property. As a result, the price they are willing to pay for a home is understated by the value of any expected appreciation. In this way, the real estate market is imperfect and does not properly value its goods. It follows that an appraisal of property based on the real estate market is likewise imperfect.[207] The solution, for bankruptcy purposes, is to include the value of expected appreciation as an element of the valuation.

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206. If the creditor assumed the risk when the original credit decision was made, then the fact of the debtor's filing bankruptcy changes nothing in the eyes of the creditor. The situation is analagous to a sunk cost. The creditor, when making the lending decision, paid for the opportuntity to make a profit with the chance of sustaining a loss.

207. Section 506 requires valuation in light of purpose and the proposed disposition or use of such property. The value the real estate market places on property is similar to a liquidation value, while the true economic value includes a component that accounts for expected future appreciation and is more closely related to a "going concern" value; that is, the property is not intended to he liquidated but retained and should he valued in light of this purpose.

### C. *A New Solution to the Cramdown Debate*

#### 1. A Prototype Solution

Recall the previous example in which the debtor used 1x of its own money and borrowed 3x to purchase a home worth 4x that subsequently fell in value to 2x. Because the debt of 3x is secured by the debtor's principal residence, the debtor may not modify the rights of the creditor if cramdown is prohibited. In jurisdictions where cramdown is prohibited, the debtor has the option of returning the house to the creditor and treating the remaining 1x debt under his Chapter 13 plan as an unsecured debt, or paying the full amount of his mortgage under the Chapter 13 plan. Because the value of the property has fallen significantly, the debtor will do better by returning the collateral to the debtor. The result is that the debtor is homeless and the creditor has been forced to accept the cramdown result: the value of the collateral plus a pro rata share for the difference. The creditor finds himself locked out of the possible future appreciation that he bargained for. This is because, although the creditor winds up with the property, the property has a greater value in the hands of a debtor that is a going concern. Further, the creditor is in the business of extending credit and not owning homes and is thus ill equipped to realize the appreciation in the property. If cramdown were allowed, the result would be the same except that the debtor would retain the house by buying it himself. By doing so, the debtor would garner any future appreciation for himself while simultaneously depriving the creditor of any future appreciation.

Assume now, however, that bifurcation and cramdown were allowed but that the court places a value on the property of 2x + y, where y is some amount equal to the expected value of future appreciation. In this situation, the creditor should be indifferent between receiving either a return of the collateral (worth 2x) plus a pro rata share of 1x, or receiving payments under the plan of 2x + y plus a pro rata share of 1x - y.[208] The reason for the indifference is that the creditor is being paid y, the expected value of future appreciation. The debtor is also indifferent between alternatives. Instead of having to give up the house worth 2x plus paying a pro rata share of 1x, the debtor keeps the house worth 2x and pays a pro rata share of only (1x - y) by paying the creditor 2x + y under the plan. The advantage of using a valuation that accounts for the expected value of future appreciation is that both parties are indifferent to reorganization with retention of the collateral and foreclosure

208. A return of the collateral would still be mathematically larger than receiving payments under the plan where unsecured creditors receive less than 100% of their claim. Compare 2x + pro rata (1x) with 2x + y + pro rata (1x - y). A return of the collateral is greater by the amount y exceeds a pro rata share of y.

with return of collateral, so that both will agree to a reorganization. This is advantageous because the debtor keeps the house and the house has a greater value in the hands of the reorganized debtor.

The one flaw in this solution is the difficulty in determining the value of y, the expected value of future appreciation. To determine y, one must be able to predict both the probability and magnitude of future appreciation. This is prohibitively difficult.[209] Nevertheless, an equivalent result may be achieved.

### 2. The Revaluation Solution

A result equivalent to the prototype solution may be achieved by first bifurcating the undersecured creditor's claim of 3x into a secured claim of 2x and an undersecured claim of 1x. Bifurcation is necessary here to set a payment amount under the plan.[210] The claims are paid under the plan, and at the conclusion of the plan some three to five years later, the collateral is revalued. If the property has appreciated, this appreciation should accrue to the benefit of the creditor to the extent that its claim has not been fully satisfied under the plan.[211] That is, to receive a discharge, the debtor must pay the lesser of the full amount of the secured claim or the appreciated value of the collateral plus a fraction of any deficiency. This solution, the revaluation solution, preserves the creditor's right to subsequent appreciation in the value of the collateral by defining the secured claim as the value of the collateral at the end of the plan. This works no real hardship to the debtor because in no case will it be required to pay more than originally contracted for and its repayment will be facilitated by the appreciation of the property.[212]

209. If it were possible, the lender would have used this figure when making the original lending decision, would not have lent more than this amount, and would not have wound up undersecured.

