

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF ILLINOIS

IN RE:)
)
LAWRENCE HAVEL and) Bankruptcy Case No. 01-32782
CHRISTINA HAVEL,)
)
Debtors.)
)
LAWRENCE HAVEL and)
CHRISTINA HAVEL,)
)
Plaintiffs,)
)
vs.) Adversary Case No. 02-3049
)
HOUSEHOLD MORTGAGE)
SERVICES,)
)
Defendant.)

AMENDED OPINION

This matter having come before the Court on a Complaint to Determine Invalidity of Lien and the Objection to Confirmation filed by Household Mortgage Services; the Court, having heard arguments of counsel and being otherwise fully advised in the premises, makes the following findings of fact and conclusions of law pursuant to Rule 7052 of the Federal Rules of Bankruptcy Procedure.

The Plaintiffs/Debtors are the owners of certain residential real estate located at 306 East Lake Drive, Edwardsville, Illinois. The parties agree that the material facts in this matter are not in dispute. Chase Manhattan Bank holds a first mortgage against the residential real estate, and Defendant/Objector, Household Mortgage Services, holds a second mortgage on the subject real estate. The parties agree that the value of the real estate is less than the amount owed on the first mortgage to Chase Manhattan Bank, and the parties further agree that Household Mortgage Services holds a wholly unsecured claim against the real estate.

On or about August 3, 2001, the Plaintiffs/Debtors filed for relief under Chapter 13 of the Bankruptcy Code. The Plaintiffs/Debtors Chapter 13 Plan treats the debt owed to Household Mortgage

Services as an unsecured debt. On or about February 5, 2002, Household Mortgage Services filed an Objection to Confirmation of the Debtors' Chapter 13 Plan objecting to its treatment as an unsecured creditor. Household Mortgage Services, in conjunction with its claim, filed a secured proof of claim in the amount of \$26,055.27. In response to the secured proof of claim filed by Household Mortgage Services, the Plaintiffs/Debtors filed a Complaint to Determine Invalidity of Lien, asserting that Household Mortgage Services' claim was completely unsecured and should be reclassified as such. On April 17, 2002, the Court consolidated Household Mortgage Services' Objection to Confirmation and the Plaintiffs/Debtors' Complaint to Determine Invalidity of Lien, and set them for hearing on June 24, 2002. That hearing was subsequently continued to July 8, 2002.

The issue before the Court in these consolidated matters is whether the lien of Household Mortgage Services, which is wholly unsecured under §506(a) of the Bankruptcy Code, falls within the antimodification exemption of 11 U.S.C. §1322(b)(2) for claims "secured only by a security interest in . . . the debtor's principal residence."

The determination of the Objection to Confirmation and the Complaint to Determine Invalidity of Lien involves the interaction of two provisions of the Bankruptcy Code, namely 11 U.S.C. §§506(a) and 1322(b)(2). Section 506(a) of the Bankruptcy Code states:

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

Section 506(a) is made applicable to Chapter 13 bankruptcies pursuant to 11 U.S.C. §103(a).

The second provision of the Bankruptcy Code applicable in this matter is 11 U.S.C. §1322(b), which permits a Chapter 13 debtor to "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." 11 U.S.C. §1322(b)(2).

The Supreme Court considered the interaction of 11 U.S.C. §§506(a) and 1322(b)(2) in the case of *Nobleman v. American Savings Bank*, 508 U.S. 324, 113 S.Ct. 2106, 124 L.Ed. 228 (1993). In that

case, a debtor sought to split an undersecured mortgage creditor's claim into a secured and unsecured portion, pay only the secured portion in the bankruptcy, and treat the balance as an unsecured debt to be discharged. The Supreme Court accepted certiorari from the decision of the Fifth Circuit Court of Appeals.

The Fifth Circuit in *In re Nobleman*, 968 F.2d 483 (5th Cir. 1992) “concluded that §506(a) and §1322(b)(2) were in conflict . . . Second, [the fifth circuit] concluded that §1322(b)(2) trumped §506(a).” *In re Bartee*, 212 F.3d 277, 286 (5th Cir. 2000). As a result, §1322(b)(2) protected the entire mortgage, without regard to the amount of the mortgage actually secured by the value of the residence. At the time, four other circuit courts had ruled differently. They ruled that the bankruptcy court must first determine the secured status of the mortgage holder under 11 U.S.C. §506(a). If the mortgage holder is partially unsecured, then the debtor may modify the unsecured portion.

