Saving the Family Homestead: Home Mortgages Under Chapter 13

I. INTRODUCTION

Chapter 13[1] of the Bankruptcy Reform Act of 1978[2] has been in effect now for four years.[3] During this time two issues regarding the treatment of home mortgages under chapter 13 have generated increasing litigation.[4] First, bankruptcy courts have wrestled with the question whether the Bankruptcy Code,[5] created by the Bankruptcy Reform Act, permits cure of default on a debtor's home[6] mortgage when the debtor files a plan for adjustment of debts under chapter 13 after the mortgage debt has been accelerated pursuant to an acceleration clause in the mortgage instrument.[7] Once a mortgage has been accelerated by the mortgagee, the mortgagor is in default on the entire principal amount of the mortgage. So far, courts have divided on the correct resolution to the permissible cure problem. The second issue that has generated litigation under chapter 13 is twofold: (1) Whether the automatic stay provisions of chapter 3's section 362(d)(2)[8] apply in whole, in part, or not at all to chapter 13; and (2) if they are applicable, how the debtor may prove that the home is necessary to an effective reorganization under section 362(d)(2)(B). A petition filed under chapter 13 operates as an automatic stay of most actions against property of the debtor's estate.[9] A mortgagee who wishes to foreclose on the mortgaged property of the debtor may seek relief from the automatic stay under section 362(d)(2). Under that section the bankruptcy court must grant relief from the automatic stay if the debtor has satisfied a two-pronged test: (1) the debtor must have no equity in the property, and (2) the property must not be necessary to an effective reorganization.[10] Some courts have held that no part of section 362(d)(2) applies to chapter 13,[11] even though section 362(d)(2) is contained in chapter 3 and section 103(a)(13)

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1. 11 U.S.C. §§ 1301–1330 (Supp. III 1979).

2. Pub. L. No. 95–598, 92 Stat. 2672 (1978) (codified as 11 U.S.C., in various sections of 28 U.S.C., and in several other titles).

3. Chapter 13 of the Bankruptcy Reform Act took effect on October 1, 1979.

4. *See, e.g., In re* Taddeo, 9 Bankr. 299 (Bankr. E.D.N.Y. 1981); *In re* Coleman, 5 Bankr. 812 (Bankr. W.D. Ky. 1980).

5. The Bankruptcy Code, which is Title 11 of the United States Code, was created by the Bankruptcy Reform Act of 1978, Pub. L. No. 95–598, 92 Stat. 2672 (1978).

6. The term "home" refers to the debtor's principal residence.

7. Chapter 13 is entitled "Adjustment Of Debts Of An Individual With Regular Income." The term "preacceleration default" will be used in this Comment to refer to the amount of default that existed prior to acceleration, rather than the amount of default existing after acceleration has occurred.

8. 11 U.S.C. § 362(d)(2) (Supp. III 1979).

9. *Id.* § 362.

10. *Id.* § 362(d)(2).

11. *See, e.g., In re* Garner, 13 Bankr. 799 (Bankr. S.D.N.Y. 1981); *In re* Feimster, 3 Bankr. 11 (Bankr. N.D. Ga. 1979).

clearly makes chapter 3 applicable to chapter 13 cases.[12] A few courts have found that, because the word "reorganization" is used in chapter 11 (business reorganizations) but not in chapter 13, only the equity prong of section 362(d)(2) applies to chapter 13 cases.[13]

Even if section 362(d)(2) applies in its entirety to chapter 13 cases, the standard of proof that will govern the second prong of the test—the effective reorganization requirement—is unclear. Section 362(g) expressly places the burden of proving lack of equity (the first prong of section 362(d)(2)) on the party seeking relief[14]—in most cases, the creditor. If the mortgagee can prove lack of equity, the burden of proof on all other issues shifts to the party opposing relief.[15] Therefore, if the court finds the second prong of section 362(d)(2) applicable to a chapter 13 case, the debtor has the burden of showing that his principal residence is necessary to an effective reorganization. If the debtor cannot meet this burden of proof, a mortgagee may have the stay lifted as a matter of right provided that he has proved that the debtor has no equity in the mortgaged property. The automatic stay will not be lifted under section 362(d)(2) if the debtor does prove necessity.

The resolution of these two technical problems—the permissible cure issue and the applicability of the reorganization prong of section 362(d)(2) to chapter 13—may have a profound effect on whether one of the primary goals of the bankruptcy reform effort is attained: encouraging debtor rehabilitation under chapter 13 as an alternative to liquidation of the debtor's entire estate under chapter 7.[16] This Comment first will address the permissible cure issue because it affects every chapter 13 debtor whose mortgage was accelerated prior to the filing of the bankruptcy petition. It then will discuss the applicability of the automatic stay provisions of section 362(d)(2) to chapter 13.

II. CURE OF PREACCELERATION DEFAULT ON THE DEBTOR'S HOME MORTGAGE

A. *The Controversy*

Section 1322(b)(2) of the Bankruptcy Code[17] provides that a chapter 13 plan[18] may "modify the rights of holders of secured claims, other than a claim

12. Section 103(a) states: "Except as provided in section 1161 of this title, chapters 1, 3, and 5 of this title apply in a case under chapter 7, 11, or 13 of this title." 11 U.S.C. § 103(a) (Supp. III 1979).

13. *See, e.g., In re* Branch, 10 Bankr. 227 (Bankr. E.D.N.Y. 1981); *In re* Youngs, 7 Bankr. 69 (Bankr. D. Mass. 1980) (the court stated that § 362(d)(2)(B) is not applicable to chapter 13, but refused to decide whether § 362(d)(2) is inapplicable in whole or in part); *In re* Sulzer, 2 Bankr. 630 (Bankr. S.D.N.Y. 1980).

14. 11 U.S.C. § 362(g) (Supp. III 1979).

15. *Id.*

16. *See, e.g.*, REPORT OF THE COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, H.R. DOC. NO. 137, 93d Cong., 1st Sess. (1973), *reprinted in* COLLIER ON BANKRUPTCY app. 2 (15th ed. 1980) [hereinafter cited as COMMISSION REPORT]; H.R. REP. NO. 595, 95th Cong., 1st Sess. (1977), *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 5963.

17. 11 U.S.C. § 1322(b)(2) (Supp. III 1979).

18. Under chapter 13 the debtor is required to file a plan for repayment of his outstanding debts. 11 U.S.C. § 1321 (Supp. III 1979). The provisions of § 1322 determine what the plan must propose in addition to what the plan may propose. *Id.* § 1322.

secured only by a security interest in real property that is the debtor's principal residence, or of holders of unsecured claims."[19] Under section 1322(b)(3) a plan may "provide for the curing or waiving of any default."[20] Section 1322(b)(5) states that a chapter 13 plan may,

> [n]otwithstanding paragraph (2) of this subsection, provide for the curing of any default within a reasonable time and maintenance of payments while the case is pending on any unsecured claim or any secured claim on which the last payment is due after the date on which the final payment under the plan is due.[21]

To illustrate the interplay of these provisions, suppose that a debtor files under chapter 13 after the mortgagee of his principal residence has exercised a contractual right of acceleration. Because the entire balance of the mortgage is immediately due, the "last payment" no longer is due "after the date on which the final payment under the plan is due." Had the mortgagee not accelerated the mortgage, the debtor, pursuant to section 1322(b)(5), would have been able to cure the prepetition default under the repayment plan filed with the court. It is unclear from a plain reading of section 1322(b)(5), however, whether the debtor may cure the default after acceleration. The ambiguity of section 1322(b) has left the courts to decide whether Congress intended an acceleration to have no effect on the debtor's use of section 1322(b) procedures, in which case the debtor clearly could cure a default on a home mortgage, or whether Congress intended the debtor to be unable to cure a default on a home mortgage once acceleration had occurred. The diversity of opinions regarding the correct answer to this question[22] attests to the ambiguity of section 1322(b)(5) and its scant legislative history.

B. *Legislative History*

The legislative processes that culminated in the enactment of the Bankruptcy Reform Act of 1978[23] began in 1970 when Congress created the Commission on the Bankruptcy Laws of the United States.[24] The Commission issued a report in 1973[25] that described the reasons for the sporadic use of Chapter XIII,[26] the predecessor of chapter 13. Under section 606(1) of the old Chapter XIII a Chapter XIII plan could not include "claims secured by estates

19. *Id.* § 1322(b)(2).

20. *Id.* § 1322(b)(3).

21. *Id.* § 1322(b)(5).

22. For an example of two courts holding opposite views on the applicability of § 1322(b)(5) to chapter 13 proceedings, compare *In re* Taddeo, 9 Bankr. 299 (Bankr. E.D.N.Y. 1981) (§ 1322(b)(5) does not preclude cure of an accelerated home mortgage), with *In re* LaPaglia, 8 Bankr. 937 (Bankr. E.D.N.Y. 1981) (no cure of accelerated home mortgage debt).

23. Pub. L. No. 95-598, 92 Stat. 2672 (1978) (codified as 11 U.S.C., in various sections of 28 U.S.C., and in several other titles).