210.. Unlike the *Dyer* approach, bifurcation under this proposed new solution does not result in a cramdown of personal liability because the amount of the secured claim will be revalued prior to discharge.

211. The converse of this should also be true. If the property has depreciated for reasons other than the debtor's bad faith or waste, then the creditor's original secured claim of 2x should be reduced by the amount of this depreciation. This would require the creditor to issue the debtor a rebate equal to the amount the secured claim was overestimated multiplied by the quantity one minus the percentage of repayment that the creditor received on his unsecured claim. The quantity one minus the percentage of repayment on unsecured claim effectively subtracts from a 100% recovery what would otherwise have been paid as an unsecured claim.

212. The debtor can borrow against this appreciation or sell the property to realize the appreciation. In fact, any lump sum repayment required at the end of the plan will be exactly equal to the lesser of the appreciation in the value of the collateral over the life of the plan less the amount paid by the debtor toward the unsecured portion of the debt, or the amount still owing on the debt.

This result is consistent with current law. Section 506 requires valuation in light of purpose. *Dewsnup* requires the secured creditor to share in the appreciation that occurs during bankruptcy up to the full amount of its claim.[213] The purpose of valuation under the revaluation solution is to fix the amount of payments to the creditor under the plan which complies with the requirements of Chapter 13 while effectuating the reorganizational goals of Chapter 13. The purpose of the revaluation at the conclusion of the plan is to prevent debtors from being able to exclude the creditor from the benefit of subsequent appreciation in the collateral. The result of the revaluation solution above complies with the requirements of Chapter 13 by paying the creditor at least as much as it would have received under Chapter 7[214] and effectuates the goal of reorganization by allowing debtors to keep their homes.

### 3. Critique of the Revaluation Solution

The revaluation solution is superior to other interpretations of Sections 1322(b)(2) and 506(a). Its two primary advantages are that it preserves the creditor's right to appreciation while fostering the goal of reorganization by leaving the debtor's assets in her own hands. The anti-cramdown interpretation often forces a debtor to return the collateral because this is less expensive to the debtor than making full payments on the debt; thus the reorganizational goal of keeping the debtor's assets in the debtor's hands is frustrated. Although the creditor gets the collateral and technically the right to its appreciation, creditors are often ill equipped to capture this appreciation. The pro-cramdown interpretation is also inferior to the revaluation solution because, although the debtor keeps the house, the creditor is deprived of subsequent appreciation.

The revaluation solution also effectuates the congressional intent behind Section 1322(b)(2)'s "other than" clause. It does this by protecting the creditor's interest. Although the creditor's rights are modified in a literal sense, the creditor receives as much or more from his claim under the revaluation solution than even under a strict anti-cramdown interpretation. This is because under the anti-cramdown interpretation, the creditor usually receives the same amount as under the pro-cramdown interpretation.[215] The difference between the revaluation so-

213. "Any increase [in the value of the collateral] over the judicially determined valuation during bankruptcy rightly accrues to the benefit of the creditor . . . ." *Dewsnup*, 112 S. Ct. at 778.

214. Sections 1325(a)(4) and 1325(a)(5) require Chapter 13 debtors to pay their creditors at least as much as they would have under Chapter 7.

215. If a debtor owes more on his home than its judicially determined value, the debtor likely can purchase an equivalent home on the market for the same amount. The debtor would do this by surrendering the home he now owns to the creditor, paying a fraction of the unsecured portion of

lution and the anti-cramdown or pro-cramdown results is that the creditor receives the appreciation in the value of the collateral under the revaluation solution. Under the pro-cramdown interpretation, the debtor is able to garner any appreciation for itself. Under the anti-cramdown interpretation, the creditor receives the collateral but is not able to capture the future appreciation.[216]

