Note

Cramming Down the Housing Crisis: Amending 11 U.S.C. § 1322(b) to Protect Homeowners and Create a Sustainable Bankruptcy System

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A familiar scene unfolded before bankruptcy judge Rich Leonard in the Eastern District of North Carolina.[1] A middle-aged, widowed debtor just lost her home despite filing for bankruptcy protection.[2] The story began four years ago, when a mortgage broker approached the debtor with an ostensibly excellent loan.[3] With only modest monthly payments, the mortgage let the debtor make needed repairs and consolidate her other debts.[4] Although aware of the type of mortgage she had taken out, an adjustable-rate mortgage (ARM), the debtor did not understand that, unlike traditional ARMs, hers had no ties to the prime rate or any other index.[5] Consequently, her interest rate skyrocketed, adjusting upward periodically, until it hit fourteen percent, at which point her social worker's salary was no longer sufficient to cover her mortgage payments.[6] Hoping to save her only residence, the debtor filed for Chapter 13 bankruptcy protection.[7] Regrettably, because existing bankruptcy

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1. *See* Rich Leonard, *A Win-Win Bankruptcy Reform*, WASH. POST, Nov. 28, 2008, at A29.
2. *Id.*
3. *Id.*
4. *Id.*
5. *Id.*
6. *Id.*
7. *Id.*

law prohibits judicial modification of home mortgages,[8] Judge Leonard could not restructure the loan to reduce payments.[9] Without judicial modification of her mortgage, the debtor's bankruptcy plan was unfeasible based on her paltry salary.[10] Judge Leonard had no choice but to allow the foreclosure to proceed.[11]

The foreclosure granted by Judge Leonard[12] was among millions of foreclosures set to take place before the end of the decade.[13] In the first quarter of 2008 alone, foreclosure filings increased by more than 100 percent from the same period a year prior,[14] and foreclosures for the entire year will run at about 2.25 million.[15] Moreover, economists project that ten million more homeowners will foreclose over the next five years.[16]

The U.S. bankruptcy system has served as a safety net for millions of Americans for the last 110 years,[17] but it failed to rescue homeowners in the ongoing recession. Amid flaming allegations and accusations,[18] politicians and judges, including Judge Leonard,[19] debate the controversial modification of loans,

8. *See* 11 U.S.C. § 1322(b)(2) (2006).

9. Leonard, *supra* note 1.

10. *Id.*

11. *Id.*

12. The debtor's filing of bankruptcy had suspended the foreclosure proceeding. *Id.* This suspension is called the "automatic stay." *See* 11 U.S.C. § 362 (2006).

13. *See* Charles Duhigg, *Fighting Foreclosures, F.D.I.C. Chief Draws Fire*, N.Y. TIMES, Dec. 11, 2008, at A1.

14. James H. Carr & Kate Davidoff, *Legislative and Regulatory Reponses to the Foreclosure Crisis*, 17 J. AFFORDABLE HOUSING & COMMUNITY DEV. L. 283, 283 (2008).

15. Ben S. Bernanke, Chairman, Fed. Reserve, Speech at the Federal Reserve System Conference on Housing and Mortgage Markets (Dec. 4, 2008) (transcript available at http://www.federalreserve.gov/newsevents/speech/bernanke20081204a.htm).

16. Duhigg, *supra* note 13.

17. Adam J. Levitin & Joshua Goodman, *The Effect of Bankruptcy Strip-Down on Mortgage Markets* 2 (Georgetown Univ. Law Ctr. Bus., Econ. & Regulatory Policy Working Paper Series, Research Paper No. 1087816; Pub. Law & Theory Working Paper Series, Research Paper No. 1087816, 2008), *available at* http://works.bepress.com/adam_levitin/11; *see* Adam Feibelman, *Defining the Social Insurance Function of Consumer Bankruptcy*, 13 AM. BANKR. INST. L. REV. 129, 134 (2005).

18. *See* Edmund L. Andrews, *Greenspan Concedes Flaws in Deregulatory Approach*, N.Y. TIMES, Oct. 24, 2008, at B1. Alan Greenspan, former chairman of the Federal Reserve, faced "one of the harshest grillings of his life," as he conceded during a congressional hearing to making regulatory mistakes. *Id.*

19. *See* Leonard, *supra* note 1 ("Allowing modifications is a solution.").

a process called cram-down or lien-stripping.[20] Cram-down is a feature of bankruptcy law[21] that allows a debtor to pay a creditor the value of the collateral instead of the full value of the loan.[22] Under current law, judges can modify mortgages on vacation or second homes and multifamily residences.[23] Oddly, the Bankruptcy Code creates an exception for mortgages secured solely by the debtor's primary residence.[24] This exception forces bankrupt homeowners who own only one home to pay their mortgages in full despite sharply declining home values.[25] Proponents of cram-down advocate for the elimination of this exception,[26] while opponents warn that changing the status quo could exacerbate the housing crisis.[27]

This Note advocates that Congress pass a temporary cram-down relief measure, based on the means test of the 2005 Amendments, in order to provide immediate assistance to distressed Chapter 13 homeowners. To create a sustainable bank-

20. *See* 11 U.S.C. § 1322(b)(2) (2006).

21. Cram-down in this Note refers to loan modification in consumer bankruptcies. Note that cram-down has a different meaning in business reorganizations. *See id.* § 1129(b).

22. *See id.* §§ 1322(b)(2), 1325(a)(5) (providing that the debtor must pay the creditor the present value of the collateral, if the creditor does not accept the debtor's repayment plan and the debtor wants to keep the collateral over the creditor's objection); Assocs. Commercial Corp. v. Rash, 520 U.S. 953, 956 (1997) (using the replacement-value standard to determine the collateral's worth).

23. *See* 11 U.S.C. § 1322(b)(2) (authorizing loan modifications but creating an exception).

24. *Id.* ("[T]he plan may modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence . . . ."). A Harvard University professor commented on the inconsistency created by § 1322(b)(2), noting that families have better consumer protection when buying an oven than when buying a home. *See* Carr & Davidoff, *supra* note 14, at 289.

25. *See* Kevin G. Hall, *Mortgages: Bad or Worse? Economists' Biggest Argument Centers on Severity of Crisis*, MODESTO BEE, Nov. 23, 2008, at A7 (providing the projections of Martin Feldstein, former chief economic adviser to Ronald Reagan). A home mortgage is "underwater" if its debt value exceeds the market value of the house. *See* Dewsnup v. Timm, 502 U.S. 410, 412 (1992); *id.* at 424 (Scalia, J., dissenting).

26. *See, e.g.*, 153 CONG. REC. S12,534 (daily ed. Oct. 3, 2007) (statement of Sen. Specter) (arguing that cram-down will help homeowners who can no longer afford their mortgages).

27. *E.g.*, Press Release, Mortgage Bankers Ass'n, MBA's Kittle Challenges Bankruptcy Myths at Hearing (Jan. 29, 2008), *available at* http://www.mortgagebankers.org/NewsandMedia/PressCenter/59656.htm ("At a time when the mortgage market is already experiencing a serious credit crunch, this bill threatens to increase costs to consumers, destabilize the mortgage market, and result in injury to the overall economy.").

ruptcy system, however, Congress should then implement a permanent system that entrusts bankruptcy judges with discretion to modify loans in a manner consistent with jurisdictional Chapter 13 practices and needs. Part I describes the purpose and function of bankruptcy and explains the intricacies of cram-down in a Chapter 13 repayment plan. Part II dissects the debate over cram-down, delving into conflicting judicial interpretations and investigating ongoing arguments from mortgage bankers and consumer groups. Lastly, Part III proposes a unique two-part solution, a carefully crafted plan that provides adequate relief while creating a sustainable bankruptcy regime.

I. PURPOSE AND FUNCTION OF BANKRUPTCY

Every year, more than 1.5 million households file for bankruptcy.[28] Contrary to the traditional notion that bankruptcy-filers are lower-class wage earners,[29] debtors in bankruptcy cover a broad spectrum of the American middle class.[30] Occasionally, a star-studded cast of troubled celebrities and politicians also pour into bankruptcy courts in search of solutions.[31] For decades, bankruptcy offered relief to American debtors while protecting their creditors.[32]

From the enactment of the Bankruptcy Code in 1978 to the passage of the 2005 Amendments,[33] each change in the bankruptcy system reflects an ongoing tension between debtors and creditors.[34] As Congress struggles to balance competing concerns, policy considerations and market conditions play hefty roles in shaping—and reshaping—the landscape of bankruptcy.

28. ELIZABETH WARREN & JAY LAWRENCE WESTBROOK, THE LAW OF DEBTORS AND CREDITORS 119 (5th ed. 2006).

29. *Id.*

30. Elizabeth Warren, *Financial Collapse and Class Status: Who Goes Bankrupt?*, 41 OSGOODE HALL L. J. 115, 144 (2003) (concluding that the overwhelming majority of bankrupt debtors are middle class).

31. WARREN & WESTBROOK, *supra* note 28, at 116–17. This glamorous cast includes actress Kim Basinger, former Texas governor John Connally, prizefighter Mike Tyson, and heart surgeon Michael DeBakey. *Id.*

32. *See, e.g.*, Levitin & Goodman, *supra* note 17, at 2 (arguing that the U.S. bankruptcy system has excelled at resolving financial distress for debtors).

33. Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23 (codified as amended in scattered sections of 11 U.S.C.).

34. *See* WARREN & WESTBROOK, *supra* note 28, at 107–12 (chronicling the history of the Bankruptcy Code).

A. PURPOSE OF BANKRUPTCY

Bankruptcy provides an orderly forum to pay creditors and resolve debts all at once.[35] Filing a bankruptcy petition suspends all collection efforts, giving the debtor "a breathing spell"[36] to sort out his options.[37] Once the debtor fulfills his bankruptcy obligations, the court discharges the remaining debts.[38] Central to bankruptcy is the concept of a "fresh start."[39] Once a debtor receives his discharge, he can then start anew.[40] Through bankruptcy, Congress intends to give hardworking but unfortunate Americans a second chance at becoming productive citizens.[41] The policy ideal of providing a fresh start is the backdrop against which the cram-down debate unfolds.

Bankruptcy law rests upon economic principles that describe rational behavior with respect to individual financial decisions. Economists justify the creation of consumer bankruptcy

35. *See* Ass'n. of St. Croix Condo. Owners v. St. Croix Hotel Corp., 682 F.2d 446, 448 (3d Cir. 1982) (stating that bankruptcy provides an "orderly liquidation or rehabilitation of the debtor"); WARREN & WESTBROOK, *supra* note 28, at 121 (describing "the two classic objectives of bankruptcy": fair distribution of debtors' assets to creditors and "fresh start" for debtors); Michelle J. White, *Bankruptcy: Past Puzzles, Recent Reforms, and the Mortgage Crisis* 2 (Nat'l Bureau of Econ. Research, Working Paper No. 14549, 2008), *available at* http://econ.ucsd.edu/~miwhite/white-ALEA.pdf.