24. The Commission was established by the Act of July 24, 1970, Pub. L. No. 91-354, 84 Stat. 468. The law was a result of S.J. Res. 88, 91st Cong., 1st Sess. (1969), and H.R. Res. 970, 91st Cong., 2d Sess. (1970).

25. COMMISSION REPORT, *supra* note 16.

26. Bankruptcy Act of July 1, 1898, ch. 541, 30 Stat. 544, as amended (repealed 1979).

in real property or chattels real."[27] The Commission concluded that this provision limited the usefulness of Chapter XIII:

> The first difficulty arises out of the fact that a Chapter XIII plan cannot deal with any claim secured by real property. The result is that, although a petitioner is frequently obligated to make installment payments for the purchase of his home, the plan itself cannot deal with that indebtedness. Nonetheless, courts have frequently enjoined foreclosure of real estate mortgages and contracts during the pendency of a Chapter XIII case and have in other ways recognized the need of a Chapter XIII petitioner for protection of his right to keep his equity in his home during his performance of the terms of a Chapter XIII plan.[28]

In addressing this problem the Commission recommended that the debtor be able "to include in his plan a proposal for paying debts secured by liens on his residence and curing defaults thereon within a reasonable time."[29] The phrase "on which payment is due after the last payment under the plan,"[30] which has been interpreted by some courts to prevent debtors from curing preacceleration default,[31] did not appear in this Commission recommendation. Instead, the Commission indicated the need for a provision that would permit cure of default even though the mortgagee had begun foreclosure proceedings.[32]

The Commission's explanation accompanying its formal recommendation contains language very similar to that found in section 1322(b)(5) as enacted:

> Accordingly, the Commission recommends that the new Act authorize inclusion in any plan proposed under . . . the successor to Chapter XIII of the present Act provisions for the curing of defaults within a reasonable time and the maintenance of payments while the case is pending on claims secured by a lien on the debtor's residence and on claims secured by personal property on which the last payment is due after completion by the debtor of all payments under the plan.[33]

Thus, the Commission recommended that a Chapter XIII plan authorize cure of the debtor's home mortgage and long-term debts. The Commission recommendation did not preclude cure of preacceleration default.

The Commission Report contained a proposed statute,[34] the "Commission Bill," that was introduced in the House[35] along with a competing bill proposed by the National Conference of Bankruptcy Judges.[36] Congress failed to formally act on the measures during the 93d Congress; thus, the Commission Bill and the Judges' Bill were reintroduced in the 94th Congress

27. *Id.* § 606(1).
28. COMMISSION REPORT, *supra* note 16, at 13.
29. *Id.*
30. 11 U.S.C. § 1322(b)(5) (Supp. III 1979).
31. *See infra* notes 58–94 and accompanying text.
32. COMMISSION REPORT, *supra* note 16, at 166.
33. *Id.*
34. *See id.* Part II.
35. H.R. 10,792, 93d Cong., 1st Sess. (1973).
36. H.R. 16,643, 93d Cong., 2d Sess. (1974).

as House Resolutions 31[37] and 32[38] respectively. Section 6-201(4) of the Commission Bill provided that a wage-earner rehabilitation plan

> may include provisions for the curing of defaults within a reasonable time and the maintenance of payments while the case is pending on claims secured by a lien on the debtor's residence and on unsecured claims or claims secured by personal property on which the last payment is due after completion by the debtor of all payments under the plan.[39]

The note accompanying section 6-201 explained:

> Clause (4) is new and confers a limited authority to deal with claims secured by a lien on the debtor's residence *and* long-term claims which cannot be fully paid under the plan. This clause does not authorize reduction of the size or varying of the time of installment payments nor, except in instances where the last payment on a claim secured by a lien on the debtor's residence is due during the term of the plan, is it contemplated that the claim would be fully paid off under the plan. Any unpaid balance would not be covered by a discharge granted pursuant to 6-207. *But while the debtor is operating under the plan, he may be able to employ the authorization given under this clause to preserve his home and to keep current on a long-term debt by provisions in the plan for curing defaults and maintaining payments.*[40]

Although section 6-201(4) did not authorize reducing the size or varying the time of installment payments, it did authorize cure.[41] The section contained no suggestion that preacceleration cure was precluded.

During the hearings on H.R. 31 the House Subcommittee on Civil and Constitutional Rights heard testimony on the importance of permitting a Chapter XIII plan to deal with home mortgages.[42] Judge Cyr of Maine, testifying on behalf of the National Conference of Bankruptcy Judges, stated:

> I think we have to permit a Chapter XIII plan to deal, in part at least, with real estate secured claims, that is at least those that involve the debtor's residence. Often the debtor has fallen behind on the mortgage payments on his home. That is one of the things that we find most often occurs. Real estate mortgagees are not the quickest ones to drop the hammer on the debtor, and debtors who are forced into this kind of circumstance will take the easy way out as long as they can. But, if they can't get the kind of relief they need in Chapter XIII, they won't be in Chapter XIII. Retaining a man's home, I submit, is a very important form of relief, which he believes he must have, but can't get now under Chapter XIII.[43]

Perhaps a similar argument influenced the House when it passed H.R. 8200.[44] Section 1322 of H.R. 8200[45] permitted a Chapter XIII debtor even

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37. H.R. 31, 94th Cong., 1st Sess. (1974).
38. H.R. 32, 94th Cong., 1st Sess. (1975).
39. COMMISSION REPORT, *supra* note 16, Part II, § 6-201(4).
40. *Id.* note 5 (emphasis added).
41. *Id.*
42. *Hearings on H.R. 31 and H.R. 32 Before the Subcomm. on Civil and Constitutional Rights of the House Comm. on the Judiciary*, 94th Cong., 1st Sess. 1330–31 (1976).
43. *Id.* (testimony of Hon. Conrad K. Cyr, Bankruptcy Judge, Maine).
44. 95th Cong., 1st Sess., 124 CONG. REC. 457–78 (1978).
45. H.R. 8200, 95th Cong., 1st Sess. § 1322, 123 CONG. REC. 11,760 (1977).

more flexibility with home mortgagees than did H.R. 31. Section 1322(b)(2) permitted the modification of the rights of holders of any secured claims.[46] Section 1322(b)(3) permitted the curing or waiving of any default.[47] Section 1322(b)(5) provided for the curing of any default within a reasonable time and the maintenance of payments while the case is pending on any unsecured or secured claim on which the last payment is due after the date on which the final payment under the plan is due.[48] Thus, the home mortgagee's claim could be modified within section 1322(b)(2) and cured within section 1322(b)(3) or 1322(b)(5).

At the same time that the House was preparing its version of section 1322(b), the Senate heard testimony that permitting debtors to modify claims secured by the debtor's principal residence would cause instability in the long-term home financing industry.[49] Perhaps in fear that enactment of the House version of section 1322(b)(2) would make securing mortgages more difficult for consumers, the Senate precluded the modification of claims wholly secured by a security interest in the debtor's principal residence in its version of section 1322(b).[50] Section 1322(b)(5) retained the provision for cure of default on long-term debt, but did not expressly apply it to a home mortgage debt.[51]

Section 1322(b)(2) of the House amendment[52] represented a compromise between opposing provisions in the House bill and the Senate bill. The House agreed to preclude modification of home mortgages under 1322(b)(2).[53] At the same time section 1322(b)(5) was amended to show that a claim secured by the debtor's principal residence may be treated under section 1322(b)(5) of the House amendment.[54] Apparently, the House preferred to permit modification and cure, the Senate preferred to preclude both modification and cure, and the final provision was intended to preclude modification but permit cure.

If Congress intended to enact a compromise that reflected the House version of the cure provisions, it also intended to permit cure of preacceleration default. H.R. 8200 section 1322(b) would have permitted this cure within either section 1322(b)(3) or section 1322(b)(5).[55] The legislative history, however, offers no resolution of the permissible cure debate. The most that can be said with assurance is that the legislative history of section 1322(b) nowhere

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46. *Id.* § 1322(b)(2).

47. *Id.* § 1322(b)(3).

48. *Id.* § 1322(b)(5).

49. *See Hearings on S. 235 and S. 236 Before the Subcomm. on Improvements in Judicial Machinery of the Senate Comm. on the Judiciary, Part 1*, 94th Cong., 1st Sess. 337 (1975) (statement of Richard Hesse, Consultant, National Consumer Law Center); *id.* at 141 (statement of Walter W. Vaughan, Chairman, American Bankers Association and Consumer Bankers Association Task Force on Bankruptcy).

50. S. 2266, 95th Cong., 1st Sess. 255 (1977).

51. *Id.*

52. 95th Cong., 2d Sess. § 1322(b)(2), 124 CONG. REC. 11,106 (1978).

53. *Compare* 11 U.S.C. § 1322(b)(2) (Supp. III 1979), *with* H.R. 8200, 95th Cong., 1st Sess. § 1322(b)(2), 123 CONG. REC. 11,760 (1977).

54. *Compare* 11 U.S.C. § 1322(b)(5) (Supp. III 1979), *with* S. 2266, 95th Cong., 1st Sess. § 1322(b)(5) (1977).

55. *See* H.R. 8200, 95th Cong., 1st Sess. § 1322(b), 123 CONG. REC. 11,760 (1977).

explicitly suggests that Congress intended to permit cure only if the mortgagee had not yet accelerated the home mortgage debt.