The Supreme Court rejected the Fifth Circuit's reasoning but upheld its final decision. The Supreme Court held:

[Debtors] were correct in looking to §506(a) for a judicial valuation of the collateral to determine the status of the bank's secured claim. It was permissible for petitioners to seek a valuation in proposing their Chapter 13 plan, since §506(a) states that “such value shall be determined . . . in conjunction with any hearing . . . on a plan affecting such creditor's interest.” But even if we accept petitioners valuation, the bank is still the “holder” of a “secured claim,” because petitioners' home retains \$23,500 of value as collateral. The portion of the bank's claim that exceeds \$23,500 is an “unsecured claim componen[t]” under §506(a) (citations omitted); however, that determination does not necessarily mean that the “rights” the bank enjoys as a mortgagee, which are protected by §1322(b)(2) are limited by the valuation of its secured claim. *Nobleman v. American Savings Bank*, 508 U.S. 324, 328-329.

The Court reasoned that §1322(b)(2) protected a mortgagee's entire “claim” (secured with unsecured) from cram down. The Court assumed Congress was trying to protect the mortgagee's state law rights to, among other things, retain its lien, accelerate the loan upon default, and proceed against the residence by foreclosure and recover any deficiency from the debtor. *Nobleman v. American Savings Bank*, 508 U.S. 324, 329. However, the Court did recognize that a mortgagee's rights are affected by a Chapter 13 bankruptcy. A Chapter 13 prevents a mortgagee from exercising its rights to foreclose and

permits a debtor to cure arrearage over the course of the debtor's plan. *Nobleman v. American Savings Bank*, 508 U.S. 324, 330.

There is a split of authority concerning the interpretation of *Nobleman* as it applies to residential mortgages that are completely unsecured. The majority opinion interprets *Nobleman* as first requiring a bankruptcy court to determine the secured status of a mortgagee under §506(a). Then “the antimodification exception of Section 1322(b)(2) protects a creditor's rights in a mortgage lien only where the debtor's residence retains enough value - after accounting for other encumbrances that have priority over the lien - so that the lien is at least partially secured under Section 506(a) . . . a wholly unsecured claim, as defined under Section 506(a), is not protected under the antimodification exception of Section 1322(b)(2).” *In re Pond*, 252 F.3d 122, 126 (2nd Cir. 2001).

This interpretation of the *Nobleman* case is the majority opinion in the country. It is supported by all the reviewing Courts of Appeal that have addressed the issue, including five Circuit Courts of Appeal and two Bankruptcy Appellate Panels. *In re Pond*, 252 F.3d 122 (2nd Cir. 2001) (finding that a wholly unsecured mortgage is not protected by §1322(b)); *In re McDonald*, 205 F.3d 606 (3rd Cir. 2000) *cert. denied* 531 U.S. 822, 121 S.Ct. 66, 148 L.Ed.2d 31 (2000); *In re Bartee*, 212 F.3d 277 (5th Cir. 2000); *In re Lane*, 280 F.3d 663 (6th Cir. 2002); *In re Tanner*, 217 F.3d 1357 (11th Cir. 2000); *In re Mann*, 249 B.R. 831 (1st Cir. B.A.P. 2000) (second mortgage wholly unsecured, Court ruled second mortgage not protected by §1322(b) and second mortgage may be “crammed down” as an unsecured debt); *In re Lam*, 211 B.R. 36 (9th Cir. B.A.P. 1997).

The minority position focuses exclusively on the mortgagee's state law rights. The minority position argues that, regardless of whether the lien is completely unsecured, as long as there exists a state law right to foreclose on the lien, a Chapter 13 bankruptcy cannot modify this right, and, as such, cannot treat that lien as an unsecured debt. In essence, the minority creates a legal fiction of a secured creditor when there is no collateral to support a security interest. However, the Supreme Court states that “[Debtors] were correct in looking to §506(a) for a judicial valuation of the collateral to determine the status of the bank's secured claim.” *Nobleman v. American Savings Bank*, 508 U.S. 324, 328-329. If the Court were to

adopt the minority position, then a review of mortgagee's claim under Section 506(a) would be meaningless. This is contrary to the Supreme Court's opinion in *Nobleman*.