36. S. REP. NO. 95-989, at 54 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5840.

37. *See* 11 U.S.C. § 362(a) (2006) (listing all prohibited activities, such as the commencement of a legal proceeding against the debtor). The suspension of collection activities is called the automatic stay. *Id.* The power of the stay is broad and "self executing." Andrews Univ. v. Merchant (*In re* Merchant), 958 F.2d 738, 741 (6th Cir. 1992); United States v. Seitles, 106 B.R. 36, 38–39 (Bankr. S.D.N.Y. 1989) (holding that even the government, unless acting in the public's interest, cannot violate the automatic stay).

38. 11 U.S.C. § 524 (describing the effect of discharge). *Compare id.* § 523 (listing the exceptions to discharge for individual debts, such as tax, child support, and student loans), *with* § 727 (mandating a global denial of discharge of all debts because the debtor has acted dishonestly).

39. 150 CONG. REC. E84-01 (daily ed. Jan. 28, 2004) (statement of Hon. Maloney) ("The purpose of the Bankruptcy Code is to help provide a fresh start to the 'honest but unfortunate debtor.'").

40. *Id.*

41. *See* 151 CONG. REC. S2,515-01 (daily ed. Mar. 11, 2005) (statement of Sen. Clinton) ("[T]raditional purposes of bankruptcy . . . recognize that we are all better off when hardworking people who have suffered financial catastrophe get a 'fresh start' and a second chance to become productive and contributing members of society.").

on two grounds.[42] First, bankruptcy facilitates consumption because it provides debtors with partial consumption insurance and increases the demand for loans.[43] Second, and of equal importance, bankruptcy encourages entrepreneurial behavior and incentivizes risk-averse individuals to engage in business.[44] Regrettably, the same protections also encourage bankruptcy abuses.[45] Studies conducted before the passage of the 2005 Amendments showed that some debtors in bankruptcy had the ability to repay a significant portion of their debts.[46] Because of the ease of filing and obtaining a discharge, many debtors derived financial benefits from filing for bankruptcy despite earning sufficient income to comfortably meet debt obligations.[47]

Taking advantage of the prodebtor law before 2005, debtors hastened to bankruptcy courts.[48] From the early 1990s to 2005, bankruptcy filings increased by 150 percent[49] and consumer bankruptcies outnumbered business bankruptcies by more than forty-five to one.[50] Economists rushed to explain the sharp increase in the number of filings.[51] Some argued that

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42. *See* White, *supra* note 35, at 3 (explaining the economic justifications for bankruptcy law).

43. *See* Feibelman, *supra* note 17, at 129; Michelle J. White, *Abuse or Protection? Economics of Bankruptcy Reform Under BAPCPA*, 2007 U. ILL. L. REV. 275, 276 n.2 (arguing that a discharge allows a debtor "to shift funds from debt repayment to consumption").

44. *See* H.R. REP. NO. 108-40, pt. 1, at 565 (2003) (discussing the importance of encouraging entrepreneurship and risk-taking).

45. *See* Scott Fay et al., *The Household Bankruptcy Decision*, 92 AM. ECON. REV. 706, 707 (2002) (hypothesizing that because debtors have the right to choose between liquidation and repayment in bankruptcy, they will choose strategically to maximize their financial gains).

46. H.R. REP. NO. 109-31, pt. 1, at 5 (2005) (noting the prevalence of bankruptcy abuse and emphasizing the need for reform).

47. *See* Fay et al., *supra* note 45, at 716 (defining financial benefit as the value of the debt discharged less the value of the nonexempt assets that debtors will have to give up in bankruptcy); White, *supra* note 43, at 281 (discussing "bankruptcy planning" as a way to maximize gains "from filing for bankruptcy by converting wealth from nonexempt to exempt" assets).

48. *But see* 151 CONG. REC. H2066–67 (daily ed. Apr. 14, 2005) (statement of Rep. Cummings) (arguing that the increase in personal bankruptcy filings is "not proof that our bankruptcy laws need reform" but a reflection that the nation's economic policies have failed to raise living standards).

49. 151 CONG. REC. E623 (daily ed. Apr. 12, 2005) (statement of Rep. DeLay).

50. 151 CONG. REC. S1814 (daily ed. Mar. 1, 2005) (statement of Sen. Frist) (projecting that at least ten percent of all filings were fraudulent).

51. *Compare id.* at S1813–14 (arguing that bankruptcy has lost its stigma and it is now just a "tool" to get out of debt), *with* Teresa A. Sullivan et al., *Less Stigma or More Financial Distress: An Empirical Analysis of the Extraor-*

families shouldered more financial burdens,[52] but others attributed the phenomenon to the deregulation of the credit market and aggressive marketing.[53] Still others argued that financial benefits derived from bankruptcy drove debtors into court.[54] At any rate, Congress concluded that reforms were necessary.[55]

B. BANKRUPTCY ABUSE PREVENTION AND CONSUMER PROTECTION ACT OF 2005

In response to the credit industry's intense lobbying and prevalent bankruptcy abuses,[56] Congress passed the Bankruptcy Abuse Prevention and Consumer Protection Act (the 2005 Amendments) to amend the Bankruptcy Code.[57] By adopting a means test,[58] Congress sought to create roadblocks in the Code to prevent reckless spenders from obtaining bankruptcy protection.[59] The means test determines a debtor's eligibility for bankruptcy.[60] The initial inquiry is whether the debtor's income exceeds the median income of similar families in the state where the debtor filed for bankruptcy.[61] A debtor below the median can proceed with a liquidation of his non-exempt assets,

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dinary Increase in Bankruptcy Filings, 59 STAN. L. REV. 213, 233–39 (2006) (concluding that stigma did not contribute to the extraordinary increase in bankruptcy filings and that stigma might actually be rising).

52. Sullivan et. al, *supra* note 51, at 233 (arguing that despite the increase in debtors' incomes and assets, debtors now have far more debts than their predecessors).

53. Other explanations include the lack of health insurance, instability of the job market, and failure of small businesses. *See* WARREN & WESTBROOK, *supra* note 28, at 152.

54. *See* Fay et al., *supra* note 45, at 716 (predicting that every $1000 increase in financial benefit received by a household in bankruptcy leads to a seven percent increase in the number of filings).

55. H.R. REP. No. 109-31, pt. 1, at 4 (2005).

56. *See* Timothy Egan, *Newly Bankrupt Raking in Piles of Credit Offers*, N.Y. TIMES, Dec. 11, 2005, at A1. The banking industry spent more than $100 million lobbying for the legislation. *Id.*

57. Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23 (codified as amended in scattered sections of 11 U.S.C.).

58. *See* 11 U.S.C. § 707(b)(2)(A) (2006).

59. *See* 151 CONG. REC. S2,470 (daily ed. Mar. 10, 2005) (statement of Sen. Nelson) ("[T]hose trying to shield their assets while abandoning their financial responsibilities will find it much more difficult to abuse the system . . . .").

60. *See* 11 U.S.C. § 707.

61. *See id.*; WARREN & WESTBROOK, *supra* note 28, at 159–60.

governed by Chapter 7.[62] A debtor exceeding the median, however, must calculate his surplus income over reasonable living expenses.[63] A large surplus may force the debtor into repayment,[64] governed by Chapter 13,[65] or out of bankruptcy altogether.[66] If a debtor originally files under Chapter 13, the means test will determine whether he must commit any surplus to paying unsecured creditors over the life of the plan.[67] Whether the 2005 Amendments embody valuable reform remains unresolved,[68] but the changes represented a victory for creditors.[69]

C. CHAPTER 13: THE REPAYMENT PLAN

The Bankruptcy Code consists of several chapters.[70] This Note focuses primarily on Chapter 13, the repayment plan. Unlike the liquidation chapter, under which the debtor gives up all nonexempt assets in exchange for a discharge of all preexisting debts,[71] in Chapter 13 the debtor keeps all assets but pledges future income to pay off debts over the life of the plan.[72]

62. *See* 11 U.S.C. §§ 701−784 (containing provisions governing liquidation).

63. *See id.* § 707(b)(2)(A); WARREN & WESTBROOK, *supra* note 28, at 159−65.

64. *See* 11 U.S.C. § 707(b).

65. *See id.* §§ 1301−1330.

66. *See id.* § 707(b) (stating that a court may dismiss the case).

67. *Id.* § 1325(b). In Chapter 13, a debtor must commit to five years of payment if his income exceeds the median income. *Id.*

68. *See, e.g.*, Bank Lawyer's Blog, *Bankruptcy Reform: Beneficial or Bust?*, http://www.banklawyersblog.com/3_bank_lawyers/2006/10/bankruptcy_refo.html (Oct. 20, 2006) (debating the benefits of the 2005 Amendments).

69. *See, e.g.*, Maya P. Hill & Thomas A. Hill, *Bankruptcy Code Section 1325: 910 Creditor Claims in the Post-BAPCPA Environment*, 61 CONSUMER FIN. L.Q. REP. 587, 587 (2007) (victory for motor-vehicle-secured creditors); Gregory Germain, *Discharging Income Tax Liabilities in Bankruptcy: A Challenge to the New Theory of Strict Construction for Scrivener's Errors*, 75 U. MISS.-KAN. CITY L. REV. 741, 741 (2007) (victory for state tax collectors).

70. *See* 11 U.S.C. § 101.

71. *See id.* §§ 701–728; Veryl Victoria Miles, *The Bifurcation of Undersecured Residential Mortgages Under § 1322(b)(2) of the Bankruptcy Code: The Final Resolution*, 67 AM. BANKR. L.J. 207, 209 (1993).

72. *See* 11 U.S.C. § 1322. Chapter 13 has several advantages over Chapter 7. *See* Miles, *supra* note 71, at 210–14. The "most compelling incentive" for a debtor to file a Chapter 13 is that it permits a debtor to retain nonexempt assets. *Id.* at 212. This is particularly important if the debtor has significant nonexempt assets. *Id.*

In the repayment plan, the type of creditor claim determines the share of the pie.[73]

1. Bifurcation of Claims: Secured and Unsecured

Creditors with secured claims, for which the debtor has pledged collateral, enjoy much greater protection than their counterparts with unsecured claims.[74] The general rule is that secured creditors get paid first and in full,[75] while unsecured creditors get paid last and only by a pro rata distribution.[76] A secured creditor can also have an *under*secured claim.[77] This occurs when the creditor's claim exceeds the value of the collateral pledged.[78] Section 506(a) of the Bankruptcy Code treats the portion of the claim equal to the value of the collateral as secured and the remaining as unsecured.[79] For example, if a debtor owes a secured creditor $100 dollars at the time of the bankruptcy filing, and the value of the collateral is $70, then the creditor has a secured claim for $70 and an unsecured claim for $30. The undersecured creditor will receive the full price of the collateral for the secured claim, but only a pro rata amount for the unsecured claim.[80] This treatment of an undersecured claim is called bifurcation, and bifurcation is the mechanism that facilitates cram-down.