C. *The Cases*

Hampered by the ambiguous language of section 1322(b) and its scanty legislative history, bankruptcy courts have been unable to reach a consensus concerning what effect the cure provisions of sections 1322(b)(3) and 1322(b)(5) will have on chapter 13 cases.

Courts holding that cure of preacceleration default pursuant to section 1322(b)(5) is not permitted under chapter 13 have declared debts immediately due and payable upon acceleration by the mortgagee.[56] Bankruptcy courts troubled by the policy implications of this holding have, in allowing cure, (1) attempted to find statutory grounds for their decisions; (2) based their analyses solely on policy considerations; or (3) relied on the "other security" approach.[57] The following discussion examines these four approaches that bankruptcy courts have employed to interpret section 1322(b)(5).

1. *No Cure of Preacceleration Default*

In re LaPaglia[58] illustrates the view that section 1322(b)(5) precludes cure of preacceleration default of a debtor's home mortgage. *LaPaglia* concerned a mortgage bond that had been accelerated before the debtor filed under chapter 13.[59] The mortgagee objected to the debtor's proposed plan because it failed to provide for the debtor's tender of the amount due on the mortgage.[60] The mortgagee argued that preacceleration default could not be cured under section 1322(b)(5) and that a plan could not "alter its right to collect the full mortgage debt over the life of the plan."[61] The debtor responded that section 1322(b)(5) allows the cure of the mortgage default within a reasonable time and the maintenance of current mortgage payments. The debtor expressed concern that all mortgagees would interpret a ruling in the mortgagee's favor as a license to accelerate mortgages upon insignificant defaults, thus defeating the cure provisions of section 1322(b)(5).[62]

The *LaPaglia* court focused on the language of section 1322(b)(5) limiting the availability of cure under that section to debts "on which the last payment

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56. *See, e.g., In re* Williams, 11 Bankr. 504 (Bankr. S.D. Tex. 1981); *In re* LaPaglia, 8 Bankr. 937 (Bankr. E.D.N.Y. 1981). *See infra* subpart II(C)(1). *See also In re* Pearson, 10 Bankr. 189 (Bankr. E.D.N.Y. 1981); *In re* Canady, 9 Bankr. 428 (Bankr. D. Conn. 1981).

57. *See, e.g., In re* Breuer, 4 Bankr. 499 (Bankr. S.D.N.Y. 1980) (statutory grounds), *see infra* subpart II(C)(2)(a); *In re* Sapp, 11 Bankr. 188 (Bankr. S.D. Ohio 1981) (statutory grounds); *In re* Acevedo, 9 Bankr. 852 (Bankr. E.D.N.Y. 1981) (statutory grounds); *In re* Taddeo, 9 Bankr. 299 (Bankr. E.D.N.Y. 1981) (policy considerations), *see infra* subpart II(C)(2)(b); *In re* Pittman, 7 Bankr. 760 (Bankr. S.D.N.Y. 1980) (policy considerations); United Co. Fin. Corp. v. Brantley, 6 Bankr. 178 (Bankr. N.D. Fla. 1980) ("other security" approach), *see infra* subpart II(C)(2)(c).

58. 8 Bankr. 937 (Bankr. E.D.N.Y. 1981).

59. *Id.* at 938.

60. *Id.* at 939.

61. *Id.*

62. *Id.* at 939–40.

is due after the date on which the final payment under the plan is due."[63] It looked first to state law to determine when the debtor's last payment on the mortgage was due.[64] Finding that under New York State law acceleration changes the debt from one payable in installments at some time in the future to one payable immediately in full, the court sustained the mortgagee's objection to confirmation of the plan.[65]

The court dismissed the argument that a holding in favor of the mortgagee would prompt all mortgagees to accelerate mortgage debts upon insignificant defaults and thereby defeat the cure provisions of section 1322(b)(5).[66] Judge Price stated in his opinion that "[i]t has been my experience, based upon the Chapter 13 cases pending before me, that banks and other lenders are loath to foreclose mortgages, considering the time and expense involved and their chances of recovering the full amount due them at a forced sale."[67] Judge Price found that the facts of the instant case supported his view. The mortgagee in *LaPaglia* took no action for eight months even though the debtor made no attempt to make any payments during that period. Even after the mortgagee exercised its right to accelerate the debt, it waited almost three months before initiating foreclosure proceedings.[68]

Judge Price's observation does not effectively rebut the argument that the court's holding in *LaPaglia* might encourage future mortgagees to accelerate more promptly than they would have done had the court permitted cure of preacceleration default. Furthermore, while it is possible that, regardless of whether debtors are permitted to cure preacceleration default, "real estate mortgagees [will not be] the quickest ones to drop the hammer on the debtor,"[69] the *LaPaglia* decision does effectively preclude many debtors in the Eastern District of New York from using chapter 13 once acceleration has occurred.[70] The *LaPaglia* court did not expressly address this possible consequence of its decision.

The *LaPaglia* court indicated that a debtor would be permitted to cure preacceleration default if state law permitted payment of arrearages after the acceleration of the mortgage's due date.[71] Judge Price noted that some

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63. *Id.* at 941.
64. *Id.*
65. *Id.* at 943.
66. *Id.* at 945.
67. *Id.*
68. *Id.*
69. *Hearings on H.R. 31 and H.R. 32 Before the Subcomm. on Civil and Constitutional Rights of the House Comm. on the Judiciary*, 94th Cong., 1st Sess. 1331 (1976) (testimony of Hon. Conrad K. Cyr, Bankruptcy Judge, Maine).
70. See, *e.g.*, *In re* Taddeo, 9 Bankr. 299 (Bankr. E.D.N.Y. 1981), in which the court stated:
> It is extremely doubtful that many mortagors faced with the three-year or five-year limit on plan duration . . . could conceivably muster enough income to satisfy a fully accelerated mortgage debt over the course of their plans. If such were required, many homeowners would in effect be categorically denied access to Chapter 13. This would exact a harsh result and obviously contrary [*sic*] to the rehabilitative thrust of Chapter 13.

Id. at 304.
71. 8 Bankr. 937, 945 (Bankr. E.D.N.Y. 1981).

states—California, Colorado, Idaho, Minnesota, Mississippi, Montana, Nebraska, Oregon, Pennsylvania, and Utah, for example—have statutes that specifically allow a debtor to stop a threatened sale and reinstate a debt if, prior to the sale at foreclosure, the debtor tenders only the arrearages, notwithstanding any acceleration provision in the mortgage or bond.[72] The court noted in dicta that, in these states, section 1322(b)(5) would permit the cure of a default by the payment, under a plan, of only the arrearages—irrespective of any acceleration.[73]

The holding in *LaPaglia* is consistent with the language of section 1322(b)(5).[74] The result, however, violates the congressional policy of encouraging debtor rehabilitation through chapter 13.[75]

The debtor in *LaPaglia* did not argue that cure of preacceleration default was permitted under section 1322(b)(3), which provides that a chapter 13 plan may "cure or waive any default."[76] The debtor in *In re Williams*,[77] however, sought to use sections 1322(b)(3) and 1322(b)(5) serially, "first to cure prepetition defaults and second, to maintain current payments while arrearages are being cured . . . ."[78] The court did not find this argument persuasive. In *Williams* the debtor proposed to cure prepetition default under section 1322(b)(3) and to maintain current payments during the plan under section 1322(b)(5).[79] The court found that "[a]lthough § 1322(b)(3) states that any default may be cured or waived, it appears to the court that (b)(3) was not intended to apply where (b)(5) . . . is applicable."[80] The court held that claims secured solely by a security interest in real property can be cured only under section 1322(b)(5).[81]

In a line of cases from the bankruptcy court of the Southern District of Ohio, Judge Sidman permitted cure by applying section 1322(b)(3) and section 1322(b)(5) serially, reasoning that deceleration is a primary objective of the provisions of section 1322(b)(5).[82] This reasoning, however, was rejected on appeal in *In re Soderlund*.[83] The mortgagee in *Soderlund* had exercised its right of acceleration before the debtor filed under chapter 13.[84] In the lower court the mortgagee argued that the final payment of its note was not due after the date upon which final payment under the plan was due and that, therefore, section 1322(b)(5) did not apply.[85] Judge Sidman found that the mortgagee had

72. *See* statutes cited *id.* at 945.
73. 8 Bankr. 937, 945 (Bankr. E.D.N.Y. 1981).
74. *See supra* text accompanying note 21.
75. *See supra* note 16 and accompanying text.
76. 11 U.S.C. § 1332(b)(3) (Supp. III 1979).
77. 11 Bankr. 504 (Bankr. S.D. Tex. 1981).
78. *Id.* at 505.
79. *Id.*
80. *Id.* at 506.
81. *Id.*
82. *See In re* Rogers, No. 80-04701 (Bankr. S.D. Ohio Mar. 5, 1981); *In re* Soderlund, 7 Bankr. 44 (Bankr. S.D. Ohio 1980), *rev'd*, 18 Bankr. 12 (S.D. Ohio 1981); *In re* Sapp, 11 Bankr. 188 (Bankr. S.D. Ohio 1981).
83. 18 Bankr. 12 (S.D. Ohio 1981).
84. *In re* Soderlund, 7 Bankr. 44, 44–45 (Bankr. S.D. Ohio 1980).
85. *Id.* at 45.

