CASE NO 04-4298

IN THE
UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

IN RE: FRANCES SCARBOROUGH
Debtor

FRANCES SCARBOROUGH
Appellant

v.

CHASE MANHATTAN MORTGAGE CORP.,
Appellee.

ON APPEAL FROM THE ORDER OF THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA, DATED OCTOBER 28, 2004
IN CASE NO. 03-228 JK
AFFIRMING
THE ORDER OF THE UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA DATED OCTOBER 14, 2003
IN ADVERSARY NO. 02-858 and BANKRUPTCY NO. 01-35194

BRIEF OF NATIONAL ASSOCIATION OF CONSUMER BANKRUPTCY ATTORNEYS AS AMICUS CURIAE IN SUPPORT OF APPELLANT

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STATEMENT OF INTEREST OF AMICUS CURIAE

Incorporated in 1992, the National Association of Consumer Bankruptcy Attorneys ("NACBA") is a non-profit organization of more than 3,100 consumer bankruptcy attorneys nationwide. Member attorneys and their law firms represent debtors in an estimated 600,000 bankruptcy cases filed each year. Third Circuit NACBA members file thousands of bankruptcy cases per year. NACBA's corporate purposes include education of the bankruptcy bar and the community at large on the uses and misuses of the consumer bankruptcy process. Additionally, NACBA advocates nationally on issues that cannot adequately be addressed by individual member attorneys. NACBA has filed *amicus curiae* briefs in various appellate courts seeking to protect the rights of consumer bankruptcy debtors, including the filing of briefs in cases involving the issues before this court. *See* In re Price, 370 F.3d 362 (3rd Cir. 1994); In re Burr, 160 F.3d 843 (1st Cir. 1998); Capital Comm. Fed. Credit Union v. Boodrow (In re Boodrow), 126 F.3d 43 (2d Cir. 1997), *cert. denied,* 522 U.S. 1117, 118 S.Ct. 1055, 140 L.Ed.2d 118 (1998).

NACBA members have a vital interest in the outcome of this appeal. They primarily represent consumer debtors, a number of whom may have one or more rental units to supplement their income. In cases where the debtors' residences and other units are both secured by one mortgage, and the payoff of the mortgage

exceeds the value of the properties, the debtors may not be able to propose a feasible chapter 13 plan to retain their homes unless the mortgages are modified under the Bankruptcy Code. Thus, debtors may be forced to abandon their homes.

NACBA members are also concerned that the affirmance of the decisions below may discourage debtors from seeking relief under Chapter 13.

The *amicus* urges reversal of the lower court's holding concerning the application of § 1322(b)(2). *Amicus* urges this Court to approve a bright line test that would allow a chapter 13 plan to modify claims secured by mortgages on real property that contain more than one residential unit.

STATEMENT OF ISSUES PRESENTED

Whether 11 U.S.C. § 1322(b)(2) prevents a Chapter 13 debtor from modifying the unsecured portion of an undersecured mortgage claim when the mortgage is on a multi-unit property that includes a unit in which Debtor does not reside.

SUMMARY OF ARGUMENT

In all bankruptcy cases, a secured claim is no more than the value of the claimant's collateral. In a chapter 13 case, the chapter 13 plan can modify the rights of a holder of a secured claim unless that creditor is entitled to the protection of a limited exception to the modification of claims under 11 U.S.C. § 1322(b)(2). If the claimant has security which includes property other than the debtor's principal residence, then the exception does not apply and the secured claim is modifiable. A mortgage in a multi-unit property includes a security interest in real property which is not the debtor's principal residence, namely the other unit or units in which the debtor does not reside. Congressional intent on this issue is manifested by the natural meaning of the language of 11 U.S.C. § 1322(b)(2), both in the context of the Bankruptcy Code and in the context of other

federal statutes which use terms other than "principal residence" when Congress intends to include multi-unit buildings.

The plain language of the statute is reinforced by the legislative history of an amendment to the Bankruptcy Code which favorably cites precedent that is contrary to the decisions of the courts below.

Reversal of the lower courts' holdings is also required by the overwhelming precedent from this Court and in the lower courts in this circuit and around the country and the absence of any textual basis for the case by case "totality of the circumstances" approach adopted below.

Finally, there is ample basis in the policies expressly enunciated by Congress in enacting the Bankruptcy Code to reverse the lower court's decision. These policies include preserving the debtor's fresh start in the face of valueless security interests and equity among creditors.

ARGUMENT

I. THE CONCLUSION OF THE COURTS BELOW THAT THE DEBTOR COULD NOT STRIP DOWN A MORTGAGE HELD ON A MULTI-UNIT PROPERTY IS CONTRARY TO THE PLAIN LANGUAGE OF THE BANKRUPTCY CODE AND TO THE PRECEDENTS OF THIS COURT

This case involves the proper construction of two subsections of the Bankruptcy Code: 11 U.S.C. § § 506(a) and 1322(b)(2). Reversal of the lower court's decision is consistent with the Supreme Court's decision in Nobelman v. American Savings Bank, 508 U.S. 324, 113 S.Ct. 2106, 124 L.Ed 2d 228 (1993), and is required by the plain language of the Code, especially when viewed in the light of subsequent legislative history of a related provision. Reversal is mandated by the long standing precedent in this circuit.

The mortgage at issue may be modified because Chase Manhattan Mortgage Corp. ("Chase") holds a security interest not only in property which serves as the debtor's principal residence, but also in another unit in which the debtor does not reside. Permissible modification includes strip down of the lien to the value of the collateral.

A. The Long Standing Precedent in Our Circuit Has Consistently Limited The Scope Of The Anti-Modification Provision of 11 U.S.C. § 1322(b)(2) In Accordance with the Plain Meaning of the Provision.

Section 11 U.S.C. § 506(a) defines whether an allowed claim is secured or unsecured. It provides:

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

Pursuant to § 1322(b), a debtor in a Chapter 13 plan may limit the amount of a secured claim to the value of the collateral. To the extent the collateral does not support the claim, the claimant is unsecured. See, In re Johns, 37 F.3d 1021, 1023-24 (3rd Cir. 1994). Pursuant to 11 U.S.C. § 506(d), the creditor's lien is void to the extent it is unsecured. The debtor is required by 11 U.S.C. § 1325(a)(5) to pay 100% of only the allowed secured portion of the claim. Use of § 506 in conjunction with §§ 1322 and 1325(a)(5) to reduce the secured claim to the value of the collateral has generally been called "strip down" and the process of modifying the rights of the secured creditor over its objection "cram down." See In re Ferandos, 402 F.3d 147, 151 (3rd Cir. 2005).