2. Cram-Down in Chapter 13

Cram-down, or lien-stripping, is the process of reducing an undersecured claim to the value of the collateral.[81] In the previous example of the $100 claim secured by collateral worth only $70, cram-down would reduce the creditor's entire claim to

73. *See* 11 U.S.C. § 1325(a)(4), (5).

74. *See id.*

75. *Id.* § 1325(a)(5)(B) (providing that the debtor must pay the secured creditor the present value of the collateral).

76. *Id.* § 1325(a)(4) (providing that the debtor must pay the unsecured creditor an amount that the creditor would have received in a hypothetical liquidation chapter, which is typically several cents on the dollar).

77. *See id.* § 506(a)(1) (determining the status of secured claims).

78. *Id.*

79. *Id.* ("An allowed claim of a creditor secured by a lien on property . . . is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, . . . and is an unsecured claim to the extent that the value of such creditor's interest . . . is less than the amount of such allowed claim.").

80. *See id.* § 1325(a)(4), (5)(B).

81. *See id.* § 1322(b)(2) (allowing for the modification of the rights of secured creditors).

$70, eliminating the $30 unsecured claim. In a Chapter 13 repayment plan, a debtor can propose to pay the secured portion in full while treating the unsecured portion like any other unsecured claim.[82]

Essentially, cram-down benefits the debtor because the debtor will only have to pay the full price of the collateral, while simply paying pro rata for the rest of the claim, which typically ends up being several cents on the dollar.[83] The debtor's gain from cram-down equals the creditor's loss, unless the undersecured asset is the debtor's principal residence. In this case, the creditor is immune from cram-down.[84]

Section 1322(b)(2) of the Code allows bankruptcy judges to cram down various types of secured debt, except for mortgages secured *solely* by the debtor's primary residence.[85] As reflected in the statutory text, "the plan may modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence."[86] The oddity in this exception is that a debtor can seek to modify mortgages on his second or vacation homes or multifamily properties in which the owner occupies a unit, but another debtor who does not own a second residence has no access to judicial modification.[87]

This inconsistency has sparked debates for years,[88] but it is receiving special attention today because of the mounting number of foreclosures. The gravity of the crisis and economic downturn calls for congressional and judicial action.

82. *Id.* § 1322(b)(2); *id.* § 506(a)(1) (describing bifurcation of a claim).

83. *Id.* § 1325(a)(5)(B) (requiring the debtor to pay the present value of the collateral); *see id.* § 506(a)(2) (using the replacement value to determine the claim's worth); Assocs. Commercial Corp. v. Rash, 520 U.S. 953, 956–57 (1997).

84. 11 U.S.C. § 1322(b)(2) (creating an exception to cram-down for primary residences).

85. *Id.*

86. *Id.*

87. *Id.*; Levitin & Goodman, *supra* note 17, at 5.

88. The controversy created a circuit split. Nobelman v. Am. Sav. Bank, 968 F.2d 483, 486 (5th Cir. 1992), *aff'd*, 508 U.S. 324 (1993); Bellamy v. Fed. Home Loan Mortgage Corp. (*In re* Bellamy), 962 F.2d 176, 180−81 (2d Cir. 1992), *abrogated by Nobelman*, 508 U.S. 324; Eastland Mortgage Co. v. Hart (*In re* Hart), 923 F.2d 1410, 1412 (10th Cir. 1991), *overruled by In re* Wicks, 5 F.3d 1372 (10th Cir. 1993); Wilson v. Commonwealth Mortgage Corp., 895 F.2d 123, 126 (3d Cir. 1990), *abrogated by Nobelman*, 508 U.S. 324; Hougland v. Lomas & Nettleton Co. (*In re* Hougland), 886 F.2d 1182, 1184 (9th Cir. 1989), *aff'd sub nom.* Lomas Mortgage v. Wiese, 980 F.2d 1279, 1282 (9th Cir. 1992), *judgment vacated by* Lomas Mortgage v. Wiese, 508 U.S. 958 (1993).

II. THE CRAM-DOWN CONTROVERSY: CONFLICTING JUDICIAL INTERPRETATIONS AND THE CURRENT DEBATE

Before 1993, several courts interpreted the Bankruptcy Code to allow judicial modification of home mortgages.[89] In *In re Bellamy*, for example, the bankruptcy court held that the language of the statute prohibits modification only of the secured portion of an undersecured claim.[90] Accordingly, a bankruptcy court could modify the unsecured portion.[91] The controversy created a circuit split: the Second, Third, Ninth, and Tenth Circuits interpreted § 1322(b)(2) more liberally to permit cram-down,[92] but the Fifth Circuit adopted a more restrictive reading, denying it to homeowners.[93] In 1993, the Supreme Court granted certiorari to resolve the conflict.[94]

A. THE SUPREME COURT'S INTERPRETATION OF § 1322(b)(2) IN *NOBLEMAN*

In *Nobleman v. American Savings Bank*, the Supreme Court concluded that § 1322(b)(2) prohibits a debtor from using § 506(a) to bifurcate and reduce an undersecured homestead mortgage to the value of the mortgaged residence.[95] The Court held that the valuation of a secured claim, determined by § 506(a), does not limit a creditor's protected rights.[96] Accor-

89. *In re* Torres Lopez, 138 B.R. 348, 351 (Bankr. D.P.R. 1992); *In re* Govan, 139 B.R. 1017, 1021 (Bankr. N.D. Ala. 1992); Taras v. Commonwealth Mortgage Corp. (*In re* Taras), 136 B.R. 941, 949 (Bankr. E.D. Pa. 1992); *In re* Honett, 116 B.R. 495, 497 (Bankr. E.D. Tex. 1990); Brouse v. CSB Mortgage Corp. (*In re* Brouse), 110 B.R. 539, 543 (Bankr. D. Colo. 1990), *rejected by* Hargrove v. Edwards Co., 133 B.R. 765 (Bankr. E.D. Va. 1991); Gaglia v. First Fed. Sav. & Loan Ass'n, 889 F.2d 1304, 1308 (3d Cir. 1989), *abrogated by* Dewsnup v. Timm, 502 U.S. 410 (1992).

90. 962 F.2d at 180–81 (arguing that modification of unsecured claims is permissible because the rule of the last antecedent dictates that the "other than" clause in 11 U.S.C. § 1322(b)(2) applies to secured claims only).

91. *See id.* at 181.

92. *See id.* at 180–81; *Wilson*, 895 F.2d at 126; *In re* Hougland, 886 F.2d at 1184; *In re* Hart, 923 F.2d at 1412.

93. *Nobelman*, 968 F.2d at 489 (concluding that a debtor must repay the mortgage's full value regardless of the property's current fair market value).

94. Nobelman v. Am. Sav. Bank, 508 U.S. 324, 327 (1993).

95. *Id.* at 332.

96. *Id.* at 328–29 ("The portion of the bank's claim that exceeds $23,500 is an unsecured claim component under § 506(a), . . . however, that determination does not necessarily mean that the 'rights' the bank enjoys as a mortgagee, which are protected by § 1322(b)(2), are limited by the valuation of its secured claim." (citation and quotations omitted)).

dingly, unlike lower courts that prohibited modification only of the secured claim,[97] the Court prohibited modification altogether.[98]

In his concurrence, Justice Stevens considered policy arguments now comprising the current debate.[99] Justice Stevens justified this favorable treatment of home mortgagees by alluding to congressional intent to encourage a flow of capital into the home lending market.[100] Since *Nobelman*, proponents and opponents of cram-down have expanded upon Justice Stevens's policy concerns.[101]

B. The Current Debate over the Impact of Cram-Down on Foreclosures, Fresh Start, and the Credit Supply

Proponents of cram-down argue that it prevents foreclosures, safeguards a debtor's "fresh start," and will have a minimal effect on interest rates.[102] Opponents, in contrast, warn that cram-down will inevitably raise costs, reduce the credit supply, and give debtors a windfall.[103] In essence, the debate centers on the different effects of Chapter 13 cram-down.[104]

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97. *See, e.g.*, Bellamy v. Fed. Home Loan Mortgage Corp. (*In re* Bellamy), 962 F.2d 176, 179 (2d Cir. 1992).

98. *Nobelman*, 508 U.S. at 331 (holding that petitioners cannot modify the payment and interest for the unsecured portion without also altering the secured portion).

99. *Id.* at 332 (Stevens, J., concurring). Justice Stevens noted the oddity in § 1322(b)(2): "[I]t seems somewhat strange that the Bankruptcy Code should provide less protection to an individual's interest in retaining possession of his or her home than of other assets." *Id.*

100. *Id.* ("[F]avorable treatment of residential mortgagees was intended to encourage the flow of capital into the home lending market.").

101. *Infra* Part II.B.

102. *See* Brief on the Merits for Petitioners at 7–8, Nobelman v. Am. Sav. Bank, 508 U.S. 324 (No. 92-641) (1993) [hereinafter Brief for Petitioners] (arguing that a reduced amount in principal is "the light at the end of the tunnel" for impoverished debtors). Petitioners reasoned that modification benefits everyone: the debtor will pay realistic amounts, the old lienholder will receive cash equal to the fair market value of the collateral, and the new lienholder gets a competitive return on current market rates. *Id.* at 8.

103. *See* Brief on the Merits of Respondent at 6, 29, Nobelman v. Am. Sav. Bank, 508 U.S. 324 (No. 92-641) (1993). Respondent argued that modification is contrary to a natural reading of the language of § 1322(b), inconsistent with the overall scheme of the Bankruptcy Code, and contradicts public policy. *Id.*; Todd J. Zywicki, *Don't Let Judges Tear Up Mortgage Contracts*, WALL ST. J., Feb. 13, 2009, at A13 ("Mortgage modification would indeed provide a windfall for some troubled homeowners . . . .").

104. *Infra* Parts II.B.1–3.

1. The Value or Cost of Foreclosures

Foreclosures affect numerous stakeholders.[105] Debtors lose their homes and must bear the cost of relocation,[106] and mortgage investors lose a portion of their investments.[107] Neighborhoods also suffer because foreclosed properties deteriorate and impose significant costs on local governments.[108] Moreover, foreclosures push down real estate prices and make it difficult for other homeowners to refinance.[109]

Because foreclosure harms debtors, creditors, investors, and local communities, Congress should enable debtors to keep their homes and continue making payments.[110] After cram-down, a debtor would pay the creditor an amount equal to the market value of the house.[111] Often, this amount equals the foreclosure sale price, and in such cases, cram-down does not change the creditor's position.[112] By avoiding the costs associated with a foreclosure, the creditor may actually have benefitted.[113]

Opponents disagree, arguing that without a foreclosure, a creditor cannot offset his loss with mortgage insurance.[114] If a

105. *Turmoil in the U.S. Credit Markets: Examining Proposals to Mitigate Foreclosures and Restore Liquidity to Mortgage Markets: Hearing on Hope for Homeowners Act of 2008 Before the S. Comm. on Banking, Housing, and Urban Affairs*, 110th Cong. 2 (2008) (statement of Arthur J. Murton, Dir., Div. of Ins. & Research, Fed. Deposit Ins. Corp.); *Using FHA for Housing Stabilization and Homeownership Retention: Hearing Before the H. Comm. on Financial Servs.*, 110th Cong. 13–14 (2008) (statement of Sheila C. Bair, Chair, Fed. Deposit Ins. Corp.) (summarizing the impact of foreclosures).