The revaluation solution is very similar to the *Dyer* approach. Neither interpretation allows a discharge of the *in rem* liability. The payments under the plan are the same under both approaches. The sole difference, practically speaking, is that the revaluation solution requires the debtor to pay the creditor a lump sum equal to the value of any appreciation[217] in the value of the collateral since the time of plan confirmation in order to receive a discharge. The *Dyer* interpretation, by allowing bifurcation, results in cramdown of the debtor's personal liability. The revaluation solution, on the other hand, bifurcates only for the purpose of determining the payments under the plan. It does not result in a discharge of personal liability until the debtor pays the creditor the value of appreciation in the collateral because the secured claim is revalued and redefined prior to discharge.[218] Under the *Dyer* approach, the debtor receives a discharge as to personal liability for the value of appreciation and can defer paying this amount to the creditor by not transferring the property.[219]

One flaw of the revaluation solution is that if the value of the property immediately prior to discharge is still less than the original claim, a bifurcation will result. This is a modification of the creditor's rights. Although a technical violation of Section 1322(b)(2), it can be justified

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the debt, and borrowing or renting an equivalent homestead. Since the debtor is typically better off by returning the collateral, the debtor will return the collateral and the creditor loses secured status. This change in status eliminates the rights the creditor enjoyed as a secured creditor. As a result, under both the cramdown and anticramdown interpretations the creditor receives either the house or its current value plus a pro rata share for the remainder.

216. The creditor is unable to capture the future appreciation because the creditor usually sells the collateral immediately to convert it to cash. Creditors do this because they are not in the business of holding on to houses but rather are in the business of extending credit.

217. If the amount of appreciation is negative, that is, the property is valued at an amount less than the value at confirmation, then the creditor should pay the debtor a rebate.

218. Note the limit of this solution: if the value of the property at the end of the plan has failed to recover fully, cramdown to the current (at the end of the plan) value of the collateral will occur. But this type of cramdown will likely occur with less frequency and in lesser amounts than cramdown under *Dyer*. Further, this is consistent with the Supreme Court's statement in *Dewsnup* that the creditor is entitled to appreciation in the value of the collateral that occurs during bankruptcy. See note 213.

219. Under *Dyer*, the only way the creditor can collect the value of the appreciation in the value of the collateral is to be paid on his lien on the transfer of the property. Thus, *Dyer* allows the debtor to defer payment indefinitely by not transferring the property.

by examining the congressional intent behind Section 1322(b)(2)'s no-modification clause.

When a creditor finds himself with an undersecured claim in bankruptcy, the collateral can either appreciate or depreciate. Further, these changes in value can be caused either by market forces in general or by unusual events, such as the construction of an interstate highway or an airport near the property. These unusual events can either increase or decrease the value of the collateral. If we assume that these unusual events are favorable as often as they are unfavorable, then creditors, on average, are neither harmed nor helped by these unusual events. What remains is appreciation or depreciation due to general market forces. The revaluation solution awards subsequent appreciation to the creditor but requires the creditor to reimburse the debtor for subsequent depreciation. The revaluation solution is favorable to mortgage lenders to the extent that the property is more likely to appreciate than it is to depreciate.

Further, property that secures undersecured liens may be more likely to appreciate than depreciate for a variety of reasons.[220] This will also deter homeowners from filing bankruptcy in an attempt to receive a windfall by cramming down their mortgages. Thus, the revaluation solution offers creditors greater protection from fluctuations in the value of collateral than does any other solution.

## IV. Conclusion

Courts disagree on the question of whether a Chapter 13 debtor may cramdown liens secured only by the debtor's principal residence. The Supreme Court's reasoning in *Dewsnup* strongly supports an anti-cramdown interpretation, and an increasing number of courts are prohibiting cramdown. Courts, however, remain split on the issue.

Both pro-cramdown and anti-cramdown interpretations of the Code have serious drawbacks. The pro-cramdown interpretation does too little to effectuate Congress' intended protection of home mortgage lenders. The anti-cramdown interpretation is largely inconsistent with the general reorganizational goal of Chapter 13 because it is more likely to force a liquidation of the debtor's home.

The root cause of the cramdown controversy is judicial misvaluation of collateral. If the value of the collateral accurately reflects the value of future appreciation, the creditor would be economically indifferent to cramdown. The creditor would allow the debtor to retain his

220. For example, the fact that the claim is undersecured suggests that the property has recently fallen in value. And property that has fallen in value may be more likely to regain its previous value.

home, thus, furthering the reorganizational goal of Chapter 13. Since the value of future appreciation is too difficult to predict, however, courts should simply revalue the collateral immediately prior to discharge and adjust the amount of the secured claim accordingly. This solution protects both the creditor's interests and the debtor's fresh start.

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