Section 1322(b)(2) governs the contents of a Chapter 13 plan and provides:

> (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....

11 U.S.C. §1322(b).

It is important to note that under section 1322(b), the ability to modify secured claims in a plan is the norm in a Chapter 13 -- subject to the one exception which is at issue in this case. See Ferandos, 402 F.3d at 151.

The section which limits a debtor's ability to modify, through the provisions of a chapter 13 plan, the rights of the holder of a claim secured only by a security interest in real property that is a debtor's principal residence is known as the "anti-modification provision." Sapos v. Provident Institution of Savings, 967 F.2d 918 (3rd Cir. 1992).

Since the provisions were enacted in 1978, this court has considered the interplay between sections 506(a) and 1322(b)(2) on at least six prior occasions.[1] In five out of the six cases the Court concluded that section 1322(b)(2) did not prohibit modifying an unsecured component of an undersecured mortgage either because the creditor was not the holder of a secured claim within the meaning of

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[1] Wilson v. Commonwealth Mortgage Corp., 895 F.2d 123 (3rd Cir. 1990); Sapos, 967 F.2d 918; Hammond v. Commonwealth Mortgage Corporation of America, 27 F.3d 52 (3rd Cir. 1994). Johns, 37 F.3d 1021; In re McDonald, 205 F.3d 606

11 U.S.C. §1322(b)(2), McDonald, 205 F.3d 606, or because the holder of the secured claim had a security interest in personalty in addition to whatever security interest it had in the real property that was the debtor's principal residence. Wilson, 895 F.2d 123; Sapos, 967 F.2d at 926; Hammond, 27 F.3d 52; Johns, 37 F.3d 1021. In the sixth and most recent case, Ferandos, 402 F.3d 147 the court found the modification of the secured creditor's rights to be precluded by 11 U.S.C. §1322(b)(2) [2].

These cases taken together demonstrate that this court has consistently read the anti-modification provision of section 1322(b)(2) literally, carefully, narrowly and in accordance with its plain meaning. This Court has consistently declined to give the provision expansive effect. In each of the cases the Court has used a plain meaning approach to its application of section 1322(b)(2) to the facts before

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(3rd Cir, 2000) and Ferandos, 402 F.3d 147.

[2] Ferandos is the only one of the six cases in which this Court found the anti-modification provision to apply. In Ferandos, the Court held that under New Jersey Law real property is defined to include rents and for this reason the grant of an interest in rents does not render the claim secured by anything other than real estate. Ferandos, 402 F.3d at 155. In addition the Court held that under New Jersey law the mortgagor has no interest in funds that are placed in escrow for taxes and insurance under a mortgage and for this reason a grant of a security interest by the mortgagor in the escrow account conveyed nothing and created no additional security. Id at 156. In reaching this result this Court followed the same analysis it used in the previous five cases. This analysis requires a reversal of the lower court decisions in the instant matter.

it. See Ferandos, 402 F. 3rd at 154. In each case the Court limited its inquiry to whether the creditor was the holder of a "claim secured only by a security interest in real property that is the debtor's principal residence" within the natural meaning of those words and declined to apply the anti-modification provision when there was other collateral. See e.g. Hammond, 27 F.3d 55, citing Sapos, 967 F.2d at 925-26; Wilson, 895 F.2d at 128. In each case, where the anti-modification provision was found not to apply, bifurcation of the claim under 11 U.S.C. § 506(a) and the modification of the claim holder's rights followed. See e.g. Hammond, 27 F.3d at 56; Sapos, 967 F.2d at 925-26; Wilson, 895 F.2d at 128.

In its analysis in the previous cases this Court adopted a template that includes a bright line rule, see In re McDonald, 205 F.3d at 613, and has consistently rejected invitations to allow the outcome of the case, which in this Court's view was dictated by the plain meaning or a natural reading of the statute, to be altered by "congressional policy", by the de minimus nature of the additional security or by the fact that the additional security was the result of "boiler plate language" in the mortgage instrument. See Ferandos, 402 F.3d at 155 ("the language and its effect are key, and if other property is actually pledged, neither the court's perception of its precise nature, nor Congressional policy, will alter the analysis or outcome."); Wilson, 859 F. 2d at 129; Sapos. 967 F.2d at 926. In its

prior decisions this Court has also made clear that it was concerned with the security interests that resulted from the "grant in the instrument, not the actual existence of collateral available to the creditor." Ferandos, 403 F.3d at 155 citing Wilson 859 F. 2d at 129. Thus, the holdings do not support explorations into the intention of the parties in creating interests, which was utilized by the courts below, but simply into whether they have been created. See, Wilson, 859 F. 2d at 129 (subjective desire of the mortgagee to obtain a security interest in the additional collateral is irrelevant).

Though this Court has had a number of occasions to construe and apply § 1322(b)(2), the instant case nonetheless presents it with a question it has not previously addressed. The primary question[3] presently before the court is not whether the security interest in question is in personalty as opposed to real

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[3] The courts below refused to treat the assignment of rents in the Rider and the "rents and profits" clause of the mortgage as creating additional security, under the law of Pennsylvania, which would take the mortgage outside the protection of the anti-modification provision. Because the mortgage is a security interest in real property that is not solely the debtor's principal residence, the anti-modification provision will not apply to Chase in any event. For this reason it will not be necessary for the Court to separately review this decision. It is worth noting however, the rents that were assigned are for the second floor unit in which Debtor does not reside. If a security interest in rents is a security interest in real property under Pennsylvania law, it is a security interest in real property in which Debtor does not reside.

property. Instead the Court must examine the highlighted parts of the phrase "claim secured *only* by a security interest *in real property that is the debtor's principal residence"* and determine whether the phrase "real property that is the debtor's principal residence" should be read to include real property that is a multi-family building including a unit in which the debtor does not reside.