failed to consider the impact of section 1322(b)(3), a section that is "not qualified in any respect and does not appear to be exclusive in its applicability to a situation involving a defaulted first mortgage on residential real estate."[86] The court concluded that section 1322(b)(3) and section 1322(b)(5) may be used serially, first to cure a prepetition default and then to maintain current payments during the life of the plan while arrearages are cured within a reasonable time.[87] The court stated:

> Since both the provisions of § 1322(b)(3) and § 1322(b)(5) indicate that a plan may provide for the curing of any default, it is immaterial that a prepetition acceleration clause may have been invoked by the creditor. The debtor has the choice, under the clear authority of § 1322(b)(3) of the Code, of providing in his plan for the curing of such prepetition default and reinstating the terms of the mortgage.[88]

On appeal Judge Kinneary held that section 1322(b)(3) does not apply to the holder of a secured claim secured only by a security interest in real property that is the debtor's principal residence.[89] The court found the arguments of the creditor persuasive. The creditor had argued that (1) section 1322(b)(3) conflicts with section 1322(b)(2); (2) section 1322(b)(3) does not contain language indicating that it was meant to be an exception to section 1322(b)(2), but section 1322(b)(5) does contain such language; and (3) section 1322(b)(5) would be unnecessary if section 1322(b)(3) were interpreted as being applicable to residential first mortgages.[90]

The court held that as a matter of statutory construction the serial application approach is flawed because section 1322(b)(3) is broader than section 1322(b)(5) and would render section 1322(b)(5) redundant if it were held to apply to cure of residential home mortgage default.[91] In addition, only section 1322(b)(5) contains the language "notwithstanding section 1322(b)(2)," indicating that Congress intended section 1322(b)(5) to be the exclusive exception to section 1322(b)(2).[92] Nonetheless, the result of the serial application approach is consistent with the broad policy objective of encouraging debtor rehabilitation instead of liquidation.

If cure of preacceleration default on a home mortgage is not permitted under sections 1322(b)(3) or 1322(b)(5) and the plan may not modify the claim because of section 1322(b)(2), then the chapter 13 debtor should be required to pay the entire principal amount of the mortgage immediately. Courts holding that the debtor can plan to provide for payment of the accelerated debt over the life of the plan, despite their finding that preacceleration default cannot be cured under sections 1322(b)(2) or 1322(b)(5), have not explained the source

86. *Id.*
87. *Id.*
88. *Id.*
89. *In re* Soderlund, 18 Bankr. 12, 16 (S.D. Ohio 1981).
90. *Id.* at 15.
91. *Id.*
92. *Id.*

of the debtor's authorization to modify the home mortgage debt.[93] If the payment is immediately due and payable and may not be modified under one of the relevant provisions of section 1322, no reason exists for permitting the debtor to pay the accelerated debt over the life of the plan. It probably makes little practical difference whether the debtor is permitted to pay the mortgage balance over the life of the plan or whether he is required to immediately pay the entire balance in full. In either case most debtors in need of relief will be effectively precluded from seeking rehabilitation if the mortgage debt on their principal residence was accelerated prior to the chapter 13 filing.

Other cases holding that a chapter 13 plan may not provide for cure of preacceleration default on the debtor's home mortgage have echoed the reasoning of *LaPaglia, Williams,* and *Soderlund* by basing their findings strictly on statutory construction.[94] No court has offered any policy reasons for interpreting section 1322(b)(5) to preclude cure of preacceleration default of a debtor's home mortgage.

2. *Permitting Cure of Preacceleration Default*

Prompted by policy concerns, a few courts have avoided the literal application of section 1322(b)(5) by finding independent grounds for concluding that section 1322(b) permits cure of preacceleration default. One bankruptcy court has interpreted the clause "on which the last payment is due" to mean "on which the last pre-acceleration payment is due."[95] Some bankruptcy judges have based their decisions solely on policy considerations.[96] Finally, a few cases have held that modification of the mortgagee's claim was not prohibited by section 1322(b)(2) because the mortgage was not secured only by a security interest in the debtor's principal residence.[97]

a. *Permitting Cure Based on Statutory Interpretation*

The court in *In re Breuer*[98] permitted cure of preacceleration default by interpreting the clause in section 1322(b)(5), "on which the last payment is

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93. *See In re* Lynch, 12 Bankr. 533 (Bankr. W.D. Wis. 1981) (the court confirmed a plan proposing payment pursuant to section 1322(b)(5) of the entire amount owed under the creditors' foreclosure judgments within the plan's three-year term); *In re* Whitten, 11 Bankr. 333 (Bankr. D.D.C. 1981) (the accelerated mortgage debt could not be modified under § 1322(b)(2), but the default could be cured under § 1322(b)(5) by providing for the payment of the entire principal amount of the mortgage within a reasonable time); *In re* Canady, 9 Bankr. 428 (Bankr. D. Conn. 1981) (debtor could cure neither under § 1322(b)(2) nor under § 1322(b)(5) because the last payment on the mortgage was not due after the date on which final payment under the plan was due; the court indicated in dicta, however, that the debtor could plan to pay the entire principal amount of the mortgage under the plan); *In re* Coleman, 5 Bankr. 812 (W.D. Ky. 1980) (the court apparently would have permitted cure of a vendor's lien within a reasonable time under § 1322(b)(5) by payment of the entire amount of the lien, which had been reduced to a judgment prior to the bankruptcy filing).

94. *See, e.g., In re* Land, 14 Bankr. 132 (Bankr. N.D. Ohio 1981); *In re* Whitten, 11 Bankr. 333 (Bankr. D.D.C. 1981); *In re* Pearson, 10 Bankr. 189 (Bankr. E.D.N.Y. 1981).

95. *In re* Breuer, 4 Bankr. 499 (Bankr. S.D.N.Y. 1980).

96. *See, e.g., In re* Taddeo, 9 Bankr. 299 (Bankr. E.D.N.Y. 1981).

97. *See, e.g., In re* Garner, 13 Bankr. 799 (Bankr. S.D.N.Y. 1981); *In re* DuPree, 6 Bankr. 476 (Bankr. S.D. Ohio 1980).

98. 4 Bankr. 499, 501 (Bankr. S.D.N.Y. 1980).

due," to mean "on which the last payment *before acceleration* is due." In *Breuer* the court found that the last payment under the mortgage before foreclosure was not due until 1993, "much later than the date on which the final payment under the plan is due."[99] Judge Schwartzberg bolstered this interpretation of section 1322(b)(5) with several persuasive policy arguments. He found that "it would be contrary to the spirit of Chapter 13, to permit the debtor to lose his residence when the payment of $2,944.78 would cure the default on his first mortgage."[100] The *Breuer* court also contrasted chapter 11 of the Bankruptcy Reform Act with chapter 13:

> Unlike Chapter 11, which by definition is a "Reorganization" chapter designed to assisting [*sic*] distressed businesses, Chapter 13 is directed to consumer relief so as to enable an individual debtor with regular income to develop and perform, under court supervision and protection, a plan for the repayment of his debts over an extended period of time, rather than opting for liquidation under Chapter 7.[101]

The court concluded that "the debtor's retention of his residence is palpably envisioned under Chapter 13"[102] if the plan otherwise complies with the provisions of chapter 13.

The *Breuer* court's interpretation of section 1322(b)(5) appears to reflect what Congress intended to accomplish by enacting its compromise version of section 1322(b)(5).[103] The only difficulty with this interpretation is its lack of support in the express language of section 1322(b)(5). That section states in pertinent part that the date of "last payment under the plan"—not the date of "last payment before acceleration"[104]—determines when cure is permitted. The plain meaning rule should not govern interpretation, however, when the statute is ambiguous.[105] When a statute is ambiguous a court should attempt to discern congressional intent rather than focus on the precise language of the statute.[106] Since a plain reading of section 1322(b) does not indicate whether cure of default of a debtor's home mortgage is allowed under chapter 13 after acceleration, the plain meaning rule has little relevance to the proper interpretation of section 1322(b)(5).

b. *Permitting Cure Based on Policy Considerations*

Judge Parente's analysis in *In re Taddeo*[107] represents one court's effort to resolve the section 1322(b) ambiguity by referring to policy considerations. In *Taddeo* Judge Parente concluded, after examining both case law and the

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99. *Id.* at 501.
100. *Id.*
101. *Id.* at 501–02.
102. *Id.* at 502.
103. *See supra* notes 52–55 and accompanying text.
104. 11 U.S.C. § 1322(b)(5) (Supp. III 1979).
105. *See, e.g.*, United States v. Missouri Pac. R.R., 278 U.S. 269 (1929); Caminette v. United States, 242 U.S. 470 (1917).
106. For an excellent discussion of the role of the courts in helping chapter 13 achieve the declared goal of Congress, see Hughes, *Chapter 13's Potential for Abuse*, 58 N.C.L. REV. 831, 849–51 (1980).
107. 9 Bankr. 299 (Bankr. E.D.N.Y. 1981).

