UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF NEW YORK

In re:

CASE NO. 98-20500

SOLOMON S. JEFFRIES and
GWENDOLYN M. JEFFRIES,

Debtors. **DECISION & ORDER**

BACKGROUND

On February 13, 1998, Solomon S. Jeffries and Gwendolyn M. Jeffries (the "Debtors") filed a petition initiating a Chapter 13 case. On August 10, 1998, the Debtors filed a motion (the "Modification Motion") which requested that the Court enter an order: (1) determining that the claim of Household Financial Services ("Household Financial"), which was secured by a third mortgage on the Debtor's residence located at 67 Eagan Boulevard, Rochester, New York ("Eagan Boulevard"), was wholly unsecured; and (2) permitting the Debtor's Chapter 13 plan to modify the rights of Household Financial and pay its unsecured claim a *pro rata* distribution along with all other unsecured creditors.[1]

The Modification Motion alleged that: (1) Eagan Boulevard had an appraised fair market value of $90,000; (2) Homeside Lending, Inc. ("Homeside") held a valid perfected first mortgage lien on Eagan Boulevard with an outstanding balance of $67,225; (3) Household Finance ("Household") held a valid perfected second mortgage on Eagan Boulevard with an outstanding balance of $25,238; (4) Household Financial held a valid perfected third mortgage on Eagan

---

[1] Although the valuation of a secured claim pursuant to Section 506 may ultimately be required to be made in an adversary proceeding pursuant to Rule 7001(2), in Chapter 13 cases this Court, in order to save costs for the parties, allows and encourages such matters to first come on by motion as a contested matter, with the right of the secured creditor, if it is appropriate, to require that it be converted to an adversary proceeding.

Boulevard with an outstanding balance of $23,246; (5) the outstanding balances due Homeside and Household exceeded the appraised fair market value of Eagan Boulevard, so that the allowed secured claim of Household Financial, after performing a Section 506(a)[2] analysis, was zero; and (6) when the Household Financial mortgage was incurred in 1997, there was no equity in Eagan Boulevard because of the first and second mortgages, so that the third mortgage was obtained for leverage only.

On the September 9, 1998 return date of the Modification Motion, the Court denied the Motion for the reasons set forth in its Decision & Order in *In re Neverla,* 194 B.R. 547 (Bankr. W.D.N.Y. 1996) ("*Neverla*").[3] On September 11, 1998, after confirmation of the Debtor's Chapter 13 plan was denied, the Debtor's requested that the Court issue a written decision on the Modification Motion so that they could appeal the decision to the United States District Court for the Western District of New York.

DISCUSSION

After: (1) the decision of the United States Supreme Court in *Nobelman v. American Savings Bank,* 508 U.S. 324 (1993) ("*Nobelman*"); and (2) a number of Bankruptcy Court decisions,

---

[2] Section 506(a) provides that:

> (a) An allowed claim of a creditor secured by a lien on property in which the estate has an interest, or that is subject to setoff under section 553 of this title, is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, or to the extent of the amount subject to setoff, as the case may be, and is an unsecured claim to the extent that the value of such creditor's interest or the amount so subject to setoff is less than the amount of such allowed claim. Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest.

11 U.S.C. §506(a).

[3] A copy of *Neverla* is attached.

published after *Nobelman,* allowed the lien-stripping in Chapter 13 of a wholly unsecured "Homestead Mortgage"[4], contrary to the exception to lien-stripping and modification set forth in Section 1322(b)(2)[5], *Neverla* was the first published Bankruptcy Court decision to hold that a debtor could not strip-down a wholly unsecured Homestead Mortgage.

Since *Neverla* was decided, although recently more and more Bankruptcy Courts have adopted its holding, the majority of the Bankruptcy Courts which have decided this issue have held that the anti-modification provision contained in Section 1322(b)(2) does not apply to a wholly unsecured mortgage.[6]

After reading all of the published decisions since *Neverla*, I continue to believe that the more appropriate, literal and functional reading of Section 1322(b)(2), necessitated by its legislative history, the Decision of the United States Supreme Court in *Nobelman,* which clearly focused upon

---

[4] For the purposes of this Decision & Order, a Homestead Mortgage is a mortgage secured only by a security interest in real property that is the debtor's principal residence.