Though the precise question raised in the instant appeal was not addressed, the analysis previously used by this Court -- the reliance on the plain meaning of the statute; the application of a bright line rule and the rejection of an inquiry into the "independent value" of the additional security or into the continued existence of the additional security - dictates a reversal in the instant case. The natural meaning of the words of the statute require the adoption of a bright line test that excludes from the protection of the anti-modification provision claims that are secured by mortgages on multi-family properties. [4]

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[4] The only other circuit to address this issue to date is the United States Court of Appeals for the First Circuit. In Lomas Mortgage, Inc. v. Louis, 82 F. 3d 1 (1st Cir. 1996), the First Circuit established a bright line rule and held "that the anti-modification provision of § 1322(b)(2)does not bar modification of a secured claim on a multi-unit property in which one of the units is the debtor's principal residence and the security interest extends to the other income producing units." Lomas, 82 F.3d at 7.

B. The Plain Language Of The Bankruptcy Code Allows Strip Down When The Creditor Has Security Which Goes Beyond The Debtor's Principal Residence.

As in all cases of statutory construction, the starting point in this case must be the statutory language. Lamie v. U.S. Trustee, 540 U.S. 526, 124 S. Ct. 1023, 157 L. Ed. 2d 1024 (2004); Kelly v. Robinson, 479 U.S. 36, 43, 107 S.Ct. 353, 357, 93 L.Ed2d 216 (1986). It is well established that "when the statute's language is plain, the sole function of the Courts – at least where the disposition required by the text is not absurd- is to enforce it according to its terms." Lamie 540 U.S. at 534. See In re Ferandos, 402 F. 2d at 151 ("On the several occasions that we have had the opportunity to apply §1322(b)(2), we have focused on the plain language of the section and have found that the grant of additional collateral sealed the mortgagee's fate.")

The Supreme Court has repeatedly emphasized the importance of plain statutory language in resolving disputes under the Bankruptcy Code. E.g., United States v. Ron Pair Enterprises, Inc., 489 U.S. 235, 241, 109 S.Ct. 1026, 1030 (1989); Patterson v. Shumate, 504 U.S. 753, 758, 112 S.Ct. 2242, 2247 (1992); Toibb v. Radloff, 501 U.S. 157, 160, 111 S.Ct. 2197, 2199 (1991).

Here the language at issue is set out in § 1322(b)(2) which provides that a 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, . . ." 11 U.S.C. § 1322(b)(2).

A plain reading of this phrase dictates that the anti-modification provision of 11 U.S.C §1322(b)(2) does not apply in the instant case where a security interest is taken in real property that contains a residential unit that is not the primary residence of the debtor, as well as a residential unit that is.[5]

Though courts have differed in their interpretation of the meaning of the relevant phrase[6], and the Court of Appeals in Lomas found the "plain meaning" approach to be "inconclusive", Lomas, 82 F.3d at 4, the language of §1322(b)(2) is not "ambiguous" and the natural meaning of the phrase, as it applies to the

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[5] There is no dispute about the pertinent facts of the case and the findings of fact made by the bankruptcy court have not been challenged by either party. In re Scarborough, 2004 U.S. Dist. Lexis 21701, *6-7.(E.D. Pa 2004). These findings establish that the real property in question is a multi-unit dwelling consisting of two apartments, one on the first floor and one on the second. Ms. Scarborough lives in the first floor unit and rents the second floor apartment to an unrelated person. The property is subject to a mortgage that includes a 2-4 Family Rider. Id., at *2-5.

[6] Contrast In re McGregor, 172 B.R. 718 at 720 (Bankr. D. Mass. 1994) (under plain language of 1322(b)(2) mortgage on real property that contains income producing unit in addition to debtor's primary residence is not protected by anti-modification provision) and In re Macaluso, 254 B.R. 899, 800 (Bankr. W.D. NY 2000)("Unambiguous and clear is the language[in 1322(b)(2)] that precludes modification of a mortgage" on real estate that includes a tailor shop and an income producing apartment in addition to debtor's primary residence.)

instant case can be discerned from a "studied examination of the statutory context. See, Lamie v. U.S. Trustee 540 U.S. at 534. As this court observed in In re Price, 370 F3d 362, 369:

> ".. Just because a particular provision may be, by itself, susceptible to differing constructions does not mean that the provision is therefore ambiguous. 'The plainness or ambiguity of statutory language is determined by reference to the language itself, the specific context of the statute in which the language is used, and the broader context of the statute as a whole.'" (citation omitted)

In the instant case "the most plausible reading in light of the statutory context", In re Price, 370 F.3d at 370, is that the anti-modification provision of § 1322(b)(2) does not extend to security interests in multi-family properties.

The language in the statute when read literally creates an equation between the "real property" that is subject to the security interest and the "debtor's principal residence" by the use of the word "is". See, McGregor, 172 B.R. 718, 720-721. As the court in McGregor observed, had Congress intended to extend the anti-modification protections of 11 U.S.C. §1322(b)(2) to the holder of a claim secured by a security interest in a multi-unit building in which the debtor had a primary residence, it would have provided that the plan could modify the rights of holders of secured claims, "other than a claim secured only by a security interest in

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real property that *includes* the debtor's principal residence." See, McGregor, 172 B.R. at 720-721. Alternatively, had Congress not intended the equation between "real property" and the "debtor's principal residence" which the plain language implies, it could have used a term that included the entire building in which the debtor's principal residence was located as it did when it drafted the Truth in Lending Act, 15 U.S.C. §1601 et seq.[7]

Since there is no definition of the term "debtor's principal residence", "principal residence" or "residence" in the Code that is applicable to the case under consideration,[8] we are left to the ordinary meaning of those words in

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[7] In that statute Congress provides rights for consumers to rescind certain mortgages on property used as a "principal dwelling". 15 U.S.C. § 1635(b)(2). Congress then defines "dwelling" to encompass "a residential structure or mobile home which contains one to four family housing units, ..." 15 U.S.C. § 1602(v). Congress neither used the term "dwelling", nor created a similarly defined term encompassing 1 to 4 family residences, in identifying claims eligible for protection from modification in §1322(b)(2).