Furthermore, it is important to note that, in reality, the rights of a completely unsecured mortgagee have little legal or practical effect. Nothing secures the right of a completely unsecured junior mortgagee to receive monthly installment payments, retain its lien, accelerate the loan, or foreclose if there is no security for the lender to foreclose on in case of default. These rights are "illusory, hypertechnical, and possibly relevant only in law review articles." *In re Mann*, 249 B.R. 832, 838 (1st Cir. B.A.P. 2000); *In re Lam*, 211 B.R. 36, 40 (9th Cir. 1997); *In re Walters*, 276 B.R. 879, 885 (Bankr. N.D. Ill. 2002). Section 1322(b)(2) should not be interpreted to give completely unsecured creditors more rights than they would receive in state court.

The Third Circuit explained that the two provisions, §§ 506 (a) and 1322(b)(2), can easily be reconciled:

We think the Supreme Court's discussion of 506(a) and 1322(b) is consistent. Perhaps the clearest explanation of how the Court's discussion of the two sections can be reconciled is to point out that while the antimodification clause uses the term "claim" rather than "secured claim" and therefore applies to both the secured and unsecured part of a mortgage, the antimodification clause still states that the claim must be "secured only by a *security interest in . . . the debtor's principal residence.*" 11 U.S.C. § 1322(b)(2) (emphasis added). If a mortgage holder's claim is wholly unsecured, then after the valuation that Justice Thomas said that debtors could seek under § 506(a), the bank is not in any respect a holder of a claim secured by the debtor's residence. The bank simply has an unsecured claim and the antimodification clause does not apply. On the other hand, if any part of the bank's claim is secured, then, under Justice Thomas's interpretation of the term "claim," the entire claim, both secured and unsecured parts, cannot be modified. We think this reading reconciles the various parts of the Court's opinion. *In re McDonald*, 205 F.3d 606, 611-612 (3rd Cir. 2000).

Neither the Seventh Circuit Court of Appeals or the Bankruptcy Court for the Southern District of Illinois has addressed this issue. However, several other courts in Illinois, both at the District and Bankruptcy Court level have examined this issue. The decisions favor the majority view as expressed by the Circuit Courts above. *Holloway v. United States*, No. 01-C-4052, 2001 WL 1249053, 5 (N.D. Ill. Oct. 16, 2001) ("Therefore, § 1322(b)(2) does not prohibit the modification of any claim secured only by a mortgage in the debtor's principal residence that is not secured by some amount of collateral in the

residence.”); *In re Waters*, 276 B.R. 879, 884 (Bankr. N.D. Ill. April 25, 2002) (The two parts of *Nobleman* are consistent because a creditor - before invoking the wide protections resulting from Congress’ use of the broader word “claim” in the exception clause - must first establish that he has a “secured claim.”); but see *In re Barnes*, 207 B.R. 588 (Bankr. N.D. Ill. 1997) (An unsecured second mortgage was not allowed to be “crammed down” under §506(a).)

This interpretation is also supported by the Colliers bankruptcy treatise.

“The *Nobleman* opinion strongly suggests . . . that if a lien is completely undersecured, there would be a different result.” 8 Collier on Bankruptcy ¶ 1322.06[1][a][i] (15th ed. rev. 2001). As Collier correctly notes, “[t]he opinion relies on the fact that, even after bifurcation, the creditor in the case was ‘still the ‘holder’ of a ‘secured claim’ because [the debtors’] home retain[ed] \$23,000 of value as collateral.” *Id.* (quoting *Nobleman*, 508 U.S. at 329, 113 S.Ct. 2106). “If the creditor had held a lien on property that had no value . . .,” Collier continues, “then under this analysis, the creditor would not have been a ‘holder of a secured claim’ entitled to protection by section 1322(b)(2). *Id.*” *In re Lane*, 280 F.3d 663, 667 (6th Cir. 2002).

In sum, the unanimous opinion of all Circuit Courts of Appeal and Bankruptcy Appellate Panels interpret the Supreme Court’s decision in *Nobleman* to require a lien holder on residential real estate to pass a threshold test of a genuine secured interest under §506(a) before the antimodification provision of §1322(b)(2) applies. This Court agrees with the analyses and conclusions of these courts.