[5] Section 1322(b)(2) provides that:

(b) Subject to subsections (a) and (c) of this section, the plan may—

(2) modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence, or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims;

[6] To date there have been no published District Court or Circuit Court decisions on this issue. Although the Bankruptcy Appellate Panel for the Second Circuit has also not decided this issue, six of the panel members have published decisions on this issue, including Bankruptcy Judge Robert E. Littlefield, Jr., who was a standing Chapter 13 trustee for over fifteen years before becoming a Bankruptcy Judge. In addition to this Court, Bankruptcy Judge Carl L. Bucki, *In re Barnes*, 199 B.R. 256 (Bankr. W.D.N.Y. 1996), and Bankruptcy Judge Littlefield, *In re Pond*, 1998 WL 357149 (Bankr. N.D.N.Y. 1998) have held that the anti-modification provision contained in Section 1322(b)(2) does apply to wholly unsecured mortgages. Holding otherwise are Bankruptcy Judge Robert L. Krechevsky, *Matter of Plouffe,* 157 B.R. 198 (Bankr. D.Conn. 1993), Bankruptcy Judge Alan H. W. Shiff, *In re Hornes*, 160 B.R. 709 (Bankr. D.Conn. 1993), and Bankruptcy Judge Stephen D. Gerling, *In re Scheuer*, 213 B.R. 415 (Bankr. N.D.N.Y. 1997).

the "rights" of the holder of a Homestead Mortgage, rather that upon any collateral value the Mortgage might have, and the failure of the United States Congress to redraft this subsection as part of the Bankruptcy Reform Act of 1994, is that the rights of the holder of a Homestead Mortgage, which include the right to be paid the amount due on the Mortgage, even if it has a claim which is wholly unsecured after a Section 506(a) analysis, cannot be modified by a Chapter 13 plan.

The principal debate surrounding this issue is whether the United States Congress intended Section 1322(b)(2) to prevent the modification of the claims and rights of the holders of a Homestead Mortgage, or only those whose Homestead Mortgage happens to have some collateral value at the time when the bankruptcy petition is filed, even if it is only one dollar. Perhaps the best analysis of why Section 1322(b)(2) must be read to protect the claims and rights of the holders of all Homestead Mortgages is contained in the treatise of Bankruptcy Judge Keith M. Lundin, *Chapter 13 Bankruptcy,* Section 4.46, pages 4-56 (2nd Edition 1994).

> Although the bank's claim in *Nobelman* was partially secured by real property that was the debtor's principal residence, Justice Thomas's analysis ties the protection from modification in §1322(b)(2) to the existence of a "claim" secured by a lien on real property, without regard to whether the claim holder would also have an allowable secured claim after valuation and analysis under §506(a). The clear implication of this analysis is that even a completely *unsecured* claim holder "secured" only by a lien on real property that is the debtor's principal residence would be protected from modification by §1322(b)(2), notwithstanding that such an "unsecured" lienholder could not have an allowable secured claim under §506(a). Although the concept of an "unsecured secured claim" is impossible under §506(a), Justice Thomas's focus on the "rights" of the "holders" of a "claim secured only by ..." in §1322(b)(2) extends the protection from modification to claims that are secured by a lien on the debtor's principal residence, without regard to the allowance or disallowance of secured claims under §506(a). In other words, the trigger for Justice Thomas's protection of rights analysis is the existence of a lien, not the presence of value to support that lien.

> Under the law of most states, even a mortgage holder with little or no "value" in the collateral to support its debt has a "right" to foreclose its lien and sell the property. The "unsecured" lienholder may not receive any proceeds from such a foreclosure sale, but it has the "right" to force such a sale and to avail itself of whatever strategic advantages it may accomplish under its contract with the debtor and under state law. *Nobelman* seems to protect even the right of an "unsecured" mortgage holder to exercise all its "rights" under the mortgage contract and under state law. Thus, the prohibition of modification in §1322(b)(2) after *Nobelman* seems also to prohibit the Chapter 13 debtor from proposing through the plan to modify any of the contract or state law rights of even an unsecured creditor if that creditor is "secured" only by a security interest in real property that is the debtor's principal residence.