[8] The Bankruptcy Abuse Prevention and Consumer Protection Act, (BAPCPA)P.L. No. 109-8 (2005), effective in cases commenced after October 17, 2005 and thus inapplicable to the instant case, added §101(13A) to the code which defines the term "debtor's principal residence" as follows:

> The term "debtor's principal residence"
> (A) means a residential structure, including incidental property, without regard to whether that structure is attached to real property; and
> (B) includes an individual condominium or cooperative unit, a mobile or manufactured home, or trailer
>
> "Incidental property" is defined in §101(27B) as:

construing the meaning of section 1322(b)(2). "Residence" is defined in the dictionary to mean "the place, esp. the house, in which one lives or resides; dwelling place; home." And "principal" is defined as "first or highest in rank, importance, value etc.; foremost. *Random House Dictionary of the English Language*, unabridged (1971). Thus in common understanding the debtor's principal residence is the place in which the debtor primarily resides. By definition a debtor can have only one "principal residence" and where, as in the instant case, the debtor's principal residence is in real property that contains more than one residence, a creditor holding a security interest in the real property is by

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The term "incidental property" means, with respect to a debtor's principal residence –

(A) property commonly conveyed with a principal residence in the area where the real property is located;

(B) all easements, rights, appurtenances, fixtures, rents, royalties, mineral rights, oil or gas rights or profits, water rights, escrow funds, or insurance proceeds; and

(C) all replacements or additions.

These definitions themselves do not address the issue in this case and offer little assistance in discerning the plain meaning of the statutory language at issue. However, the court in Lomas invited congress to amend section 1322(b)(2) if it disagreed with its construction of that statute, Lomas, 82 F.3d at 7 ("If we are wrong as to what Congress intended, legislation can provide a correction"). Despite the invitation Congress when enacting BAPCPA chose to make no correction.

definition not "secured *only* by a security interest in real property that *is* the debtor's principal residence," because included in the real property subject to the security interest is a residence in which the debtor does not reside.

This reading of section 1322(b)(2), which requires the real property subject to the security interest to be the principal residence of the debtor, and nothing more, for the anti-modification provision to be applicable, is supported by the different language Congress chose to use in each of two subsections of 11 U.S.C. §1322(c)[9] to reference the debtor's principal residence.

Both subsections of section 1322(c) create exceptions to the application of the anti-modification provision and create rights that go beyond what might be available to a debtor under applicable non-bankruptcy law. Section 1322(c)(1)

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[9] 11 U.S.C. §1322(c) provides as follows:
Notwithstanding subsection (b)(2) and applicable nonbankruptcy law –
(1) a default with respect to, or that gave rise to, *a lien on the debtor's principal residence* may be cured under paragraph (3) or (5) of subsection (b) until *such residence* is sold at a foreclosure sale that is conducted in accordance with applicable nonbankruptcy law; and
(2) in a case in which the last payment on the original payment schedule for *a claim secured only by a security interest in real property that is the debtor's principal residence* is due before the date on which the final payment under the plan is due, the plan may provide for the payment of the claim as modified pursuant to section 1325(a)(5) of this title. (Emphasis added).

enables the debtor to cure a default "with respect to, or that gave rise to *a lien on the debtor's principal residence*... until *such residence* is sold at a foreclosure sale. In contrast, Section 1322(c)(2) allows the debtor in certain circumstances to extend the payments beyond when they would normally be due for "a claim secured only by a security interest in real property that is the debtor's principal residence."

By using the different terms in those two sections Congress demonstrated its understanding of the distinction between the "debtor's principal residence" - which may or may not be real property and may or may not be a part of real property; which can be subject to a separate lien, whether it is real property or not and which can be separately sold at a foreclosure sale, whether or not it is real property or a part of a real property - and "real property which is the debtor's principal residence". In the case of section 1322(c)(1) Congress chose to use language that was expansive and included in its coverage structures that were not included in the more narrow language Congress chose to use in section 1322(c)(2).

In the former subsection the debtor's extended right to cure a default applies whether the lien is on the debtor's principal residence alone or whether it is on other things as well, and it applies whether the principal residence is real property or not. In the latter subsection the right to stretch out the payments under that sub-

section is only available when the property involved is "real property that is the debtor's principal residence".

Clearly Congress is capable of devising language that is broad and inclusive when it wants to. If Congress had intended to make the anti-modification provision applicable to claims secured by security interests in real property that contained residences of others, in addition to the debtor's principal residence, it knew how to craft the language that would have accomplished that result. [10] See, In re Adebanjo, 165 B.R. 98, 104 (Bankr. D. Conn. 1994)(adopting plain language reading of §1322(b)(2) that equated "real property "with "debtor's principal residence" and providing several examples of statutes in which Congress used language that effected the intention of covering debtor's principal residence

[10] Macaluso, 254 B.R. 799 is perhaps the only case holding that the plain language of §1322(b)(2) requires the application of the anti-modification provision to multi-unit dwellings so long as the debtor uses one of the units as her primary residence. In reaching that result the court in Macaluso observes: "Notably, the statute does not limit its application to property that is used *only* as a principal residence, but refers generally to any parcel of real property the debtor uses for that purpose." Id. (emphasis in original). Significantly, however, Congress elected to use the word "is" in the phrase "secured only by real property that is the debtor's principal residence" and not the word "uses" or the phrase "uses as", though Congress did use the phrase "uses as" in describing what interest debtor could exempt as part of a homestead exemption. See 11 U.S.C. § 522(d)(1) (permitting the debtor to exempt an interest in "real property or personal property that the debtor ... *uses* as a residence ....") This demonstrates once again that Congress is capable of using more expansive language when it deems it appropriate to do so.

as well as income producing rental units in the same building.)

Thus, the plain meaning of the words used in §1322(b)(2) when compared and contrasted with the language used in related provisions of the Code leads to a natural reading of the anti-modification provision which excludes from its coverage multi-unit properties, even when one of the units is the debtor's principal residence. As is discussed at greater length in Part I(D) below, this understanding of the plain meaning of 11 U.S.C. §1322(b)(2) has been adopted by the clear majority of the courts which have addressed the issue and have decided that the anti-modification provision does not apply to multi-unit properties. Many of these courts applied the same plain language analysis used by the court in McGregor. See e.g In re Maddaloni (Ford Consumer Finance Company v. Maddaloni), 225 B.R. 277, 280 (D. Conn. 1998); In re Legowski, 167 B.R. 711, 714-15 (Bankr. D. Mass. 1994); In re Adebanjo, 165 B.R. at 104 (Bankr. D. Conn. 1994).