deceleration provisions of chapter 11, that "neither contractual acceleration clauses nor foreclosure judgments thereon preclude a bankruptcy court from reinstating a pre-acceleration payment schedule where federal bankruptcy law so permits."[108]

The *Taddeo* court based its conclusion that federal bankruptcy law does permit cure of preacceleration default of home mortgages under chapter 13 on four considerations. First, the court found that

> in view of the debtor rehabilitation theme so pervasively laced throughout Chapter 13 . . . it is difficult to perceive how as a matter of policy or logic one can justify turning back the clock on acceleration for business debtors in Chapter 11, but refuse to do the same for consumer debtors in Chapter 13.[109]

Second, the court observed that the mortgagee's claim is protected even if cure of preacceleration default is permitted.[110] Claims on which the last payment is due after the expiration of the debtor's plan are nondischargeable under section 1328(a)(1);[111] therefore the mortgagor must pay the mortgage debt in full.[112] In addition, the mortgagee's claim is not subject to "cram down" under section 1322(b)(2).[113]

Third, the *Taddeo* court found that if mortgagors were required to "muster enough income to satisfy a fully accelerated mortgage debt over the course of their plans,"[114] many homeowners would be effectively denied access to chapter 13. This result, the court held, is contrary to the "rehabilitative thrust of Chapter 13."[115]

Fourth, the court concluded that nothing in the legislative history of the Code or in the language of section 1322(b)(5) indicates that the drafters intended to preclude deceleration of the chapter 13 debtor's home mortgage debt.[116] All of these considerations supported the court's holding that chapter 13 debtors may attempt cure of preacceleration default and reinstate the original mortgage payment schedule at any time prior to the sale of the foreclosed property.[117]

The *Taddeo* decision is thorough and well reasoned. By allowing cure of preacceleration default, it satisfies Congress' intention (gleaned from the legislative history of section 1322(b)(5)) to encourage repayment under a rehabilitation plan rather than force liquidation of the debtor's estate.[118]

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108. *Id.* at 303.
109. *Id.*
110. *Id.* at 304.
111. *Id.*
112. *Id.*
113. *Id.* A cram down is the confirmation by a court of a classification plan over the dissent of a class of claims or ownership interests. Klee, *All You Ever Wanted to Know About Cram Down Under the New Bankruptcy Code*, 53 AM. BANKR. L.J. 133, 134 (1979). For specific requirements, see 11 U.S.C. § 1325(a)(5)(B) (Supp. III 1979).
114. 9 Bankr. 299, 304 (Bankr. E.D.N.Y. 1981).
115. *Id.*
116. *Id.* at 305.
117. *Id.* at 306.
118. *See supra* note 16 and accompanying text.

c. *Permitting Cure Based on the "Other Security" Approach*

The third approach used to support a finding that cure of preacceleration default of a debtor's home mortgage is permitted under section 1322(b) can be called the "other security"[119] approach. Section 1322(b)(2) precludes modification only of a claim "secured only by a security interest in the debtor's principal residence."[120] One court has interpreted the section 1322(b)(2) proviso to permit cure of preacceleration default when the mortgagee's claim has been reduced to a judgment.[121] To understand this interpretation, it is helpful to consider two cases that apply section 1322(b)(2) in a conventional manner: *In re DuPree*[122] and *United Companies Financial Corp. v. Brantley*.[123]

In *In re DuPree* a debt was secured by an automobile and a real estate mortgage.[124] The court noted that the legislative history accompanying section 1322(b)(2) shed no light on whether Congress intended to permit a chapter 13 plan to modify such a claim.[125] However, "with knowledge of the overall intent of Chapter 13 to afford debtor relief,"[126] the court held that the prohibition in section 1322(b)(2) was inapplicable to the mortgagee's claim because it was secured by both an automobile and a real estate mortgage.[127] The *DuPree* court did not discuss the rationale for prohibiting modification of claims secured only by a security interest in the debtor's principal residence.

In *United Companies Financial Corp. v. Brantley*[128] the court considered the policy objectives that engendered the section 1322(b)(2) proviso.[129] In *Brantley* the creditor's claim was secured by a mortgage on the debtor's principal residence. The debtor also had assigned a life insurance policy to the creditor.[130] In determining whether the mortgagee's claim could be modified pursuant to section 1322(b)(2), the court discussed the policy objectives of the section 1322(b)(2) proviso:

> Although the legislative history is silent, the plain intent of the exception (in section 1322(b)(2)) is to provide stability in the residential long-term home financing industry and market. It is to specifically protect institutional lenders engaged only in providing long-term home mortgage financing and not lenders primarily engaged in consumer or other areas of financing but who take security interests in a residence or homestead to secure non-home financing debts.[131]

The *Brantley* court found that the creditor in that case was not engaged in

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119. *See infra* text accompanying notes 140–45.
120. 11 U.S.C. § 1322(b)(2) (Supp. III 1979).
121. *See In re* Garner, 13 Bankr. 799 (Bankr. S.D.N.Y. 1981).
122. 6 Bankr. 476 (Bankr. S.D. Ohio 1980).
123. 6 Bankr. 178 (Bankr. N.D. Fla. 1980).
124. 6 Bankr. 476, 477 (Bankr. S.D. Ohio 1980).
125. *Id.*
126. *Id.*
127. *Id.*
128. 6 Bankr. 178 (Bankr. N.D. Fla. 1980).
129. *Id.* at 189.
130. *Id.* at 181.
131. *Id.* at 189.

long-term residential financing[132] and that the assignment of the life insurance policy "was taken for the stated purpose of providing additional security."[133] The court concluded that "under these circumstances, the exception to § 1322(b)(2) is manifestly inapplicable."[134] Accordingly, the *Brantley* court refused to prohibit modification of the terms of the mortgage.[135]

The *Brantley* court's interpretation of the policy underlying the section 1322(b)(2) proviso is sensible. The secured creditor's claim is well protected by section 1325.[136] It appears that Congress intended to provide extra protection to certain residential mortgagees, but not to extend this limitation on modification to every creditor who might take a security interest in the debtor's principal residence. If this interpretation of the section 1322(b)(2) proviso is correct, then a key consideration in determining whether a claim is "secured only by a security interest" in the debtor's home for purposes of section 1322(b)(2) should be whether the mortgagee is engaged only, or primarily, in the business of providing long-term home mortgage financing. If a creditor's claim is secured by a purchase money mortgage, it should receive the extra protection afforded by the section 1322(b)(2) proviso. If the claim arose, for example, from the sale of farm machinery, it should not receive any extra protection.

Some creditors have sought to take advantage of the section 1322(b)(2) proviso by canceling their security interests in the debtor's personal property.[137] A creditor contemplating such an action should be aware that at least two courts have found that creditors who cancel their security interest in the debtor's personal property do not act in good faith.[138] These courts confirmed the debtor's plans despite the creditor's objection.[139]

The "other security" approach to permitting cure of preacceleration home mortgage default has been employed in a context quite unlike that of *Brantley* and *DuPree*. For example, in *In re Garner*[140] the court interpreted section 1322(b)(2) to permit modification of a mortgagee's claim, regardless of whether the mortgagee was an institutional lender engaged in providing long-term home mortgage financing, if the mortgagee's claim was reduced to a judgment before the debtor filed in chapter 13.[141]

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132. *Id.*

133. *Id.*

134. *Id.* at 190.

135. *Id.*

136. *See* 11 U.S.C. § 1325 (Supp. III 1979). This section provides that when a plan has been confirmed the court may order that part or all of the debtor's income be paid to the trustee. For a plan to be approved it must, among other requirements, give to the holder of the secured claim an amount equal to the allowed amount of the claim. The holder of the claim must approve the plan.

137. *See In re* Green, 7 Bankr. 8 (Bankr. S.D. Ohio 1980); *In re* Baksa, 5 Bankr. 184 (Bankr. N.D. Ohio 1980).

138. *In re* Green, 7 Bankr. 8 (Bankr. S.D. Ohio 1980); *In re* Baksa, 5 Bankr. 184 (Bankr. N.D. Ohio 1980).

139. *In re* Green, 7 Bankr. 8, 8–9 (Bankr. S.D. Ohio 1980); *In re* Baksa, 5 Bankr. 184, 187 (Bankr. N.D. Ohio 1980).

140. 13 Bankr. 799 (Bankr. S.D.N.Y. 1981).

141. *Id.* at 801.