In the supplement to his treatise, Judge Lundin discussed the two different lines of decisions, and pointed out why the majority's reasoning was an incorrect interpretation of *Nobelman*.

> Most reported decisions have rejected the proposition that *Nobelman* prohibits modification of a totally unsecured lien on a Chapter 13 debtor's principal residence. These courts interpret *Nobelman* to require the existence of an allowable secured claim as the predicate for the protection from modification in §1322(b)(2).
>
> These courts do not explain why Justice Thomas went to such pains in the quotation above to link the protection from modification in §1322(b)(2) to the existence of a "claim" secured by a lien on a debtor's principal residence if, in addition, the creditor must have a "secured claim" to trigger that protection. Linking the antimodification protection in §1322(b)(2) to the existence of any allowable secured claim means that a mortgage holder with one dollar of collateral value is protected from modification to the extent of its entire claim, while a mortgage holder pennies "under water" forfeits the protection from modification with respect to its entire mortgage. This ascribes to Congress the odd intent to extend the antimodification protection in §1322(b)(2) to residential mortgage holders with any toehold on the debtor's property and to refuse that same protection where collateral values have shifted a peppercorn below the creditor's position. The lien rights of either creditor under state law – rights of much concern to Justice Thomas in *Nobelman* – are typically the same whether the mortgage holder is a dollar above or a dollar below the allowed secured claim threshold. This reading of *Nobelman* puts an undeserved premium on valuation of residential

> real property – it assumes a degree of accuracy in the valuation process that is without foundation in reality.

[Lundin, supra at 220.]

As stated in *Neverla* and in the decisions of a number of Bankruptcy Courts which have adopted its holding, if Homestead Mortgage claims are to be subject to lien-stripping and modification in future Chapter 13 cases, it should only be after the United States Congress has so clarified Section 1322(b), and not as the result of judicial legislation.[7]

In view of today's lending practices, allowing the lien-stripping and modification of some or all wholly unsecured Homestead Mortgages may be in the best interests of debtors, mortgage lenders and the bankruptcy system. However, that is a judgment which must be made by the United States Congress.[8] If Congress makes that determination in the future, it will clearly be a different determination than it made when it enacted Section 1322(b)(2) and when it failed to amend or clarify it as part of the Bankruptcy Reform Act of 1994.

CONCLUSION

---

[7] As pointed out in *Neverla*, Justice Stevens noted in his concurring opinion in *Nobelman* that "favorable treatment of residential mortgagees was intended to encourage the flow of capital into the home lending market...It therefore seems quite clear that the Court's literal reading of the text of the statute is faithful to the intent of Congress." It would seem to this Court that this Congressional intent, to provide favorable treatment of residential mortgages, should be interpreted as broadly as possible. If that is so, how can Bankruptcy Courts assume that it was the intent of Congress in implementing this broad policy by the enactment of Section 1322(b)(2) to make distinctions between fully secured, undersecured, and wholly unsecured residential mortgages, especially when that determination must often be made many years after the mortgage loan was made? This section, when read literally as suggested by Justice Stevens, makes no distinctions, as it easily could have, between residential mortgages based upon collateral value at the time of the filing of the bankruptcy petition.

[8] Should the United States Congress make the determination that lien-stripping and the modification of Homestead Mortgages, whether wholly or partially unsecured, is permissible in Chapter 11 or 13, the home lending industry will make the necessary underwriting adjustments in connection with any future mortgage lending.

The Modification Motion which requested that the claim and the rights of Household Financial be modified by a Chapter 13 plan that would: (1) treat the claim as a wholly unsecured claim; and (2) pay the resulting unsecured claim only a *pro rata* distribution with other unsecured creditors, is denied as being prohibited by the provisions of Section 1322(b)(2).

IT IS SO ORDERED.

_____/s/_____
HON. JOHN C. NINFO, II
U.S. BANKRUPTCY JUDGE

Dated: September 28, 1998