This natural reading of section 1322(b)(2) does not lead to an absurd result.[11] To the contrary, this reading is consistent with Congressional intent of the

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[11] The alternate reading of the plain language of the provision suggested in Macaluso would of course lead to a patently absurd result, which has been almost uniformly rejected, even by those who seek to circumvent a plain reading of the

anti-modification language and with this court's application of the provision to date.

Nor will the natural reading of the provision result in any undue prejudice to the creditor. Clearly the lender in the instant case was aware it was taking a security interest in a multi-family dwelling which included at least one unit that was not the debtor's residence. Because the mortgage involved a multi-unit building, the lender included as part of the mortgage a Multi-Family Rider that contained provisions beneficial to the lender that were not part of the mortgage on a single family home. Specifically, this rider, designed to "amend and supplement the Mortgage", (App. 34) included an assignment of rents which specifically created a security interest in the rents generated by the residential unit in which Ms. Scarborough did not reside. The lender knowingly took special steps to insure it had a security interest in the residential unit that was not Ms. Scarborough's residence over and above what was created by the mortgage alone.

Here the mortgage lender bargained for and obtained a security interest in a

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statute in favor of a case by case "totality of the circumstances analysis. Clearly, the recognized Congressional purpose for the section 1322(b)(2) exception: to protect the traditional mortgage lender who provides long term financing that enables individuals to purchase their home, see Ferandos at 151, would not be served by applying the anti-modification provision to a building consisting of dozens or even hundreds of units, simply because the debtor occupied one of them

multi-unit building. Under the law there are benefits and liabilities resulting from its doing so which the lender is fully capable of taking into account at the time it enters into the transaction. See, Ferandos, 402 F.3d at 155 (we read our case law as focusing on the effect of the grant in the instrument); Wilson, 895 F.2d 129 (If lender wishes to be covered by anti-modification provision , it should delete offending language from its agreements).

As is demonstrated above, the natural reading of the term "secured only by a security interest in real property that is the debtor's principal residence" requires the exclusion of mortgages on multi-unit or multi-family buildings from the protection of the anti-modification provision, even when the debtor resides in only one of the units. The natural reading does not produce an absurd result and therefore must be applied in the absence exceptional "extratextual indicators" that would dictate a variance from that result. See Price, 370 F. 3d at 375.

As can be seen from the discussion that follows there are no such considerations which would support not applying the natural reading of the statute. To the contrary, the legislative history of the provision before its enactment and of a related provision subsequently enacted, the overwhelming weight of judicial authority and the overall policies underlying the Bankruptcy Code support the

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as his or her principal residence.

natural reading of section 1322(b)(2) that requires the exclusion of mortgages on multi-unit or multi-family buildings from anti-modification protection.

C. Permitting Modification When A Property Includes Both A Principal Residence And A Rental Unit Was Expressly Endorsed In The Legislative History When Congress Enacted A Provision Protecting Residential Mortgage Holders In Chapter 11. This Subsequent Congressional Declaration Is Entitled To Great Weight.

In 1994 Congress made significant amendments to the Bankruptcy Code. Pub. Law No. 103-394 (October 22, 1994). Among those changes, Congress for the first time prohibited strip down of residential mortgages under Chapter 11 of the Bankruptcy Code. Id. at § 206. The amendment rewrote 11 U.S.C. § 1123(b)(5). That provision now tracks the language of § 1322(b)(2) exactly.[12]

Legislative history to the amendment states that the exception to modification conforms the treatment of residential mortgages in Chapter 11 to that in chapter 13 ...

---

[12] 11 U.S.C. § 1123(b)(5) now states:

(b) Subject to subsection (a) of this section, a plan may . . .

> (5) 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; ...

> It does not apply to *a commercial property*, or to any transaction in which the creditor acquired a lien on property other than real property used as the debtor's residence.

(emphasis added). H.R. Rep. No. 103-835 (Judiciary Committee) at 46, 103rd Cong. 2d Sess. 5 (1994) reprinted in 1994 U.S.C.C.A.N. 3340, 3354.[13]

Since the scope of the amendment to chapter 11 plan requirements, like § 1322(b)(2), is limited to real property that is the debtor's principal residence, there is no reason to reference "commercial property" except to make clear that residential property with a commercial use does not come within the ambit of the exception.

More importantly, the House Judiciary Committee referenced In re Ramirez, 62 B.R. 668 (Bankr. S.D.Cal. 1986) to illustrate the point about commercial properties. See 1994 U.S.C.C.A.N. at 3355, at n. 13. In Ramirez, the property was both the debtor's principal residence and two rental units -- facts which are almost identical to the case here. The court in Ramirez found that modification of the mortgage in Chapter 13 was not contrary to § 1322(b)(2). By citing Ramirez with approval, Congress made clear its intention to allow modifications on residential property with additional rental units in Chapter 11. There is no reason to interpret the identical statutory language in Chapter 13 any differently. See, Sullivan v.

Stroop, 496 U.S. 478, 110 S.Ct. 2499, 110 L.Ed. 2d 438 (1990) (applying the "normal rule of statutory construction" in which "identical words used in different parts of the same act are intended to have the same meaning.")

Although this legislative history was made subsequent to the passage of the provision at issue, it is not subsequent legislative history in its conventional sense. It was not a statement which was intended by the committee to have an impact on courts interpreting § 1322(b)(2), but rather it was express committee approval of extant holdings in passing an identically worded provision of law. This type of subsequent Congressional declaration is entitled to great weight. See Red Lion Broadcasting v. F.C.C., 395 U.S. 367, 380-82, 89 S.Ct. 1794, 1801-02, 23 L.Ed.2d 371 (1969).

Respect for established case law is one of the cornerstones for interpreting Congressional amendments to bankruptcy law in general. In bankruptcy jurisprudence, the Supreme Court has repeatedly relied on an expectation that Congress was aware of existing case law under the Bankruptcy Act when the Bankruptcy Code was passed in 1978. The Court has repeatedly held that Congress must enact clear language or expressly denounce existing case law if it intends for it to be legislatively overruled. See, Kelly v. Robinson, 479 U.S. 36,

(..continued)

[13] The House bill was passed in lieu of the Senate bill.