In a Chapter 13 bankruptcy plan, a debtor may “cram down” a mortgage lien on residential real estate as an unsecured debt, if the lien is completely unsecured by the value of the collateral under 11 U.S.C. §506(a). If a mortgage lien is completely unsecured, treatment, as such, as an unsecured claim in a Chapter 13 bankruptcy plan is not barred by the antimodification provisions of 11 U.S.C. §1322(b)(2). However, if a mortgage lien is secured in part or in total by the value of the collateral, then the lien may not be treated as an unsecured debt and is protected from modification by 11 U.S.C. §1322(b)(2). This analysis and conclusion is consistent with the legislative history and promotes the public policy of the Bankruptcy Code.

Justice Stevens, in his concurring opinion in *Nobleman*, explained that the result reached by the unanimous Court comported with the legislative history of §1322(b)(2), which reflected Congress’ intent

to bestow “favorable treatment” upon residential mortgage lenders “to encourage the flow of capital into the home lending market.” *Nobleman v. American Savings Bank*, 508 U.S. 324 at 332.

Congress’ intent was to protect only first mortgagees, not second or third mortgagees. Judge Squires summarizes the majority position as follows:

Congress, however, by originally intending to encourage the flow of capital into the home-lending market enacted § 1322(b)(2), actually had only first mortgagee’s, or true mortgage lenders, in mind, because second mortgagee’s are generally involved with home improvement, debt consolidation, or consumer financing - not home purchases or construction. See *Tanner*, 217 F.3d at 1359; *Bartee*, at 212 F.3d at 292-93; *Lam*, 211 B.R. at 41. Protecting secondary mortgagees will have virtually no impact on home building and buying, as they are more akin to general unsecured creditors and secured consumer lenders. See *Bartee*, 212 F.3d at 293; *McDonald*, 205 F.3d at 613. Moreover, protecting second or third mortgagees will bestow upon them windfalls, as they are able to convert otherwise dischargeable unsecured debt into nondischargeable secured debt; this unintended benefit is particularly unearned by the many opportunistic and predatory lenders who abuse mortgage lending by over appraising property or by burdening already over secured property. See *Bartee*, 212 F.3d at 292-93; *Mann*, 249 B.R. at 839-40. The exception to § 1322(b)(2) found in § 1322(c)(2), which was added by the 1994 amendments to the Bankruptcy Code, is additional evidence that Congress did not intend to include disguised consumer lending under the umbrella of protections afforded in § 1322(b)(2)’s anti-modification clause. See *Bartee*, 212 F.3d at 294. In *Waters*, 276 B.R. 879, 887-888 (Bankr. N.D. Ill. 2002).

Furthermore, the majority interpretation is consistent with the public policy of promoting Chapter 13 bankruptcies. “Courts have repeatedly emphasized Congress’ preference that individual debtors use Chapter 13 instead of Chapter 7.” *In re McDonald*, 205 F.3d 606, 614 (3rd Cir. 2000); *In re Bartee*, 212 F.3d 277, 284 (5th Cir. 2000). The goal is to encourage debtors to pay as much unsecured debt as reasonably possible.

A rule requiring debtors to pay completely unsecured mortgages through their bankruptcy plans will cause many more debtors to convert to a Chapter 7 bankruptcy to eliminate the mortgage. This will result in unsecured creditors receiving little or no payment. The majority rule encourages debtors to stay in Chapter 13 bankruptcy and pay their unsecured creditors. *In re McDonald*, 205 F.3d 606, 614 (3rd Cir. 2000); (A debtor who has outstanding balances on multiple mortgages exceeding the current value of the debtor’s home often will not try to keep a home encumbered with so much debt, and instead will turn to a Chapter 7 bankruptcy and allow the home to be sold in liquidation.”); *In re Bartee*, 212 F.3d 277,

294 (5th Cir. 2000), (“Many courts have also expressed concern that over-extension of § 1322(b)(2)’s antimodification protections would diminish the appeal of Chapter 13 and lead to an increase in either Chapter 11 reorganizations or Chapter 7 liquidations.”)

ENTERED: August 15, 2002.

/s/ GERALD D. FINES
United States Bankruptcy Judge