106. Michelle J. White & Ning Zhu, *Saving Your Home in Chapter 13 Bankruptcy* 2 (Nat'l Bureau of Econ. Research, Working Paper No. 14179, 2008).

107. Levitin & Goodman, *supra* note 17, at 3.

108. *See, e.g.*, Dan Immergluck & Geoff Smith, *The External Costs of Foreclosure: The Impact of Single-Family Mortgage Foreclosures on Property Values*, 17 HOUSING POLICY DEBATE 57, 58 (2006) (estimating that in Chicago, the 3750 foreclosures that took place between 1997 and 1998 reduced nearby property by more than $598 million, or $159,000 per foreclosure).

109. White & Zhu, *supra* note 106.

110. 153 CONG. REC. S12,537 (daily ed. Oct. 13, 2007) (statement of Sen. Durbin) (quoting a spokesman from JPMorgan Chase to support the argument that modification will best serve the interests of servicers, borrowers, and investors).

111. Jane Kaufman Winn, *Lien Stripping After* Nobelman, 27 LOY. L.A. L. REV. 541, 548–50 (1994).

112. *Id.* at 550.

113. Brief for Petitioners, *supra* 102, at 8 (noting the frequency with which the mortgagee is the only bidder at a foreclosure sale).

114. *See* Winn, *supra* note 111, at 545.

creditor proceeds with a foreclosure, the creditor can retain the property until market conditions improve and real estate values rise again.[115] In practice, however, many creditors do not retain the property long enough to reap the benefits of appreciation.[116] In choosing to foreclose, some creditors also point out that a foreclosure allows them to seek a deficiency judgment against the debtor to recover the difference between the sale and contractual values.[117] Despite this entitlement, many states have antideficiency laws similar to bankruptcy's cram-down that limit the amount of a creditor's recovery.[118]

2. "Fresh Start" or "Head Start"

Cram-down is also consistent with bankruptcy's "fresh start" policy.[119] For many debtors, it would be difficult to start anew after foreclosing.[120] By instituting cram-down, Congress can protect the full benefit of a debtor's discharge in bankruptcy.[121] Although a foreclosure, coupled with antideficiency protection under state law, releases a debtor from liability and is therefore a form of discharge, it forces the debtor out of his homestead.[122]

Creditors, on the contrary, protest that cram-down is not a "fresh start" but a "head start,"[123] reaped at the expense of servicers, investors, and other debtors who honor their debts.[124]

115. *Straightening Out the Mortgage Mess: How Can We Protect Home Ownership and Provide Relief to Consumers in Financial Distress?—Part II: Hearing on H.R. 3609 Before the Subcomm. on Commercial and Administrative Law of the H. Comm. on the Judiciary*, 110th Cong. 10 (2007) [hereinafter *Protect Home Ownership Hearing*] (statement of David G. Kittle, Chairman-Elect, Mortgage Bankers Ass'n).

116. Winn, *supra* note 111, at 587.

117. *See id.* at 592–93. After a debtor defaults, the creditor may choose to foreclose on the property. *Id.* at 592. A court or an agent of the mortgagee may supervise the sale. *Id.* The proceeds from the sale go first to the creditor. *Id.* Any surplus over the debt will go to junior lien holders, and whatever remains then goes to the debtor. *Id.* If the proceeds do not cover the debt, the debtor is responsible for the deficiency. *Id.*

118. *Id.* at 587.

119. 151 CONG. REC. H1975 (daily ed. Apr. 14, 2005) (statement of Rep. Stark) ("Bankruptcy has always been about giving a fresh start to those who have fallen on hard times.").

120. *See* Brief for Petitioners, *supra* 102, at 4.

121. *See id.* at 7−8.

122. Winn, *supra* note 111, at 592.

123. *Id.* at 578.

124. *See Protect Home Ownership Hearing*, *supra* note 115, at 9 ("This windfall occurs when the borrower is permitted to reduce the debt to the de-

Through cram-down, a debtor may retain his home and enjoy the benefits of appreciation once market conditions improve.[125] This windfall to debtors, nonetheless, may be a "red herring" because home prices do not always rebound.[126] Additionally, institutional creditors generally liquidate foreclosed properties promptly and therefore do not enjoy much appreciation before sale.[127] Thus, the creditors' fear of a head start for debtors is perhaps an overstatement.[128]

3. Availability of the Credit Supply

Lastly, the prospect of a reduced credit supply alarms opponents of cram-down.[129] The risk of receiving reduced payments may drive creditors to raise the price of credit and cut back on lending.[130] Cram-down can also harm secondary markets for mortgage-backed securities[131] and effectively force future homeowners to subsidize current homeowners, if future homeowners must pay more than current homeowners to obtain credit.[132] Furthermore, if creditors reduce lending, then in-

pressed value of the property, retain the property, and enjoy the benefits of appreciation in value when market conditions improve . . . while having no obligation to pay the lender the full contractually agreed upon debt."); Winn, *supra* note 111, at 578 (describing a windfall for the debtor created at the lender's expense).

125. *Protect Home Ownership Hearing*, *supra* note 115, at 9.

126. Winn, *supra* note 111, at 579.

127. *Id.*

128. *See id.* at 578.

129. Letter from John M. Robbins, Chairman, Mortgage Bankers Ass'n, to John Conyers, Chairman, H. Comm. on the Judiciary & Lamar Smith, Ranking Member, H. Comm. on the Judiciary (Oct. 15, 2007), *available at* http://www.mortgagebankers.org/files/stopthebankruptcycramdown/MBAopposesh.r.3609.pdf.

130. *Compare id.* ("[T]his bill threatens to increase costs to consumers, destabilize the mortgage market and result in injury to the overall economy. . . . This uncertainty will require higher interest rates and larger downpayments [sic] to offset the new risk and will push many lenders out of making certain mortgages."), *with* Levitin & Goodman, *supra* note 17, at 41 ("There is no empirical evidence that supports a conclusion that permitting either strip-down or other forms of modification of principal home mortgage loans in bankruptcy would have more than a minor impact on mortgage interest rates or on home ownership rates.").

131. *See* Les Christie, *Foreclosure Prevention Plan Under Attack*, CNNMoney.com, Feb. 22, 2008, http://money.cnn.com/2008/02/21/real_estate/cram_downs_coming/index.htm(describing opponents' concern that interest rates will have to rise to attract investors).

132. Winn, *supra* note 111, at 578 (describing lenders' concern that lien stripping will force future home buyers to subsidize existing homeowners); Letter from Robert L. Clarke, Comptroller of the Currency, 1985 to 1993, Wil-

stituting cram-down may thwart the federal policy of promoting and sustaining homeownership.[133] Although the legitimacy of this policy is beyond the scope of this Note, it has become the subject of renewed debate amid the housing market failure.

In response, consumer groups point out that mortgage bankers have not proffered evidence that implementing cram-down will affect interest rates or the number of bankruptcies.[134] A recent study suggests that cram-down will only negligibly affect the credit supply.[135] Moreover, mortgage credit is still available for vacation and second homes, despite the availability of cram-down for these mortgages.[136] Additionally, states with antideficiency laws that have the effect of cramming down mortgages continue to have a high supply of credit.[137] Thus, consumer groups contend that cram-down will not affect interest rates.

liam M. Issac, FDIC Chairman, 1981 to 1985 & Donald E. Powell, FDIC Chairman, 2001 to 2005, to John Conyers, Chairman, H. Comm. on the Judiciary & Lamar Smith, Ranking Member, H. Comm. on the Judiciary (Nov. 6, 2007) (on file with Mortgage Bankers Ass'n) *available at* http://www.mortgagebankers.org/files/stopthebankruptcycramdown/formerregulatorslettertohousejudiciarycommittee.pdf (arguing that cram-down hurts all homeowners, including the "vast majority" who make their payments and never file for bankruptcy).

133. Nobelman v. Am. Sav. Bank, 508 U.S. 324, 332 (1993) (Stevens, J., concurring).

134. *The Looming Foreclosure Crisis: How to Help Families Save Their Homes: Hearing Before the S. Comm. on the Judiciary*, 110th Cong. 196 (2007) (testimony of Henry J. Sommer, President, National Association of Consumer Bankruptcy Attorneys) (arguing that cram-down, as permitted by four circuits prior to the Supreme Court's decision in *Nobelman*, has not affected the price and availability of mortgages over the years). Additionally, Sommer pointed out that opponents' fear of rising interest rates is unfounded because permitting cram-down will have the same economic effect as voluntary modifications, which are already taking place. *Id.* at 197. Lastly, a creditor does not lose more money merely because the debtor has filed for bankruptcy. The loss becomes a reality when the debtor can no longer service the debt. *Id. But see* Press Release, Mortgage Bankers Ass'n, Oppose Cramdown Legislation (Oct. 5, 2007), *available at* http://www.mortgagebankers.org/advocacy/issuepapers/legislativeproposalstoamendthebankruptcycodetomodifyloanterms.htm (emphasizing that cram-down will increase the costs of all mortgages).

135. Levitin & Goodman, *supra* note 17, at 41.

136. *Straightening Out the Mortgage Mess: How Can We Protect Home Ownership and Provide Relief to Consumers in Financial Distress? Hearing Before the Subcomm. on Commercial and Administrative Law of the H. Comm. on the Judiciary*, 110th Cong. 6–7 (2007) (statement of Richard Levin, Vice Chair, Nat'l Bankr. Conference) (contending that despite cram-down and fluctuations in values of secondary homes during a recession, mortgage credit for these properties remains widely available).

137. *Id.* at 7.

C. UNSATISFACTORY PROPOSALS TO THE CRAM-DOWN DEBATE

Proponents of cram-down seek to change the Code, while opponents intend to keep the current law.[138] Both solutions are unsatisfactory because they do not effectively address housing problems.

1. Congress Should Not Retain the Exception in § 1322(b)(2)

Keeping the current law is undesirable.[139] With ten million more homeowners projected to foreclose in the next several years,[140] the prohibition on home mortgage modification can further aggravate the housing market. Home prices have fallen nationwide, and price will probably continue to decline.[141] For the first time since 1945, the average homeowner's equity fell to just above fifty percent at the end of 2007.[142] If left unchecked, declining property values can generate a self-perpetuating cycle of foreclosures.[143] As discussed, foreclosures reduce home values, and declining home values can in turn prevent more families from refinancing and consequently trigger more foreclosures.[144] It is an unrelenting process with the potential to hurt millions of stakeholders.[145]

Although many foreclosures occur outside of bankruptcy, the current law can intensify the aggregate cycle of foreclosures because it prevents bankrupt homeowners from saving other-

138. *See supra* Part II.B.