47, 107 S.Ct. 353, 359 (1986), citing Midlantic National Bank v. New Jersey Dept. of Environmental Protection, 474 U.S. 494, 106 S.Ct. 755 (1986). In Midlantic, the court stated:

> The normal rule of statutory construction is that if Congress intends for legislation to change the interpretation of a judicially created concept, it makes that intent specific. The Court has followed this rule with particular care in construing the scope of bankruptcy codifications.

106 S.Ct. at 760.

There is no reason to evaluate amendments to the Bankruptcy Code any differently -- especially where, as here, Congress has expressly cited existing case law with approval. Moreover, a change in the weight of the case law which Congress referenced in amending Chapter 11 would unnecessarily call into doubt the reach of the new provision. Significant consequences to the scope of Chapter 11 would be an unintended result.[14]

Applying this reasoning, the Court of Appeals for the First Circuit in Lomas, 82 F.3d 1, held that the anti-modification provision of § 1322(b)(2) does not bar modification of a secured claim on a multi-unit property in which one of the units is the debtor's principal residence and the security interest extends to

[14] Because chapter 11 is used by a variety of small businesses, special protections which apply to commercial use of property which also serves as a debtor's residence have special importance.

other income producing units. Because the mortgage lender's security interest extended to two other income producing units, the anti-modification provision of §1322(b)(2) did not apply to that interest, and modification pursuant to § 506(a) was appropriate. Id. The Court concluded that "[g]iven this clear expression of congressional intent, the inference becomes quite strong that Congress believes the anti-modification provision in Chapter 13 does not reach such multi-unit properties. Id. at 6 citing 5 Collier on Bankruptcy, ¶ 1322.06[1][a], 1322-23 n. 13 (stating that Ramirez was cited by Congress in the Bankruptcy Reform Act as a correct statement of the current law of §1322(b)(2)).

D. The Great Weight Of Authority Supports the Modification of Mortgages on Multi-Unit Properties

Most of the courts addressing this issue have ruled that the anti-modification provision of section 1322(b)(2) does not apply to multi-unit properties where the debtor resides in only one unit. See Lomas, 82 F.3d 1; In re Falotico, 231 B.R. 35 (D.N.J. 1999), (three family property, debtor resided in one unit and rented the other two); In re Bulson, 327 B.R. 830 (Bankr. W.D. Mich. 2005); In re Kimbell, 247 B.R. 35 (Bankr. W.D. N.Y. 2000)(two unit property, debtor resided in one); Maddaloni, 225 B.R. 277 (two family dwelling, one unit rented, other was debtor's principal residence,); In re Del Valle, 186 B.R. 347

(Bankr. D. Conn. 1995)(debt secured by a duplex, debtor lived in one side and rented the other); McGregor, 172 B.R. 718 (four unit property, debtor lived in one unit); Legowski, 167 B.R. 711; Adebanjo, 165 B.R. 98; In re Zablonski, 153 B.R. 604 (Bankr. D. Mass. 1993) (multi-unit residence which included a rental property); In re McVay, 150 B.R. 254 (Bankr. D. Ore. 1993) (portion of property was used as a bed and breakfast); Matter of Torres Lopez, 138 B.R. 348 (D. P.R. 1992) (if part of the property is inherently income producing, then modification is permitted); In re Jackson, 136 B.R. 767, 803 (Bankr.N.D. Ill 1992)(a mortgage encumbering a two flat unit, where the debtor lived in one unit and occasionally rented the other). In re Ramirez, 62 B.R. 668 (Bankr. S.D. Cal. 1986) (property included debtor's residence and two rental units).

In Adebanjo, the court stated that § 1322(b)(2):

> protects claims secured only by a security interest in real property that is the debtor's principal residence, not real property that *includes* or *contains* the debtor's principal residence, and not real property *on which the debtor resides*.
>
> Id. at 104 (emphasis in original).

These courts have all concluded that mortgages on multi-unit properties are subject to cram down in Chapter 13 because the exception to modification contained in § 1322(b)(2) does not apply.

E. The Lower Courts' Adoption Of The Case-By Case "Intent Of The Parties" Test is Flawed

Rather than choosing a bright line test based on the clear statutory language which can provide guidance and certainty to the mortgage lending industry, the lower courts adopted the Brunson v. Wendover Funding, Inc., (In re Brunson), 201 B.R. 351, 353 (Bankr. W.D.N.Y. 1996), case-by-case, totality of the circumstances approach. The Brunson court created a laundry list of factors to determine whether the mortgage was either residential or commercial, which include the following:

> [w]hether the Debtor (to the lender's knowledge owned other income producing properties or other properties in which [the debtor] could choose to reside; whether the debtor had a principal occupation other than as landlord, and the extent to which rental income or other business income from the real estate contributed to [the Debtor's] income; whether [the Debtor's] total income was particularly high or particularly low; whether the mortgage was handled through the commercial loan department or the residential mortgage loan department of the lender; whether the interest rates applied to the mortgage were home loan rates or commercial loan rates; the demographics of the market (e.g. are "doubles" a much more affordable "starter home" than a single, in that locale); and the extent to which, and purpose for which, potential business uses of the land. . . were considered by the lender.

Scarborough, U.S.Dist. Lexis 21701 at *19-20, citing Brunson 201 B.R. at 353.

The rationale stated for creating this case-by-case intent of the parties approach, is based upon Congress' intent in adding the "home mortgage"

exception to 1322(b)(2) to encourage the flow of capital into the lending market." Litton Loan Servicing LP, 298 B.R. at 512 (quoting from Nobelman, 508 U.S. 324, 332, 113 S.Ct. 2106, 124 L.Ed.2d 228 (1993)).

However, the case by case approach invented by the Brunson court and endorsed by the lower courts in this case is flawed. First, it flies in the face of the settled law in this circuit, which provides that the subjective intent of the Lender is irrelevant when applying §1322(b). See, Wilson, 859 F. 2d at 129 (subjective desire of the mortgagee to obtain a security interest in the additional collateral is irrelevant)[15]

Second, it fails to effectuate the recognized Congressional policy underlying the anti-modification clause. If it was Congress' intent to "encourage the flow of capital into the lending market" it is of no relevance that the individual borrower's total income is "particularly high or particularly low" or that the borrower had a "principal occupation other than as a landlord?" Brunson, 201 B.R. at 353.