In the *Garner* case the creditor, Dale Funding Corporation, had taken a purchase money mortgage in the debtors' principal residence. When the debtors defaulted on their mortgage payments, Dale Funding commenced a foreclosure action that resulted in a judgment of foreclosure. After Dale Funding obtained the judgment of foreclosure, but before the property was sold, the debtors' filed their chapter 13 petition.[142] When the debtors proposed to cure the preacceleration default on their home mortgage, Dale Funding argued that the claim could be neither cured under section 1322(b)(5), because the debtors' rights under the mortgage were terminated pursuant to state law, nor modified under section 1322(b)(2), because the claim was secured only by a security interest in the debtors' principal residence.[143]

The *Garner* court held that Dale Funding's claim was not secured only by a security interest in the debtors' home.[144] The court stated that "[w]hen Dale Funding obtained its rights under the foreclosure judgment it could no longer assert that its rights in the real estate were 'secured only by a security interest' under an existing consensual mortgage and therefore not subject to modification under Code § 1322(b)(2)."[145]

The court's conclusion that the section 1322(b)(2) limitation on modification does not apply if the mortgagee has obtained a judgment prior to the chapter 13 filing is novel. Although the *Garner* court's interpretation of section 1322(b)(2) appears to favor the mortgagor, the court's holding in effect takes a middle road between those cases holding that a mortgage default can be cured even after judgment[146] and those cases holding that the mortgagee's claim cannot be modified because of section 1322(b)(2) and cannot be cured under section 1322(b)(5).[147] Other courts that have considered whether a home mortgage default can be cured once the mortgage has been reduced to a judgment implicitly have held that a mortgagee who otherwise has a claim secured only by a security interest in the debtor's principal residence continues to hold that claim even after the mortgagee has obtained a judgment in its favor.[148] These courts have disagreed on whether preacceleration mortgage default can be cured under section 1322(b)(5) once the mortgage debt has been

142. *Id.* at 800.

143. *Id.* at 800–01.

144. *Id.* at 801.

145. *Id.*

146. *See, e.g., In re* Acevedo, 9 Bankr. 852 (Bankr. E.D.N.Y. 1981) (debtors not precluded from preacceleration cure even though state court had entered final judgment of foreclosure and sale for mortgage balance prior to debtors' filing of chapter 13 petition); *In re* Breuer, 4 Bankr. 499 (Bankr. S.D.N.Y. 1980) (even though mortgagee has obtained a judgment of foreclosure and sale, the debtor should have an opportunity to repay his creditors).

147. *See, e.g., In re* Pearson, 10 Bankr. 189 (Bankr. E.D.N.Y. 1981) (chapter 13 plan that did not provide payment to mortgagee who obtained foreclosure judgment could not be confirmed); *In re* LaPaglia, 8 Bankr. 937 (Bankr. E.D.N.Y. 1981), *see supra* text accompanying notes 58–68.

148. *See, e.g., In re* Beckman, 9 Bankr. 193 (Bankr. N.D. Iowa 1981); *In re* Coleman, 2 Bankr. 348 (Bankr. W.D. Ky. 1980).

reduced to a judgment.[149] The logical result of holding that a debtor cannot cure a preacceleration default under either section 1322(b)(2) or section 1322(b)(5) once the mortgagee's claim has been reduced to a judgment is that a mortgagor cannot plan within chapter 13 to pay the judgment in installments. Most debtors in need of relief will be unable to pay their entire mortgage principal over the life of a three-year plan; even fewer debtors will be able to pay their home mortgage debt immediately in full.

By construing section 1322(b)(2) to permit modification once the mortgagee's claim has been reduced to a judgment, Judge Schwartzberg would allow the mortgagor to attempt at least to pay the principal amount of the mortgage in installments over the life of the plan. Although most mortgagors would not be able to do this, fewer mortgagors would be effectively precluded from seeking chapter 13 rehabilitation under the *Garner* interpretation of section 1322(b)(2) than would be precluded if they could not modify their "immediately due and payable" mortgage judgment within a chapter 13 plan. For this reason the *Garner* interpretation—permitting modification of a judgment but requiring payment of the full amount of the judgment over the life of the plan—makes more sense than an interpretation that would not permit any modification under section 1322(b)(2) and would not allow the debtor to attempt cure. In light of the congressional preference for rehabilitation rather than liquidation, however, this interpretation makes less sense than one that forbids modification of the accelerated debt or judgment under section 1322(b)(2) but allows modification under section 1322(b)(5) to the extent required to permit cure of preacceleration mortgage default and reinstatement of the mortgage.

None of the bankruptcy judges' interpretations of section 1322(b) as applied to cure of preacceleration default have been entirely satisfactory. The approach of the *LaPaglia* and *Williams* courts, in denying cure of preacceleration default, fails to satisfy important policy concerns.[150] On the other hand, courts interpreting section 1322(b) to permit cure of preacceleration home mortgage default have had trouble explaining this result in light of the statute's language.[151]

It is no reflection on the diligence or ability of the judges charged with interpreting the effect of section 1322 on defaulted home mortgages that they have been unable to reach a result that makes sense of the relevant provisions of section 1322(b). Sections 1322(b)(2), 1322(b)(3), and 1322(b)(5) are ambiguous. The legislative history of section 1322(b) does not clearly disclose congressional intent concerning the treatment of home mortgages under the

149. *Compare In re* Taddeo, 9 Bankr. 299 (Bankr. E.D.N.Y. 1981), *with In re* Pearson, 10 Bankr. 189 (Bankr. E.D.N.Y. 1981).

150. *See supra* notes 58–81 and accompanying text.

151. *See supra* notes 98–106 and accompanying text.

chapter 13 cure provisions. It does, however, indicate that the process of political compromise rendered section 1322(b)(5) ambiguous.

D. *Conclusion*

The cure provisions of chapter 13 should be interpreted to permit cure of a defaulted home mortgage and reinstatement of payments regardless of whether the mortgagee exercises a right of acceleration before the debtor seeks chapter 13 relief. Strong policy reasons exist for permitting cure of accelerated home mortgage debt when cure would have been permitted if the mortgage had not been accelerated before filing. Permitting cure encourages repayment of unsecured creditors by giving the debtor an important incentive to file under chapter 13: the opportunity to try to save his home. The cost to the mortgagee is no different from the cost Congress clearly has required the mortgagee to pay under section 1322(b)(5) by allowing a chapter 13 plan to modify the mortgagee's claim to the extent required to permit cure. Finally, nothing in the legislative history suggests that Congress intended to distinguish between accelerated and nonaccelerated debt for the purposes of permitting cure of home mortgage default. For these reasons bankruptcy courts should permit cure of preacceleration home mortgage default unless they are prepared to give persuasive policy reasons for not doing so.

Because of the lack of consensus among bankruptcy courts, Congress should amend the relevant provisions of section 1322(b) to clarify the permissible cure issue. Inconsistent application of the Bankruptcy Code threatens to undermine confidence in judicial and legislative processes. For example, in the Eastern District of New York one individual whose home mortgage is accelerated prior to his filing in chapter 13 may receive a favorable decision while his neighbor in identical financial straits receives an unfavorable judgment simply because a different judge hears his case. Unless Congress amends the cure provisions of chapter 13, bankruptcy courts will be forced to continue their struggle, hampered by the ambiguous language of the statute, to reach correct results.

III. SECTION 362(d)(2) AND CHAPTER 13

For some chapter 13 debtors a liberal interpretation of the cure provisions of section 1322(b)(2) will not be helpful. The debtor who lacks equity in his home may find that chapter 13 will not help to save his family homestead because he is unable to prevent the court from lifting the automatic stay imposed by section 362.[152] The court's interpretation of section 362(d)(2) is crucial to the debtor without equity in his home.

A. *The Controversy*

Pursuant to the provisions of section 362, a petition filed under chapter 13

152. 11 U.S.C. § 362(d)(2)(A) (Supp. III 1979).

operates as an automatic stay of most proceedings against the debtor's estate.[153] A party in interest[154] may obtain relief from the automatic stay either

> (1) for cause, including the lack of adequate protection of an interest in property of such party in interest; or
> (2) with respect to a stay of an act against property, if—
> (A) the debtor does not have an equity in such property; and
> (B) such property is not necessary to an effective reorganization.[155]

Section 362(g)[156] allocates the burden of proof in a hearing under section 362(d). The party requesting relief from the stay "has the burden of proof on the issue of the debtor's equity in property."[157] The party opposing relief has the burden of proof on all other issues.[158]

The term "reorganization" does not appear in chapter 13. For this reason some courts have concluded that use of that term in the effective reorganization prong of section 362(d)(2) makes section 362(d)(2) inapplicable in whole or in part to chapter 13,[159] despite section 103 of the Bankruptcy Code, which clearly makes chapter 3 applicable to chapter 13 cases.[160]

B. *Legislative History*

The legislative history of section 362(d)(2)(B) does not reveal whether Congress intended section 362(d)(2)(B) to apply to chapter 13 cases. If passed, the Bankruptcy Amendments Act pending in the House[161] will amend section 362(d)(2)(B) by inserting immediately after the word "reorganization" the phrase "in a case under Chapter 11 of this title or to an effective plan in a case under Chapter 13 of this title, as the case may be."[162]

C. *The Cases*

1. *Section 362(d)(2) Does Not Apply to Chapter 13*

In re Feimster,[163] decided shortly after the Bankruptcy Code took effect, was one of the first cases to hold that section 362(d)(2) does not apply in its entirety to chapter 13. In *Feimster* the creditor argued that the automatic stay should be lifted from collateral of the creditor because (1) the debtor had no equity in the collateral (a mobile home) and (2) the mobile home was not

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153. *Id.* § 362.

154. A party in interest is not defined in the Code. It seems, however, that "party in interest" would include the debtor, any creditor of the debtor, and the trustee.