139. *But see The Looming Foreclosure Crisis: How to Help Families Save Their Homes: Hearing Before the S. Comm. on the Judiciary*, 110th Cong. 13 (2007) (statement of Mark S. Scarberry, Professor of Law, Pepperdine Univ. Sch. of Law).

140. Charles Duhigg, *Lightening Rod Emerges on Foreclosures: A Republican Official Sides with Democrats*, INT'L HERALD TRIB. (Paris), Dec. 11, 2008, at 1.

141. Lawrence Summers, *America Needs A Way to Stem Foreclosures*, FIN. TIMES (London), Feb. 25, 2008, at 9.

142. J.W. Elphinstone, *Losing Their Grip on Homeownership: Declining Values Put Many Who Took Out Home-Equity Loans in a Bind that May Worsen*, WASH. POST, Jan. 19, 2008, at F19.

143. *See* Ben S. Bernanke, Chairman, Fed. Reserve, Speech at the Columbia Business School's 32nd Annual Dinner: Mortgage Delinquencies and Foreclosures (May 5, 2008), *available at* http://www.federalreserve.gov/newsevents/speech/bernanke20080505a.htm (arguing that lenders and borrowers are better off avoiding foreclosures because foreclosures are costly).

144. *See* JOINT ECONOMIC COMMITTEE, 110TH CONG. REPORT ON SHELTERING NEIGHBORHOODS FROM THE SUBPRIME FORECLOSURE STORM 1 (2007) (discussing the costs of foreclosures to families, businesses, city and local governments, and neighboring homeowners).

145. *Id.*

wise salvageable homes.[146] For example, in the debtor's case discussed at the beginning of this Note, but for the exception in § 1322(b)(2), Judge Leonard could restructure the debtor's loan to resemble a conventional mortgage.[147] In fact, the judge conceded that, without the exception, he would have adjusted the interest rate to reflect the prevailing market and reduce payments to mirror the house's actual value.[148] With reduced payments and a steady income, the debtor could have met her debt obligations and kept her home.[149]

Judge Leonard is not the only authority to realize that some foreclosures in bankruptcy are preventable. Federal Reserve Chairman Ben Bernanke also indicated that some foreclosures are preventable and loan servicers can help if they "accept a principal write-down by an amount at least sufficient to allow the borrower to refinance into a new loan from another source."[150] Often, adjusting interest rates for distressed homeowners is inadequate because negative equity prevents them from refinancing.[151] The current law also exposes neighboring families to the risk of losing home equity.[152] One study projects that forty million families will see their home values decline because their neighbors have foreclosed.[153]

The exception to cram-down is particularly unacceptable in the current recession.[154] The U.S. unemployment rate in Octo-

146. *See, e.g.*, CTR. FOR RESPONSIBLE LENDING, SOLUTION TO HOUSING CRISIS REQUIRES ADJUSTING LOANS TO FAIR MARKET VALUE THROUGH COURT-SUPERVISED MODIFICATIONS 2 (2008), *available at* http://www.responsiblelending.org/pdfs/court-supervised-modifications-would-make-large-scale-foreclosure-prevention-possible.pdf (arguing that allowing judges to "modify harmful mortgages" would save the homes of many families).

147. Leonard, *supra* note 1.

148. *Id.*

149. *Id.*

150. CTR. FOR RESPONSIBLE LENDING, *supra* note 146.

151. *Id.*

152. White & Zhu, *supra* note 106.

153. CTR. FOR RESPONSIBLE LENDING, SUBPRIME SPILLOVER: FORECLOSURES COST NEIGHBORS $202 BILLION; 40.6 MILLION HOMES LOST $5,000 ON AVERAGE 1–2 (2008), *available at* http://www.responsiblelending.org/pdfs/subprime-spillover.pdf (listing the three factors affecting the cost to neighbors: the number of projected subprime foreclosures, density of local housing units, and the current value of these units); Posting of Eric Posner to The Volokh Conspiracy, http://volokh.com/posts/1234543266.shtml (Feb. 13, 2009, 11:41 EST) (comparing the negative externalities on third parties to "a kind of pollution").

154. Jon Hilsenrath, Serena Ng & Damian Paletta, *Worst Crisis Since '30s, with No End Yet in Sight*, WALL ST. J., Sept. 18, 2008, at A1 ("This has been the worst financial crisis since the Great Depression. There is no question

ber 2008 soared to the highest level in fourteen years, and more than 1.2 million Americans lost their jobs.[155] More Americans are in debt, and Americans on average carry more debt.[156] Many debtors simply cannot service their debts.[157] Without access to judicial modification of their mortgages, many families in bankruptcy cannot keep up their payments. Since Chapter 13 requires full payment on home mortgages,[158] more homeowners will likely fail their bankruptcy plans and foreclose.[159] Thus, the exception to cram-down can exacerbate housing problems.

Ironically, the law as it stands obliterates families' chances of getting a fresh start—the underlying policy of bankruptcy law.[160] For many debtors who lost both jobs and homes in the recession, starting anew is a grim prospect. The moral hazard and windfall[161] that creditors fear are perhaps less ominous in an economic downturn. Struggling to keep their jobs or stay in

about it." (quoting a New York University economist who worked with Ben Bernanke, Chairman, Fed. Reserve)).

155. Peter S. Goodman, *U.S. Jobless Rate Hits 14-Year High*, N.Y. TIMES, Nov. 8, 2008, at A1 (predicting that the economy will lose several hundred thousand jobs per month going forward, making the unemployment rate close to eight percent, a level that the United States has not seen for a quarter century).

156. *See* Robert M. Lawless et al., *Did Bankruptcy Reform Fail? An Empirical Study of Consumer Debtors*, 82 AM. BANKR. L.J. 349, 373 (arguing that families filing for bankruptcy today are worse off than families who filed in the past because mortgages and total debt loads are higher now and the median net worth per family is lower).

157. *See id.* at 369 (explaining that even though both of debtors' assets and debts are rising, debts are outpacing assets).

158. 11 U.S.C. § 1322 (b)(2) (2006).

159. Experts predict that the United States is currently at the "tip of the iceberg" for subprime foreclosures. *See Mortgage Market Turmoil: Causes and Consequences: Hearing Before the S. Comm. on Banking, Hous., and Urban Affairs*, 110th Cong. 6 (2007) (statement of Sandra Thompson, Dir., Div. of Supervision and Consumer Protection, Fed. Deposit Ins. Corp.); *see* Gene Sperling, *Subprime Market—Isolated or a Tipping Point?*, BLOOMBERG NEWS, March 14, 2007, http://www.bloomberg.com/apps/news?pid=20601039&sid=a2mHr9ol.GUs&refer=columnist_sperling (contemplating whether subprime woes are isolated or part of a broader fallout). The Center for Responsible Lending predicts that the United States will enter "the worst foreclosure experience ever in the modern mortgage market . . . ." ELLEN SCHLOEMER ET AL., LOSING GROUND: FORECLOSURES IN THE SUBPRIME MARKET AND THEIR COST TO HOMEOWNERS 3 (2006), *available at* http://www.responsiblelending.org/pdfs/FC-paper-12-19-new-cover-1.pdf.

160. *See* 151 CONG. REC. H1975 (daily ed. Apr. 14, 2005) (statement of Rep. Stark) ("Bankruptcy has always been about giving a fresh start to those who have fallen on hard times.").

161. Zywicki, *supra* note 103.

business,[162] the debtors who file for bankruptcy today are more likely to be honest homeowners rather than opportunistic planners. Part III will discuss various mechanisms to facilitate cram-down without "unleash[ing] a torrent of bankruptcies."[163]

Moreover, because bankruptcy does not provide adequate relief under the current Code, the federal government has sunk billions of taxpayer dollars in numerous programs to prevent foreclosures.[164] For example, through the Foreclosure Prevention Act of 2008, the federal government plans to inject nearly four billion dollars in purchasing and rehabilitating foreclosed properties.[165] Also, in a historic move, the Treasury pledged to buy up mortgages and mortgage-backed securities to restructure loans.[166] Section 1322(b)(2)'s exception can burden taxpayers as long as the federal government continues to expend taxpayer dollars to ease the tide of foreclosures,[167] both within and outside of bankruptcy.

In contrast, if bankruptcy can sufficiently assist families who file and qualify for Chapter 13, then Congress can shift its spending to preventing foreclosures outside of bankruptcy. As discussed, cram-down provides adequate relief in bankruptcy because many families could continue making mortgage payments if bankruptcy judges modify their loans.[168] A study projects that cram-down will help at least 600,000 families save their homes in Chapter 13.[169] This relief will allow Congress to

162. *See, e.g.*, Kate Fazzini, *Slowing Economy Reflected in Rise of Corporate, Personal Bankruptcies*, N.Y.L.J., Dec. 26, 2008, at col. 3 (showing that a tighter credit market is forcing more consumers and businesses into bankruptcy).

163. Zywicki, *supra* note 103 (fearing that allowing mortgage modification would unleash "a torrent of bankruptcies").

164. David Goldman, *Your $3 Trillion Bailout: Washington Is Waging War on the Financial Crisis. Mr. Obama: You Have to See It Through*, CNNMONEY.COM, Nov. 5, 2008, http://money.cnn.com/2008/11/05/news/economy/three_trillion_dollar_bailout/ (listing sixteen categories of action Barack Obama will have to take in office).

165. Foreclosure Prevention Act of 2008, Pub. L. No. 110-289, 122 Stat. 2830 (providing emergency assistance to all states and directly to more than 250 hard hit cities and counties to resell, redevelop, and rehabilitate homes).

166. Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, 122 Stat. 3765 (colloquially referred to as the "bailout").

167. *See* Jon Ward, *Obama Nixes New Deal*, WASH. TIMES, Nov. 17, 2008, at A5 (describing Barack Obama's promise to increase spending and assist homeowners).

168. CTR. FOR RESPONSIBLE LENDING, *supra* note 146.

169. CTR. FOR RESPONSIBLE LENDING, PERMITTING JUDICIAL MODIFICATION OF HOME LOANS WOULD SAVE 600,000 HOMES—PURCHASE OF SECURI-

limit its spending to rescuing foreclosing homeowners who do not qualify for Chapter 13.[170] It will also ease the burden on taxpayers.