The Brunson Court's approach has also been rightfully criticized by other courts "because there is nothing within the four corners of section 1322(b)(2) to suggest that the debtor's intent, or even lender's intent is to have any bearing on the determination of whether a particular claim is 'secured only by a security

interest that is the debtor's principal residence.'" See In re Bulson, 327 B.R. 830, 841-42 (W.D. Mich. 2005).

In reality, the Brunson case- by- case approach actually undermines the intent of Congress. A case by case, totality of the circumstances approach will provide no guidance to mortgage lenders to lend. On the contrary, it will lead to uncertainty that will make mortgage lending more difficult. As stated in In re Bulson:

> "a precise definition even if arbitrary, is exactly what is needed to avoid disruption in the home mortgage capital market. Uncertainty is the one thing that all markets hate. Markets work best when there are clear rules consistently applied. Although investors certainly value fairness, they place an even higher value on certainty. Investors can adjust for inequities. It is much harder to adjust for uncertainty. Deciding whether a particular mortgage falls within the home mortgage exception perhaps years after the fact on a case by case basis may ensure an equitable result for the particular debtor and lender involved. However, the home mortgage lending market as a whole pays a price for this result because of the considerable uncertainty such an approach lends to the underwriting decision when home loans are made." Id. at 842.

The Brunson analysis is weak for another simple reason. The Brunson court attempts to re-write the statute and asks a different question than the plain language of the statute requires. The language of the statute asks whether the security interest is only on the debtor's principle residence. The Brunson court

(..continued)

[15] See discussion at pp. 9-10, *supra*.

asks a different question – whether the parties intended the property to be residential or commercial. That question is simply not what the statute asks. There is no reference whatsoever to the terms "residential" or "commercial" in the statute.

Brunson also cites In re Ramirez, *supra* for the justification of using an intent of the parties test. However, Ramirez did not use such a test. It used a simple functional use test. Was one portion of the property used as a rental and another used as the debtor's residence? Id. at 669-670. If yes, then the mortgage can be modified. Similarly, here there is no question that one unit of the real property is used as the debtor's residence and the other as an income producing rental unit. Under the Ramirez functional use test, Chase's mortgage is clearly modifiable.

The Brunson court objected to the use of the First Circuit's bright line test as "arbitrary." Brunson, 201 B.R. at 352. But this Circuit has already accepted a bright line test when it comes to interpreting the anti-modification clause of § 1322(b). In McDonald, , this Court endorsed a bright line test for interpreting section 1322(b)(2) to determine whether to modify wholly unsecured second mortgages. If a second mortgage is

wholly unsecured it can be modified in a Chapter 13 plan. If it has merely one dollar of value, it can not.

As this Court said in McDonald:

> Bright-line rules that use a seemingly arbitrary cut-off point are common in the law. A day beyond the statute of limitations and the plaintiff must lose, even if the claim was otherwise unquestionably a winning one. If the evidence is just over a preponderance, the plaintiff wins full damages; just under, the plaintiff gets nothing. In bankruptcy law a Chapter 7 trustee cannot contest the validity of a debtor's claimed exemption when the 30-day period for objecting has expired and the trustee failed to obtain an extension; and this is true even if the debtor has no colorable basis for claiming the exemption. ... To take an example closer to our case, we have read the word "only" in the antimodification clause's phrase, "secured only by a security interest in ··· the debtor's principal residence," to mean that the clause's protection is unavailable when the loan is secured not just by the debtor's residence but by other property as well. ... What these examples show is that line drawing is often required in the law and, at the boundary, the appearance of unfairness is unavoidable. Simply pointing out that some arbitrariness occurs is not a compelling objection.

McDonald, 205 F.3d at 613 (citations omitted).

Accordingly, this Court should endorse a bright line test which follows the plain meaning of the statute, will promote guidance and certainty for lenders and which will, as a result, encourage capital in the home lending market.

II. THE FUNDAMENTAL PURPOSES OF THE BANKRUPTCY CODE SUPPORT REVERSAL IN THIS CASE.

Although resolution of this case does not require review of relevant policy concerns, the underlying purposes of the specific statutory provisions at issue, and of the Bankruptcy Code in general, also support reversal of the courts below. The debtor is using an appropriate process to fairly adjudicate a creditor's claim, to address a default caused by circumstances beyond her control, and to achieve discharge of a debt which is not presently secured. All of these goals are fully consistent with the Bankruptcy Code.

A. <u>The Purpose Of § 506 Is To Recognize The Economic Reality Of An Undersecured Creditor's Position, Vis-A-Vis The Debtor And Other Creditors.</u>

In 1978, Congress revised § 506(a) with both the debtor's fresh start and the principle of equity between creditors in mind. These principles are embodied in the debtors' use of § 506 in this case. The House Report states:

> One of the more significant changes from current law in proposed title 11 is the treatment of secured creditors and secured claims. Unlike current law, H.R. 8200 distinguishes between secured and unsecured claims, rather than between secured and unsecured creditors. The distinction becomes important in the handling of creditors with a lien on property that is worth less than the amount of their claim, that is those creditors who are undersecured. Current law is ambiguous and vague, especially under chapter XIII, on whether an undersecured creditor is to be treated as a secured creditor, or as a partially secured and partially unsecured creditor. By addressing the problem in terms of claims, the bill makes clear that an

> unsecured creditor is to be treated as having a secured claim to the extent of the value of the collateral, and an unsecured claim for the balance of his claim against the debtor.
>
> The new treatment of secured claims, especially the bifurcation of the claims into secured and unsecured claims, has important protective consequences for both creditors and the debtor. For the creditor, the bill requires that once the secured claim is determined, the court must insure that the holder of the claim is adequately protected. The secured creditor is entitled to realize his claim, and not have his collateral eroded by delay or by use by the estate. For the debtor, the determination of the amount of the secured claim facilitates reorganization in the business context, and repayment plans in the consumer context, by defining the precise extent of the claims against the debtor that must be treated specially as secured claims.
>
> * * *
>
> Because of the uncertain treatment of secured creditors under current law, the debtor is often required to err on the side of overprotection when formulating a reorganization or repayment plan. Secured creditors have exercised great leverage by virtue of the uncertainty, and have made reorganization and individual repayment plans more difficult to consummate than would be the case under this bill. Since a successful reorganization or chapter 13 plan inures to the benefit of all creditors, the change under the bill should increase recoveries by creditors generally.