155. 11 U.S.C. § 362(d) (Supp. III 1979).

156. *Id.* § 362(g).

157. *Id.* § 362(g)(1).

158. *Id.* § 362(g)(2).

159. *See infra* notes 163–80 and accompanying text.

160. See 11 U.S.C. § 103(a) (Supp. III 1979), which states that "chapters 1, 3, and 5 of this title apply in a case under chapter 13 of this title."

161. S. 863, 97th Cong., 1st Sess., 127 CONG. REC. 4682 (1981).

162. *Id.* § 25(d).

163. 3 Bankr. 11 (Bankr. N.D. Ga. 1979).

"necessary to an effective reorganization."[164] The debtor agreed that he had no equity in the property. He also admitted that the mobile home was not necessary to his rehabilitation.[165] The court held, however, that section 362(d)(2) was not applicable to chapter 13 cases: "The absence of the use of the term "reorganization" anywhere except in Chapter 11 leads this court to the conclusion that its use in § 362(d)(2)(B) makes § 362(d)(2) applicable only to Chapter 11 Reorganization cases; and not applicable to Chapter 13 cases."[166]

The court argued that if Congress had intended to make section 362(d)(2)(B) applicable to chapter 13, Congress would have used either the term "rehabilitation"[167] or "Chapter 13" in section 362(d)(2)(B).[168] The court held that the creditor could have the automatic stay lifted under section 362(d)(1) only "'for cause, including the lack of adequate protection of an interest in property' of this secured creditor."[169]

Perhaps the *Feimster* court was reluctant to find section 362(d)(2) applicable to chapter 13 cases for reasons made explicit in *In re Garner.*[170] In *Garner* the court recognized that section 103(a) applies chapters 1, 3, and 5[171] to cases under chapters 7, 11, and 13.[172] The court stated, however, that "it does not follow that every *section* and *subsection* in Chapter 3 must apply with equal vigor in Chapter 13, notwithstanding that such application produces an unintended or illogical result."[173] The *Garner* court apparently was apprehensive that a chapter 13 debtor would be unable to satisfy its burden of proof under the effective reorganization prong of section 362(d)(2).[174] If the debtor could not meet his burden of proving necessity, the court would be compelled to lift the automatic stay whenever the mortgagee could prove that the debtor had no equity in his home. Indeed, this would be the result if one assumes, as did the *Garner* court, that "[c]learly, these non-income produc-

164. *Id.* at 13.

165. *Id.* at 13–14.

166. *Id.* Chapter 11, 11 U.S.C. § 1101–1174 (Supp. III 1979), is entitled "Reorganization"; its provisions are available to any person who may be a debtor under chapter 7 (liquidation), except a stockbroker or a commodity broker, and a railroad. 11 U.S.C. § 109(d) (Supp. III 1979). The standards for determining what entities may file for relief under chapter 7 are found in § 109(b). Section 109(e) contains standards for debtor eligibility under chapter 13. An important purpose of chapter 13 is to provide individuals and small sole proprietors in need of relief with an alternative to the cumbersome chapter 11 procedures. *See* H.R. REP. NO. 595, 95th Cong., 1st Sess. 320 (1977), *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 5963. To ensure that the persons for whom chapter 13 relief is intended are the ones who employ its provisions, Congress has stated that only an individual with regular income who falls within the limitations on debts set forth in § 109(e) may be a debtor under chapter 13. *See* 11 U.S.C. § 109(e) (Supp. III 1979).

167. The term "rehabilitation" does not appear in chapter 13. The term frequently is used, however, to distinguish between a chapter 11 reorganization and a chapter 13 proceeding. The latter is referred to as debtor "rehabilitation."

168. 3 Bankr. 11, 14 (Bankr. N.D. Ga. 1979).

169. *Id.* at 15 (quoting 11 U.S.C. § 362(d)(1) (Supp. III 1979)).

170. 13 Bankr. 799 (Bankr. S.D.N.Y. 1981).

171. Chapter 1 contains general provisions and is codified as 11 U.S.C. §§ 101–109 (Supp. III 1979). Chapter 3, 11 U.S.C. §§ 301–366 (Supp. III 1979), governs case administration. Chapter 5 is entitled "Creditors, the Debtor, and the Estate" and is contained in 11 U.S.C. §§ 501–554 (Supp. III 1979).

172. "There is no question that Code § 103(a) expressly makes Chapter 3 applicable in a Chapter 13 case." 13 Bankr. 799, 802 (Bankr. S.D.N.Y. 1981).

173. *Id.* (emphasis in original).

174. *Id.* at 803.

ing and non-business related assets are not necessary to 'an effective reorganization.'"[175]

It is not at all clear, however, that a nonincome producing asset such as the debtor's principal residence is unnecessary to an effective chapter 13 plan. It is true that one's principal residence may not be necessary to a debtor proceeding under chapter 13 in the same way that a piece of machinery is necessary to an effective chapter 11 reorganization. This argument, however, encourages interpreting the terms "necessary" and "effective" differently in chapter 11 and chapter 13 proceedings, rather than finding that section 362(d)(2) does not apply to chapter 13 cases. Section 103 clearly commands that all provisions of chapter 3 apply to cases under chapter 13.[176]

The *Garner* court noted that the debtor might have applied for relief under chapter 13 rather than under chapter 7 "only to save the house or the automobile."[177] It is clear from the legislative history of chapter 13 that Congress wished to encourage repayment of creditors under chapter 13 rather than liquidation under chapter 7.[178] One of the major incentives for a debtor to attempt repayment under chapter 13 is the provision that enables the debtor to retain a mortgaged home and other property.[179] If the automatic stay must be lifted when the mortgagee proves that the debtor has no equity, the debtor who has no equity in his home might see little advantage to filing under chapter 13.[180]

If the *Garner* court is correct in assuming that debtors cannot meet their burden of proving their homes' necessity to an effective reorganization, the policy of encouraging debtor rehabilitation as an alternative to liquidation would be enhanced by holding that section 362(d)(2) is not applicable to chapter 13. If section 362(d)(2) is applicable in its entirety to chapter 13 but the debtor cannot carry his burden of proving necessity, or if only the equity prong is applicable to chapter 13, the debtor would lose his home once the mortgagee proves that the debtor has no equity in his principal residence.

2. *Only the Equity Prong Applies to Chapter 13*

At least two cases have indicated that the court must lift an automatic stay on real property of the debtor if the creditor establishes lack of equity,

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175. *Id.*

176. 11 U.S.C. § 103(a) (Supp. III 1979).

177. 13 Bankr. 799, 803 (Bankr. S.D.N.Y. 1981).

178. *See supra* note 16 and accompanying text.

179. The benefit to the debtor of developing a plan of repayment under chapter 13 rather than opting for liquidation under chapter 7 is that it permits the debtor to protect his assets. *See* 11 U.S.C. §§ 1301–1330 (Supp. III 1979). In a liquidation case the debtor must surrender his nonexempt assets for liquidation and sale by the trustee. *See* 11 U.S.C. §§ 701–766 (Supp. III 1979).

180. "[I]f they [debtors] can't get the kind of relief they need in Chapter XIII, they won't be in Chapter XIII. Retaining a man's home, I submit, is a very important form of relief, which he believes he must have, but can't get now under Chapter XIII." *Hearings on H.R. 31 and H.R. 32 Before the Subcomm. on Civil and Constitutional Rights of the House Comm. on the Judiciary*, 94th Cong., 1st Sess. 1330–31 (1976) (testimony of Hon. Conrad K. Cyr, Bankruptcy Judge, Maine).

regardless of whether the property is necessary to an effective reorganization.[181] Neither of these cases, however, considered the degree to which such a holding frustrates the policy objectives of chapter 13.

In re Sulzer[182] was the first reported case to suggest that the equity requirement applies to chapter 13 cases but that the effective reorganization provision does not.[183] *Sulzer* was a chapter 11 case in which the mortgagee commenced an adversary proceeding for relief from an automatic stay.[184] The debtor, a psychoanalyst who occasionally used his home for an office,[185] sought to prove that his principal residence was necessary to an effective chapter 11 reorganization.[186] The court found that the debtor did not prove that his home was necessary to an effective reorganization:[187] "An effective reorganization is not dependent on the debtor remaining in possession of his home; his practice may be maintained from any convenient office, including his present office in New York City."[188]

Perhaps anticipating that the frustrated debtor might seek to save his home by filing a petition under chapter 13, the *Sulzer* court noted in dictum:

> [H]ad the debtor filed a petition under Chapter 13 of the Code, the alternative test to be applied under Code § 362(d)(2) would only involve the debtor's equity in the property. . . . In such a case, only the lack of equity test under Code § 362(d)(2) will be the alternative to the test applicable under Code § 362(d)(1) for relief from the automatic stay for cause shown, including the lack of adequate protection.[189]

The court reached this result by recognizing that chapter 13 permits an "Adjustment of Debts of an Individual with Regular Income," not a "reorganization."[190] The court hinted that even if the chapter 13 plan constituted a business reorganization, as might occur if the debtor was a sole proprietor,[191] the debtor could not stop the court from lifting the automatic stay by demonstrating that his home was necessary to an effective reorganization.[192] While apparently ignoring the provision of section 1322(b)(5), the court observed that section 1322(b)(2) prevents a debtor from modifying the rights of mortgagees of his principal residence.[193]

Only one reported case, *In re Branch*,[194] has held that the equity prong

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181. *In re* Branch, 10 Bankr. 227 (Bankr. E.D.N.Y. 1981); *In re* Sulzer, 2 Bankr. 630 (Bankr. S.D.N.Y. 1980).