2. Cramming Down All Undersecured Mortgages Is Too Risky

Cramming down all undersecured mortgages is one solution to the current housing debacle. It would allow homeowners to continue paying and retain their homes, but this solution[171] is equally unsatisfactory. Home mortgages are different from mortgages on second and vacation homes, car loans, and loans on other personal assets subject to cram-down[172] because home mortgages underlie a deep-rooted federal policy: homeownership.[173] In the debate over cram-down, mortgage bankers voice a legitimate concern that the current law enables creditors to

TIES WILL NOT SAVE ANY 1 (2008), *available at* http://www.responsiblelending.org/pdfs/crl-judicial-mod-of-home-mortgages-brf.pdf (arguing that spending billions of dollars buying illiquid mortgage-related assets will not help homeowners). *But see Helping Homeowners: Before the Subcomm. on Fin. Serv. and Gen. Gov't of the S. Comm. on Appropriations*, 110th Cong. (2008) (statement of Bruce Gottschall, Executive Dir., Neighborhood Hous. Servs. of Chicago) (reporting that fifty percent of homeowners receiving loan modifications redefault within several months but conceding that good loan modifications can "go to great lengths to stem the tide of foreclosures"); John Poirier & Karey Wutkowski, *Regulators Scratch Their Heads Over Housing Crisis*, REUTERS, Dec. 8, 2008, http://www.reuters.com/article/domesticnews/idusn0847256620081208 (noting that despite redefaults on loan modification, rate reduction and extending loan life have helped many save their homes).

170. *See, e.g.*, *60 Minutes: Obama on Economic Crisis, Transition* (CBS television broadcast Nov. 16, 2008) (pledging to do "whatever it takes" to fix the economy, including setting up a clear, focused program for homeowners if such a program does not exist by the time he takes office).

171. This is the solution proposed by Professor Adam J. Levitin. *See* Adam Levitin, *Resolving the Foreclosure Crisis: Modification of Mortgages in Bankruptcy*, WIS. L. REV. (forthcoming 2009), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1071931.

172. *See* 11 U.S.C. § 1322(b)(2) (2006).

173. Nobelman v. Am. Savings Bank, 508 U.S. 324, 332 (1993) (Stevens, J., concurring) (explaining that although the cram-down rule may appear strange at first, it is sensible in light of Congress's intent to inject capital into the home-lending market); 153 CONG. REC. H13,964-01 (daily ed. Nov. 15, 2007) (statement of Rep. Altmire) ("[E]very American deserves the opportunity to achieve the American Dream of homeownership."); Joseph A. Snoe, *My Home, My Debt: Remodeling the Home Mortgage Interest Deduction*, 80 KY. L.J. 431, 451 (1991) (describing how the federal government has historically implemented policies to increase the flow of capital into the housing market and reduce the cost of homeownership); Gordon H. Sellon, Jr., *The Role of Government in Promoting Homeownership: The U.S. Experience*, 75 ECON. REV. 37, 40–41 (1990) (discussing how the government has used taxes to promote homeownership).

offer lower interest rates and consequently encourage homeownership.[174] Although higher interest rates and more expensive credit can stifle the rise in home prices and help keep housing affordable, the federal government has historically enhanced affordability by lowering interest rates.[175] Assuming the legitimacy of this federal policy, cramming down all undersecured mortgages is too risky because it remains uncertain whether interest rates will rise.[176] Studies that predict cram-down will negligibly affect interest rates[177] confine to specific geographic regions and do not forecast the results of a national cram-down.[178]

Although the national effect may remain equally negligible, the converse may be true. Analogous research shows that creditor entitlements under state law, such as creditors' rights to pursue deficiencies in foreclosure sales, affect interest rates.[179] For example, a study reveals that tedious foreclosure procedures caused interest rates to rise.[180] Because the exception to cram-down is a form of creditor protection, a corollary to these studies is that cram-down can increase the cost of lending. If so, creditors will likely shift some of the increased costs to debtors in the form of more expensive credit. In essence, because creditors had previously increased the price of credit to

174. *Compare* Press Release, Mortgage Bankers Ass'n, MBA's Kittle Challenges Bankruptcy Myths at Hearing (Jan. 29, 2008), *available at* http://www.mbaa.org/NewsandMedia/PressCenter/59656.htm (arguing that rates will certainly rise and that the prohibition on modification of home mortgages is not a loophole but a deliberate congressional attempt to increase the flow of capital to homebuyers), *with* PATRICK LEAHY, HELPING FAMILIES SAVE THEIR HOMES IN BANKRUPTCY ACT OF 2008, S. REP. NO. 110-514, at 6 (2008) (arguing that opponents have not produced credible evidence to support the claim that cram-down would raise the cost of mortgages by 1.5 to 2 percentage points).

175. Snoe, *supra* note 173, at 451.

176. *See supra* note 167 and accompanying text.

177. *See, e.g.*, Levitin & Goodman, *supra* note 17, at 40–41 (hypothesizing that an unlimited strip-down regime will raise interest rates by five to fifteen basis points, but maintaining the possibility that strip-down has no effect at all).

178. *See id.* at 32 (limiting research results to "Chapter 13 cases filed in the Riverside office of the Bankruptcy Court for the Southern District of California in the last [several] months of 2007").

179. *See* Terrence M. Clauretie & Thomas Herzog, *The Effect of State Foreclosure Laws on Loan Losses: Evidence from the Mortgage Insurance Industry*, 22 J. MONEY, CREDIT & BANKING 221, 231 (1990) ("[S]tate foreclosure laws affect the risk of residential mortgage lending. . . . [B]orrowers in states with onerous foreclosure laws could expect to bear the cost of the risk.").

180. Mark Meador, *The Effects of Mortgage Laws on Home Mortgage Rates*, 34 J. ECON. & BUS. 143, 147 (1982).

cope with onerous mortgage laws,[181] they will probably respond similarly if Congress decides to provide cram-down generously.

Although Congress should pass cram-down to stabilize home values and keep bankrupt debtors in their homes, it must not sacrifice the goal of affordable housing. Opponents of cram-down correctly warn that indiscriminately cramming down all undersecured mortgages may generate a myriad of unintended consequences[182] and disrupt the federal homeownership agenda.[183] Congress must strike a balance between stabilizing home prices and enhancing affordability by allowing modification, but only after carefully conditioning its use. It must also act immediately to accomplish these goals.

D. PROPOSED CRAM-DOWN BILLS

Proponents attempted to eliminate the exception in § 1322(b)(2) as recently as January 2009.[184] The two bills introduced in the 111th Congress are the Helping Families Save Their Homes in Bankruptcy Act of 2009[185] and the Emergency Homeownership and Equity Protection Act of 2009.[186] In the 110th Congress, proponents generated several bills that varied considerably in content, but none succeeded in becoming law.[187] Although all cram-down bills provide some judicial modification of home mortgages as a baseline,[188] they differ in the amount of judicial discretion and eligibility requirements.[189] Despite

181. *Id.*

182. *See* Zywicki, *supra* note 103 ("[Allowing mortgage modification] will open the door to a host of unintended consequences . . . .").

183. *See Developments in Banking Law: 1991*, 11 ANN. REV. BANKING L. 1, 170 (1992) (discussing the U.S. Department of Housing and Urban Development's (HUD) opposition to cram-down); HUD's Mission, http://www.hud.gov/library/bookshelf12/hudmission.cfm (last visited Apr. 26, 2009) ("HUD's mission is to increase homeownership, support community development, and increase access to affordable housing free from discrimination.").

184. Helping Families Save Their Homes in Bankruptcy Act of 2009, H.R. 200, 111th Cong. § 4 (2009); Emergency Homeownership and Equity Protection Act, H.R. 225, 111th Cong. § 3 (2009).

185. H.R. 200.

186. H.R. 225.

187. *E.g.*, Homeowners' Protection Act of 2008, H.R. 7328, 110th Cong. (2008); Helping Families Save Their Homes in Bankruptcy Act of 2008, S. 2136, 110th Cong. (2008); Foreclosure Prevention Act of 2008, S. 2636, 110th Cong. (2008); Emergency Home Ownership and Mortgage Equity Protection Act of 2007, H.R. 3609, 110th Cong. (2007).

188. *E.g.*, H.R. 7328; S. 2136; S. 2636; H.R. 3609.

189. For example, the Home Owners' Mortgage and Equity Savings (HOMES) Act was the most restrictive of the bills on cram-down because it

laudable efforts to eliminate the exception to cram-down, proponents have only drafted piecemeal legislation, including the two pending bills,[190] that fail to account for both short- and long-term consequences of cram-down. If proponents do not pursue a more holistic approach, the bills are unlikely to create a sustainable bankruptcy system.

Very similar in content,[191] the pending bills are insufficient for two reasons: first, they only apply to homeowners who received foreclosure notices,[192] and second, the bills do not include sunset provisions.[193] These features make the bills both overincluisve and underinclusive. Restricting eligibility to those who received foreclosure warnings sets up a technical roadblock, excluding distressed homeowners otherwise eligible for relief. For some homeowners, the restriction can also reduce the effectiveness of modification because it forces them to wait until a foreclosure is imminent to seek relief, at which point circumstances may have already become so dire that a foreclosure is inevitable. Part III will address ways to prevent cram-down abuses without setting up a procedural barrier.

The bills are also shortsighted because they do not sunset. Without sunset provisions, the bills fail to account for long-term, unforeseeable consequences of cram-down,[194] which may include negative effects on interest rates, homeownership, and other types of consumer credit.[195] Although cram-down is crucial in the current recession, Congress must delicately condition its use once the market rebounds in order to minimize these consequences. Like farm-focused Chapter 12 bankruptcy[196] at its inception,[197] cram-down legislation designed to address a specific economic crisis should be interim. A sunset provision will allow Congress to fine tune cram-down legislation in the future and provide creditors with an additional layer of protection. In sum, the pending bills are insufficient because they

requires a creditor's consent in writing before a judge can modify a loan. S. 2133, 110th Cong. § 2 (2007).

190. H.R. 200; H.R. 225.

191. H.R. 200; H.R. 225.

192. H.R. 200, § 4; H.R. 225, § 3.

193. *See* H.R. 200; H.R. 225.

194. *See* Zywicki, *supra* note 103.

195. *See id.* (fearing the spread of "the mortgage contagion to other types of consumer credit").

196. 11 U.S.C. §§ 1201−1231 (2006).

197. 151 CONG. REC. S2470 (daily ed. Mar. 10, 2005) (statement of Sen. Nelson) (discussing the permanent extension of Chapter 12 bankruptcy).

set up a barrier to immediate relief and fail to provide for the long run.

Proponents also failed to propose balanced strategies in the previous congressional session.[198] The bills defeated in the 110th Congress[199] were equally insufficient. For example, the Home Owners' Mortgage and Equity Savings (HOMES) Act[200] was the most restrictive of the bills on cram-down and would have had the least effect on home mortgage modification. Under the bill, in order to seek relief, a debtor must obtain consent in writing from his creditor.[201] This requirement would have blocked many debtors from relief altogether because creditors, out of fear of investor lawsuits and multiple other considerations,[202] generally oppose mortgage modification. Although the bill incorporated a sunset provision,[203] the consent requirement rendered the legislation toothless. The history of defective cram-down proposals is proof that Congress needs a new strategy.