H.R. Rep. No 595, 95th Cong., 1st Sess. 180-81 (1977) (footnotes omitted).

The importance of § 506(a) is that it imports into virtually every aspect of bankruptcy law the economic reality of security interests. A creditor with a security interest, in addition to potential unsecured rights under a loan note, has the right to foreclose or otherwise execute on the security to obtain repayment. However, the security interest is only as valuable as the underlying collateral.

11 U.S.C. § 506(a) recognizes this economic reality when valuing secured claims. Holders of secured claims get only the equivalent of what they would have received if they had foreclosed. If they are undersecured, the unsecured portions of their claims are treated the same as any other unsecured claims.

No unfairness results, because creditors get the economic value of their security, all unsecured claims are treated equally, and the debtor gets the benefit of a fresh start free of the unjustified leverage which a retained, but economically valueless security interest represents. As stated in the House Report:

> Current chapter XIII does little to recognize the differences between the true value of the goods and their value as leverage. Proposed chapter 13 instead views the secured creditor-debtor relationship as a financial relationship, and not one where extraneous, non-financial pressure should enter. The bill requires the court to value the secured creditor's interest. To the extent of the value of the security interest, he is treated as having a secured claim, entitled to be paid in full under the plan, unless, of course, he accepts less than full payment. To the extent that his claim against the debtor exceeds the value of his collateral, he is treated as having an unsecured claim, and he will receive payment along with all other general unsecured creditors. .... This is an important departure from a few misguided decisions under current law, under which a secured creditor with a $2,000 secured by household goods worth only $200 is entitled in some cases to his full $2,000 claim, in preference to all unsecured creditors.

H.R. Rep. No. 595, 95th Cong., 1st Sess. 124 (1977) (footnotes omitted).

As interpreted by the Supreme Court in Nobelman, 11 U.S.C. § 1322(b)(2) represents an exception to the ability of debtors to stripdown mortgages on certain

residential property in bankruptcy. However, nothing in § 1322(b)(2) or the Nobelman decision requires application of the exception broadly to situations which go beyond the plain meaning of the statutory language. To reaffirm the court's decision below would unnecessarily trump the fundamental policies which Congress articulated for Chapter 13 of the Bankruptcy Code based on its passage of § 506.

B. The Bankruptcy Code's Policy Is To Treat Similarly Situated Creditors Equally.

Bifurcation of claims into their secured and unsecured components is an integral part of the Code's balance between the rights of secured and unsecured creditors. United Savings Ass'n of Texas v. Timbers of Inwood Forest Associates, Ltd., 484 U.S. 365, 108 S.Ct. 626 (1988). Bifurcation ensures that wholly unsecured creditors receive the same treatment for their claims as partially secured creditors receive for the unsecured portion of their claims. In Timbers, relying both on the language and structure of the Code as well as pre-Code practice, the Court declined to adopt a result that would permit undersecured creditors to receive interest on their allowed secured claims before unsecured creditors received any payment. "To allow a secured creditor interest where his security was worth less than the value of his debt was thought to be inequitable to

unsecured creditors." Timbers, 484 U.S. at 373, 108 S.Ct. at 631 citing Vanston Bondholders Protective Committee v. Green, 329 U.S. 156, 164, 67 S.Ct. 237, 240 (1946).

In this case, an undersecured creditor seeks not simply interest on its secured claim, but also principal and interest on its unsecured claim, to be paid prior to any payment to unsecured creditors. If the creditor is successful in these efforts, this would violate the principle of equity among similarly situated creditors. Every additional dollar paid to an undersecured creditor delays or prevents a payment to the general unsecured creditors.[16]

Bifurcation of claims in § 506(a) is designed to recognize the real world economic rights of creditors to the debtor's property at the time of a bankruptcy case. Creditors are given the special treatment accorded by the Code to holders of secured claims only to the extent they have security that has economic value. Beyond that, the bankruptcy policy of equity among creditors dictates that they be treated identically with wholly unsecured creditors.

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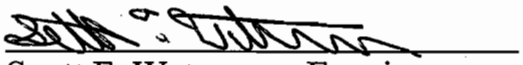
[16] Under the Act in effect at the time this case was filed, Chapter 13 debtors were required to commit all of their disposable income to payments under their plan. 11 U.S.C. § 1325(b). Unless debtors could afford to pay 100% of their

CONCLUSION

For all the foregoing reasons, the decisions below must be reversed. This court should endorse a bright line test which authorizes the cram down of mortgages on multi-unit properties, even when one of the units is the principal residence of the debtor.

Respectfully submitted,



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unsecured creditors, larger payments to secured creditors will always reduce payments to unsecured creditors on a dollar for dollar basis.

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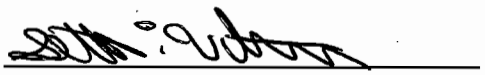
CERTIFICATION OF BAR MEMBERSHIP

I hereby certify that I am a member of the bar of the United States Court of Appeals for the Third Circuit.



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CERTIFICATE OF COMPLIANCE

Pursuant to Fed.R. App. P. 32(a)(7)(C) and 3rd Cir. LAR 31.0(c) (1997), the undersigned counsel certifies that this amicus brief exceeds the type-volume limitations of Fed.R.App.P. 32(a)(7)(B).

1. Exclusive of the portions exempted by Fed.R.App.P. 32(a)(7)(B)(iii), this brief contains 9,359 words printed in proportionally spaced typeface.

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CERTIFICATE OF SERVICE

I, Scott F. Waterman, hereby certify that on July 10, 2006 I provided two copies of the foregoing Brief for the Amicus Curiae to all interested parties by first class mail, postage prepaid, to the following:

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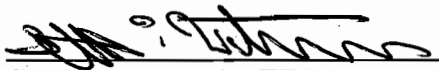

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