182. 2 Bankr. 630 (Bankr. S.D.N.Y. 1980).

183. *Id.* at 636.

184. *Id.* at 631.

185. *Id.* at 634.

186. *Id.*

187. *Id.*

188. *Id.* at 635.

189. *Id.* at 636.

190. *Id.*

191. A sole proprietor can petition for relief under chapter 13 if his debts do not exceed the limits set forth in § 109(e). *See* 11 U.S.C. § 109(e) (Supp. III 1979).

192. 2 Bankr. 630, 636 (Bankr. S.D.N.Y. 1980).

193. *Id.*

194. 10 Bankr. 227 (Bankr. E.D.N.Y. 1981).

applies to chapter 13 but the effective reorganization prong does not.[195] The *Branch* court merely asserted that "[s]ince this is a Chapter 13 case, subsection '(B)' of the test is inapplicable."[196]

The only argument raised in favor of construing section 362(d)(2) to require a court to lift the automatic stay if the creditor proves that the debtor lacks equity, regardless of whether the property is necessary to an effective reorganization, is that the effective reorganization prong uses the term "reorganization." Although the *Branch* and *Sulzer* courts accepted this argument, it ignores the policy and intent of section 362(d)(2).

3. *Section 362(d)(2) Applies in Full to Chapter 13*

Most courts that have addressed the applicability of section 362(d)(2) to chapter 13 have held that section 362(d)(2) is applicable in its entirety.[197] The court in *In re Rodebaugh*[198] resolved this issue in a footnote, explaining that it was

> unable to accept the view adopted by a few bankruptcy courts, that Bankruptcy Code § 362(d)(2)(B) is inapplicable in chapter 13 cases . . . which ignore the clear command of Bankruptcy Code § 103(a) that chapter 13 [*sic*] is to be applied in its entirety in chapter 13 cases. . . . Of course, in some circumstances real estate may be as essential to an effective "reorganization" of the financial affairs of a chapter 13 debtor, whether or not *engaged in business*, as in any chapter 11 reorganization.[199]

This result is consistent with the express provisions of the Bankruptcy Code that apply chapter 3 to cases brought under chapter 13.[200] This result also is consistent with the policy of promoting the use of chapter 13 rather than chapter 7, provided the clause "necessary to an effective reorganization" is interpreted so that the debtor can meet his burden of proof on the necessity issue. The Bankruptcy Amendments Act[201] would amend the effective reorganization prong of section 362(d)(2) to make clear the application of

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195. *Id.* at 229.

196. *Id.* In support of this proposition the court cited *In re* Sulzer, 2 Bankr. 630 (Bankr. S.D.N.Y. 1980) (the *Sulzer* court noted in dictum that only § 362(d)(2)(A) would apply to a chapter 13 case), and *In re* Youngs, 7 Bankr. 69 (Bankr. D. Mass. 1980) (the *Youngs* court refused to decide whether § 362(d)(2) is wholly or only partially inapplicable to chapter 13). Neither *Sulzer* nor *Youngs* squarely held that § 362(d)(2)(A) applies to chapter 13 but § 362(d)(2)(B) does not. *In re* Branch is the only case to date that has reached this holding.

197. *See, e.g., In re* Miller, 13 Bankr. 110 (Bankr. S.D. Ind. 1981) (creditor sustained burden of proof on issue of debtors' equity and debtors failed to prove property was necessary to effect reorganization); *In re* Rodebaugh, 12 Bankr. 81 (Bankr. D. Me. 1981) (when real estate was unnecessary to adjustment of debts and debtors had no equity, mortgage was entitled to relief from stay); *see also In re* Buschardt, 9 Bankr. 400 (Bankr. S.D. Tex. 1981); *In re* Ruank, 7 Bankr. 46 (Bankr. D. Conn. 1980); *In re* Zellmer, 6 Bankr. 497 (Bankr. N.D. Ill. 1980).

198. 12 Bankr. 81 (Bankr. D. Me. 1981).

199. *Id.* at 82 n.1 (emphasis in original).

200. *See supra* note 160 and accompanying text.

201. S. 863, 97th Cong., 1st Sess., 127 CONG. REC. 7893, 7895–96 (1981). *See supra* text accompanying notes 161–62.

the necessity provision to chapter 13.[202] The Bill does not provide any guidance, however, on how a chapter 13 debtor may demonstrate "necessity."

If a court finds that section 362(d)(2)(B) is applicable to chapter 13, it then must determine how the debtor may satisfy his burden of proving that the property is "necessary to an effective reorganization." The policy considerations discussed above indicate that the debtor should not be required to shoulder an impossible burden. It appears that a debtor's home, at least, should be deemed "necessary to an effective Chapter 13 proceeding." But as the court in *In re Garner* observed,

> Although a debtor would be physically and emotionally inconvenienced by the loss of a home or an automobile, an individual with regular income could, nevertheless, offer to apply that income towards the debts owed and achieve a confirmation if the payments to be made under the plan satisfy the Code § 1325(a)(4) standard as "not less than the amount that would be paid" on liquidation.[203]

The *Garner* court did not consider that the concept of an effective chapter 13 proceeding may differ from the concept of an effective chapter 11 plan. A chapter 11 reorganization is effective if it allows the business debtor to maintain its corporate existence. An individual debtor will maintain his existence whether he files under chapter 7 or chapter 13. Therefore, if chapter 13 relief is to appeal to an individual debtor, it will be for reasons other than those that make chapter 11 relief desirable to a business debtor.

One of the major reasons an individual debtor may seek chapter 13 relief rather than bankruptcy under chapter 7 is to retain his principal residence. At least one court has said that a chapter 13 debtor needs his home.[204] It is more accurate to say that "the only reason the debtor [may have] applied for relief under Chapter 13 was to save the house or automobile."[205]

A presumption that the debtor's residence is necessary to an effective chapter 13 plan when the debtor proves that the residence is his principal residence would be consistent with the language of the Bankruptcy Code and with the policies underlying chapter 13. This interpretation would allocate a meaningful burden of proof to the debtor and would be consistent with the policy objective of encouraging debtors to attempt repayment under chapter 13 as an alternative to chapter 7 liquidation.

4. *Conclusion*

Policy considerations and the clear command of Code section 103 require that the effective reorganization prong of section 362(d)(2) apply to chapter

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202. "Section 362(d)(2) of title 11 is amended in subparagraph (B), by inserting 'in a case under chapter 13 of this title, as the case may be' immediately after 'reorganization.'" S. 863, 97th Cong., 1st Sess. § 25(d), 127 CONG. REC. 7893, 7895-96 (1981).

203. *In re* Garner, 13 Bankr. 799, 803 (Bankr. S.D.N.Y. 1981).

204. "Here, the [chapter 13] debtors have a significant interest in rehabilitating their obligation with Central Federal as they naturally need to keep their home." *In re* King, 6 BANKR. CT. DEC. (CRR) 1270, 1272 (Bankr. S.D. Cal. 1980).

205. *In re* Garner, 13 Bankr. 799, 803 (Bankr. S.D.N.Y. 1981).

13. Regardless of the standards that the courts employ in applying the effective reorganization prong to property other than the debtor's principal residence, the debtor's home should be deemed the type of property that is necessary to an effective chapter 13 plan. Under this interpretation a court will not be required to lift the automatic stay whenever the mortgagee shows that the debtor has no equity in his principal residence. If the creditor establishes lack of equity, but the debtor proves that the property is his principal residence, the creditor will not be entitled to have the automatic stay lifted under section 362(d)(2). The creditor, however, still could have the stay lifted under section 362(d)(1) "for cause, including lack of adequate protection."[206]

IV. CONCLUSION

The problems of permissible cure and the application of the section 362(d)(2) effective reorganization provision to chapter 13 are fairly technical. The importance of these issues, however, should not be obscured by their mechanical appearance. Whether the most protected creditor should receive additional protection at the expense of the debtor and other creditors is crucial to all those involved in chapter 13 proceedings. Congress clearly intended to encourage debtor rehabilitation as an alternative to liquidation. Rehabilitation generally provides unsecured creditors with a greater dividend than they would have received under a liquidation, while permitting the debtor to retain much of his property. Ambiguities in chapter 13 should be resolved in light of these broad policy considerations. In the absence of a clear legislative mandate debtors should not be effectively precluded from making use of chapter 13 or discouraged from attempting rehabilitation in the interest of over-protecting the most secure of all creditors, the mortgagee of the debtor's principal residence. Until Congress clarifies its intent about section 1322(b) and section 362(d)(2), courts should interpret these sections to increase the availability to debtors of chapter 13.

Susan L. Russell-Chema

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206. 11 U.S.C. § 362(d)(2) (Supp. III 1979).