III. CRAM-DOWN LEGISLATION: TEMPORARY RELIEF BASED ON THE MEANS TEST OF THE 2005 AMENDMENTS, FOLLOWED BY A PERMANENT SYSTEM BASED ON JUDICIAL DISCRETION

Prohibiting cram-down could intensify the housing crisis, but allowing overly generous cram-down could raise interest rates and thwart homeownership. In spite of the dilemma, Congress must act. Congress should adopt a unique two-part legislation that helps Chapter 13 debtors weather the recession while creating a sustainable bankruptcy system. First, to resolve the housing market failure, Congress should temporarily impose cram-down based on the means test of the 2005 Amendments.[204] To account for uncertainties with regard to in-

198. *See* Homeowners' Protection Act of 2008, H.R. 7328, 110th Cong. (2008); Helping Families Save Their Homes in Bankruptcy Act of 2008, S. 2136, 110th Cong. (2008); Foreclosure Prevention Act of 2008, S. 2636, 110th Cong. (2008); Emergency Home Ownership and Mortgage Equity Protection Act of 2007, H.R. 3609, 110th Cong. (2007).

199. *E.g.*, S. 2136, 110th Cong. (2008); S. 2636, 110th Cong. (2008); H.R. 3609, 110th Cong. (2007); H.R. 7328, 110th Cong. (2008).

200. HOMES Act, S. 2133, 110th Cong. (2007).

201. *Id.* § 2.

202. S. REP. NO. 110-514, at 3 (2008) (discussing the obstacles to voluntary loan modifications).

203. S. 2133, § 6.

204. *See supra* notes 57–67 and accompanying text.

terest rates and homeownership, Congress should then sunset this measure and replace it with a permanent system. The initial cram-down will serve as a transitory measure, providing relief quickly and effectively to distressed homeowners who qualify for Chapter 13 protection. The means test will serve as a formulaic determination to sort out the neediest debtors, particularly victims of predatory lending. The permanent system should differ in that it will rely on judicial discretion, instead of the means test, to fulfill jurisdictional Chapter 13 needs and fine tune cram-down. A carefully crafted two-part system can generate sustainable mortgages without sacrificing the credit supply and homeownership.

A. TEMPORARY RELIEF MEASURE TO QUICKLY ASSIST HOMEOWNERS IN CHAPTER 13

To provide urgent relief to distressed Chapter 13 homeowners, Congress should pass a bill similar to, but distinct from, a bill proposed in 2007.[205] It should apply cram-down to nontraditional and subprime mortgages[206] incurred between January 1, 2000, and the effective date of the bill and use a means test to determine eligibility. Specifically, only homeowners unable to cure their defaults can petition for relief, and those petitioning must pass the means test of the 2005 Amendments. A debtor will qualify if, after deducting reasonable living expenses allowed under § 1325(b)(3) from the debtor's current monthly income, the debtor lacks sufficient income to cure his default and continue making payments.[207] The legislation should sunset, like the Home Owners' Mortgage and Equity Savings of 2007, applying only to cases filed within seven years after its enactment.[208] Legislation with these provisions can provide immediate relief to debtors while minimizing costs to creditors.

205. Emergency Home Ownership and Mortgage Equity Protection Act of 2007, H.R. 3609, 110th Cong. § 4 (2007).

206. As defined in the Helping Families Save Their Homes in Bankruptcy Act of 2008, nontraditional mortgages are loans with periodic payments that do not cover the interest due or cover only the interest, and subprime mortgages are loans with interest rates higher than the rates of U.S. Treasury securities with similar periods of maturity. Helping Families Save Their Homes in Bankruptcy Act of 2008, S. 2136, 110th Cong. § 101 (2007).

207. 11 U.S.C. 1325(b)(3) (2006) (referring to expenses allowed under §§ 707(b)(2)(A) and (B)).

208. HOMES Act, S. 2133, 110th Cong. § 6 (2007).

1. Responding to the Recession

To provide adequate relief and curtail the wave of foreclosures, Congress must eliminate the exception in § 1322(b)(2) quickly. As previously mentioned, economists project that ten million more homeowners will foreclose in the next several years.[209] With the unemployment rate soaring to the highest level in fourteen years,[210] families are struggling to service their debts, and more families are turning to bankruptcy for protection.[211] In October 2008 alone, bankruptcy filings averaged 4,936 each business day, up nearly thirty-four percent from a year prior.[212]

Consequently, Congress needs a drastic measure to ensure the success of these bankruptcies. Just as it had modified the Bankruptcy Code in the early 1980s to instantly respond to adverse economic developments,[213] it should modify the Code now to address a new crisis. The current housing crisis is similar to the predicament affecting American farmers in the 1980s,[214] during which many farmers could not service their mortgages because of plummeting farmland value.[215] Immediately, in 1986, Congress created Chapter 12 to serve farmers' unique needs.[216] The new chapter delivered the needed relief to farmers,[217] many of whom could not qualify for existing chapters.[218] Originally a temporary chapter, Chapter 12 ultimately

209. Duhigg, *supra* note 13.

210. Goodman, *supra* note 155 (referencing October 2008 statistics).

211. Tara Siegel Bernard & Jenny Anderson, *Bankruptcies by Consumers Climb Sharply*, N.Y. TIMES, Nov. 16, 2008 ("The number of personal bankruptcy filings jumped nearly eight percent in October from September, after marching steadily upward for the last two years . . . .").

212. *Id.*

213. H.R. REP. NO. 108-804, at 34–35 (2005).

214. *See id.* at 35.

215. WARREN & WESTBROOK, *supra* note 28, at 338.

216. 11 U.S.C. §§ 1201−1231 (2006) (applying to farmers and fishermen).

217. H.R. REP. NO. 108-804, at 34 ("The special attributes of chapter 12 make it better suited to meet the particularized needs of family farmers in financial distress than other forms of bankruptcy relief, such as chapter 11 (business organization) and chapter 13 (individual reorganization)."); 149 CONG. REC. S1,6063-04 (daily ed. Nov. 25, 2003) (statement of Sen. Leahy) ("Everyone agrees that Chapter 12 has worked."); 149 CONG. REC. E2366-04 (daily ed. Nov. 20, 2003) (statement of Rep. Baldwin) ("There is great consensus that Chapter 12 bankruptcy protection works well.").

218. Many famers could not meet the debt load requirements in Chapter 13. 11 U.S.C. § 109(e) (2006) (providing a debt ceiling for filing under Chapter 13). They also could not fit comfortably in Chapter 11, designed for businesses with more regular cash flow. *Id.* § 1101.

became a permanent feature of the Bankruptcy Code because of its success.[219] In the wake of the crumbling housing market, Congress should similarly amend the Code to meet the needs of distressed homeowners who qualify for Chapter 13. To protect creditors, nevertheless, Congress should resort to the means test to determine eligibility.

2. Using the Means Test to Determine Eligibility

Congress should require debtors to pass the means test, thus ensuring that only truly distressed homeowners have access to relief. After all, the goal of the 2005 Amendments was to combat abuse and fraud.[220] Designed to restrict bankruptcy to honest debtors, the means test of the 2005 Amendments also classifies debtors for different treatment in bankruptcy.[221] In Chapter 13, the means test compels debtors with surpluses of income over living expenses to pay unsecured creditors over the life of the plan.[222] The policy argument is that debtors who can pay, *should* pay. Similarly, using the means test to determine cram-down eligibility will assure that debtors entitled to relief are debtors who cannot pay. This consistent treatment in cram-down will preserve the spirit of the 2005 Amendments. Equally important, implementing this limitation can help minimize any disruption to the mortgage market.[223]

Accordingly, under the means test, debtors who have insufficient monthly income to make mortgage payments, after deductions for reasonable living expenses set by IRS guidelines,[224] can petition for mortgage modification. Because in many Chapter 13 cases the debtor must use the means test to determine, if any, the amount of payments owed to unsecured creditors over the life of the plan,[225] the debtor should have ready access to re-

219. 151 CONG. REC. S2470 (daily ed. Mar. 10, 2005) (statement of Sen. Nelson) (describing the permanent extension of Chapter 12 bankruptcy as an "important safeguard" for American farmers).

220. *Id.* ("[T]hose trying to shield their assets . . . will find it much more difficult to abuse the system . . . .").

221. 11 U.S.C. § 1325(b)(2)–(3).

222. *Id.*

223. *See* Posting of Eric Posner to The Volokh Conspiracy, *supra* note 153.

224. 11 U.S.C. § 1325(b)(2)(A)(i) (defining living expenses as "amounts reasonably necessary to be expended—for the maintenance or support of the debtor or a dependent of the debtor, or for a domestic support obligation").

225. *Id.* § 1325(b)(1)(B) (2000) ("[T]he plan provides that all of the debtor's projected disposable income to be received in the applicable commitment period . . . will be applied to make payments to unsecured creditors under the plan."); *id.* § 1325(b)(2) (defining disposable income).

levant data. Since the means test uses of fixed calculations,[226] with due diligence, qualified homeowners should be able to obtain relief quickly.[227] The means test is also useful in capturing holders of abusive loans, since these loans typically come with excessively high, unaffordable payments.[228]

3. Targeting Nontraditional and Subprime Loans

To further protect creditors while giving much needed relief to debtors, Congress should narrow the legislation to nontraditional or subprime loans, many of which have abusive terms.[229] A qualified debtor should have the power to prohibit adjustments to an adjustable-rate mortgage, convert such a mortgage into a fixed rate loan, or reduce the rate on a subprime loan.[230] Targeting holders of nontraditional or subprime loans will likely capture the many victims of predatory lending.[231] From a policy standpoint, cram-down is sensible in light of the history of deplorable lending practices that unfolded within the last two decades.[232] Aggressive lenders cajoled borrowers to take out loans with outlandish terms.[233] Had they taken out traditional loans for which they qualified, many fami-

226. *Id.* § 1325(b)(1)–(2).

227. *Compare* 151 CONG. REC. S1779 (daily ed. Feb. 28, 2005) (statement of Sen. Specter) (applauding the means test for requiring high-income debtors to repay their debts while providing relief to low-income debtors), *with* Lawless et al., *supra* note 156, at 359 (criticizing the means test for failing to push "high-income, can-pay debtors" out of bankruptcy).

228. *See* H.R. REP. NO. 110-217, at 19 (2007) ("Predatory lending occurs when lenders . . . impose excessive rates and fees, prepayment penalties, and reset terms that can result in exorbitant interest rate increases.").

229. *But see* H.R. REP. NO. 109-589, at 10 (2006) (distinguishing subprime from predatory lending).

230. In *Till v. SCS Credit Corp*., 541 U.S. 465, 479 (2004), the Supreme Court used the prime rate, adjusted to account for risk of nonpayment, when modifying the interest rate on a truck loan.

231. *But see* H.R. REP. NO. 110-217, at 10 (comparing predatory and subprime lending).

232. *See* 153 CONG. REC. H13,965 (daily ed. Nov. 15, 2007) (statement of Rep. David Scott) ("They target the most vulnerable people among us. . . . They take advantage of the significant complexity of the language and the complicated situations that are involved in the mortgage industry, so that many people don't know what they are signing for on the bottom line . . . ."). For a discussion of challenges federal and state agencies face in combating predatory lending, see U. S. GEN. ACCOUNTING OFFICE, CONSUMER PROTECTION: FEDERAL AND STATE AGENCIES FACE CHALLENGES IN COMBATING PREDATORY LENDING 30–35, 59–62 (2004), *available at* http://www.gao.gov/new.items/d04280.pdf.

233. 153 CONG. REC. H13,965 (statement of Rep. David Scott).

lies in default today may not have defaulted.[234] Although Congress is in the midst of reforming consumer mortgage practices,[235] it must provide assistance instantly to these families.

4. Sunsetting the Temporary Relief Measure

Congress should sunset the relief measure, applying cram-down based on the means test only to cases filed within seven years after the bill's enactment.[236] The needs of the economy seven years from now will differ from those today,[237] and a relief measure enacted to address particular problems of a particular recession is unsuitable for the market once it recovers. For example, with lending reform in progress to reduce the number of abusive loans,[238] it is unlikely that Congress will have to rescue subprime borrowers in the future. Furthermore, although the means test can provide relief quickly to homeowners today,[239] the test is unfitting in the long run, when Congress may have different objectives for cram-down. Accordingly, Congress should sunset the relief legislation. To create a sustainable bankruptcy system, nevertheless, Congress must institute a permanent home mortgage modification system.

B. SUSTAINABLE SYSTEM BASED ON JUDICIAL DISCRETION TO SERVE LOCAL CHAPTER 13 NEEDS

Congress should retain cram-down in order to reduce the likelihood of another foreclosure crisis. Permanently incorporating cram-down into the Code will also reinforce the concept of a fresh start and equality in bankruptcy. By letting debtors keep their homes, Congress can accentuate the importance of

234. *See* CTR. FOR RESPONSIBLE LENDING, *supra* note 146, at 1.

235. *See* Mortgage Reform and Anti-Predatory Lending Act of 2007, H.R. 3915, 110th Cong. (2007).

236. *See* HOMES Act, S. 2133, 110th Cong. § 6 (2007).

237. *See* Anthony Karydakis, *How Long Will the Recession Last?*, CNNMONEY.COM, Dec. 3, 2008, http://money.cnn.com/2008/12/03/news/economy/karydakis.recession.fortune/; *How Long Will the Recession Last?* (WJS.com video Nov. 21, 2008), *available at* http://online.wsj.com/video/how-long-of-a-recession-is-it/A09B7F49-6151-4245-9BEF-92DFD9E61499.html (estimating that the recession will last sixteen months).

238. *See* H.R. 3915 (proposing the imposition of a federal duty of care on brokers, liability to secondary market securitizers, and minimal standards for all mortgages).

239. Not everyone endorses the means test, however. For general criticisms of the means test, see Lawless et al., *supra* note 156.

giving "honest but unfortunate debtor[s]"[240] a second chance in their lives' endeavors.

To limit the effects on interest rates, however, Congress should enact guidelines to ensure that judges cram down sparingly and treat modification as a last resort. Such guidelines should require parties to negotiate realistically and in good faith before a debtor can seek relief. In cramming down, judges should take into account jurisdictional Chapter 13 needs and practices. Because bankruptcy needs vary temporally and geographically,[241] introducing some flexibility into the system will allow judges to better serve local debtors and creditors while screening out neighborhood abuses. Since judicial discretion should align with local practices, the new system will retain elements of predictability and stability.

Accordingly, if a debtor can only keep up his mortgage payments after cram-down, then a judge should modify his loan to avoid a foreclosure. To change the text of § 1322(b)(2), Congress should strike out the prepositional phrase "other than" and replace it with "including." Congress should also insert the phrase "in a manner consistent with jurisdictional Chapter 13 practices and not inconsistent with this title." The altered text of § 1322(b)(2) should read as follows:

> [T]he plan may modify the rights of holders of secured claims, *including* ~~other than~~ a claim secured only by a security interest in real property that is the debtor's principal residence, *in a manner consistent with jurisdictional Chapter 13 practices and not inconsistent with this title*, or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims.

This altered language will preserve cram-down and give judges leeway to modify mortgages.

1. Requiring Parties to Negotiate

The parties must negotiate before a debtor can request cram-down. This requirement will ensure that parties have seriously contemplated alternatives before judges proceed to modify the loan. It will force unwilling creditors to the negotiation

240. 150 CONG. REC. E84-01 (2004) (daily ed. Jan. 30, 2004) (statement of Hon. Maloney).

241. *See, e.g.*, Gordon Bermant & Ed Flynn, *Measuring Projected Performance in Chapter 13: Comparisons Across the States*, 19 AM. BANKR. INST. J. 22, 35 (2000); Scott F. Norberg, *Consumer Bankruptcy's New Clothes: An Empirical Study of Discharge and Debt Collection in Chapter 13*, 7 AM. BANKR. INST. L. REV. 415, 419 ("Consumer bankruptcy practices vary among judicial districts . . . .").

table, and the prospect of cram-down should give debtors the leverage they otherwise lack.[242] Under current law, few voluntary negotiations are taking place because, among other considerations, creditors fear investor suits or have signed mortgage pooling agreements prohibiting modifications.[243] Under the new system, the threat of cram-down should force recalcitrant creditors to cooperate with distressed debtors to fashion a compromise.

In addition, the new law should carefully safeguard creditors' interests. Because bankruptcy judges should cram down sparingly, the new law will incentivize debtors to agree to reasonable mortgage reductions emerging from negotiations. Negotiations will likely generate a continuum of values. A debtor will push for a reduction closest to the cram-down value, and a creditor will push for a reduction that essentially leaves the mortgage unmodified. As long as the agreement falls comfortably on the continuum, a bankruptcy judge should refrain from cramming down.

To ensure the effectiveness of the negotiations, the new law should require parties to submit negotiation records and proof that they have bargained in good faith. It should also impose time restraints and penalties to prevent creditors from engaging in dilatory practices.

2. Catering to Jurisdictional Chapter 13 Practices and Needs

Introducing some flexibility into the cram-down regime is desirable because Chapter 13 practices vary enormously across states.[244] For example, the Executive Office for U.S. Trustees shows that the success rate of Chapter 13 plans is forty-seven percent in West Virginia but only eleven percent in Florida.[245] Also, the number of Chapter 13 filings averaged 36,765 in

242. *See Second Anniversary of the Enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005: Are Consumers Really Being Protected: Hearing Before the Subcomm. on Commercial and Administrative. Law of the H. Comm. on the Judiciary*, 110th Cong. 19–20 (2007) (statement of Henry J. Sommer, President, Nat'l Ass'n of Consumer Bankr. Attorneys) (describing the endless phone chains, constant changes in representatives, and enormous paperwork that housing counselors and attorneys must go through when negotiating with creditors).

243. S. REP. NO. 110-514, at 3 (2008) (discussing the numerous obstacles to voluntary loan modifications). Even with voluntary modifications that are taking place, reductions are typically too minor to make a difference. *Id.*

244. Bermant & Flynn, *supra* note 241, at 22–35 (2000).

245. *Id.* at 35.

Georgia but only 110 in South Dakota.[246] The per-case yields to creditors also vary enormously: $12,010 in Michigan but a meager $4,080 in New Jersey.[247] The numbers probably reflect, among other explanations, differences in local features such as socioeconomic conditions and available exemptions.[248] A study suggests that local legal culture also has a significant effect on consumer bankruptcy decisions.[249] For example, prevalent practices of trustees and lawyers affect debtors' chapter choices in bankruptcy.[250] Because some or all of these factors probably affect debtors' incentive to seek cram-down, giving judges some room to consider local trends may help them serve jurisdictional Chapter 13 needs more effectively. It may also enable them to screen out local bankruptcy abuses more efficiently. Since cram-down should align with jurisdictional practices and judges can consider it only after the parties have negotiated, the cram-down question will be an objective inquiry, one that affords stability and predictability to protect creditors.

In cramming down, judges should look to the jurisdictional success rate of Chapter 13 plans, the success rate of crammed-down plans, the prevalence of bankruptcy abuses, fluctuations of real estate values, conditions of the financial markets, and the history of predatory lending. This inquiry should resemble that of the Supreme Court in *Till v. SCS Credit Corporation*.[251] In determining the interest rate for a crammed-down loan for a car, the Court in *Till* considered the state of financial markets, circumstances of the bankruptcy estate, and characteristics of the loan.[252] The inquiry was objective,[253] and it required the Court to adjust the rate accordingly to reflect the risk of nonpayment of the bankrupt debtor.[254] Similarly, in cramming

246. *Id.* at 34.

247. *Id.*

248. *Cf.* 142 CONG. REC. S5246 (daily ed. May 17, 1996) (statement of Sen. Byrd) (describing the "mansion loophole" which enables an opportunistic debtor to buy a house in a state with a generous homestead exemption and declare bankruptcy after to avoid payments).

249. Jean Braucher, *Lawyers and Consumer Bankruptcy: One Code, Many Cultures*, 67 AM. BANKR. L.J. 501, 503 (1993) (suggesting that local legal culture has more effect on chapter choices than features typically considered important in consumer bankruptcy decisions, such as the discharge in Chapter 13).

250. *Id.*

251. 541 U.S. 465, 479 (2004).

252. *Id.*

253. *Id.* (mandating "a straightforward, familiar, and objective inquiry").

254. *Id.*

down, bankruptcy judges should adhere to an objective standard to meet the needs of local debtors and creditors.

CONCLUSION

In implementing loan modification for Chapter 13 debtors, Congress created an exception. It prohibited modification of mortgages secured solely by a debtor's primary residence. Against the backdrop of a recession that may worsen, the current law failed to save millions of homeowners from foreclosing. Although keeping the current law is unacceptable, cramming down all undersecured mortgages is too risky because it can reduce borrowers' access to credit and obstruct homeownership. Accordingly, Congress needs a unique two-part strategy that can adequately relieve distressed Chapter 13 debtors while creating a sustainable bankruptcy system.

Congress should pass a temporary cram-down relief measure based on the means test of the 2005 Amendments, and afterward implement a permanent system that entrusts bankruptcy judges with discretion to modify loans in a manner consistent with jurisdictional Chapter 13 needs and practices. Based on the established means test of the 2005 Amendments, the temporary measure should provide relief quickly to distressed Chapter 13 homeowners, particularly victims of predatory lending. The relief measure should sunset, however, to account for unforeseeable consequences of cram-down. The permanent system will differ in that, although judges can continue to modify loans, they must treat cram down as a last resort and carefully pursue an objective inquiry. If designed and monitored carefully, cram-down can be a win-win proposition, and the victim-debtor in Judge Leonard's courtroom could receive her much needed relief.