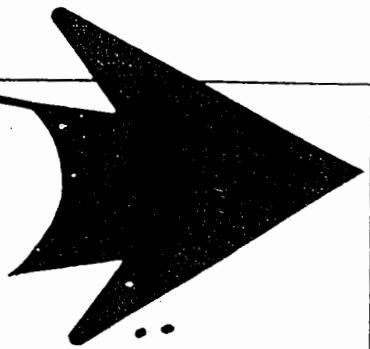


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SUPREME COURT RULES FOR MORTGAGE LENDERS

For some time, various federal courts have been struggling with how to resolve an apparent conflict between two (2) sections of the Bankruptcy Code and their operation in Chapter 13 cases. The United States Supreme Court has now resolved that conflict in favor of mortgage lenders in a unanimous opinion authored by Justice Clarence Thomas. Nobleman v. American Savings Bank, ___ U.S. ___, 1993.

The legal problem arose from attempts to interpret 11 U.S.C. Sec. 1322 (b) (2) and Sec. 506(a) in a consistent manner.

Sec. 506 provides, in relevant parts, as follows:

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 said 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 said allowed claim.

Lawyers for Chapter 13 debtors have used Section 506

(a) to split a mortgage holder's claim into a secured claim equal to the amount of the value of the debtor's residence, and a general, unsecured claim for the balance. Since general, unsecured creditors in a Chapter 13 frequently receive little in the way of dividends, mortgage lenders were understandably upset by such practice.

Mortgage lenders and their counsel found comfort, however, in another section of the Bankruptcy Code, 1322 (b) (2), which stated that a Chapter 13 plan may ". . . modify the rights of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence . . ." [Emphasis added.]

To split a mortgage holder's claim into a secured claim and an unsecured claim, and to pay little, if anything, on the secured claim, surely amounted to a modification of the rights of the mortgage holder contrary to this exception in the statute -- an exception clearly meant to favor creditors who were secured only by a security interest in

the debtor's principal residence.

By the time the issue had reached the United States Supreme Court for final resolution, no less than four (4) United States Courts of Appeal had allowed Chapter 13 debtors to split secured homestead mortgages under 506(a) and thus deny their mortgage lenders the special protection the Code seemed to afford creditors secured only by the debtors' residence under Sec. 1322 (b) (2).

When the issue reached the Supreme Court, the debtors argued that Sec. 1322 (b) (2) applies only to the extent that the mortgagee holds a "secured claim" in the debtor's residence and that the Court must look first to Sec. 506 (a) to determine the value of the mortgagee's "secured claim."

Justice Thomas, writing for the unanimous Court, however, stated that the debtor's argument failed ". . . to take adequate account of Sec. 1322 (b) (2)'s focus on 'rights.'" That section of the Code does not talk about modifying "claims",

as pointed out by Justice Thomas, but "...it focuses on the modification of 'rights' of holders of such claims." Whether or not the debtors could split the mortgage holder's claim under Sec. 506 (a), they could not then proceed to alter the mortgage holder's "rights" in contravention of Sec. 1322 (b) (2).

In short, although the Code allowed the debtors to cure the arrearage owed the mortgage holder over time in their Plan, the mortgage holder was otherwise entitled to enforcement of its note and mortgage upon their terms.

Judge Thomas's decision is to a large part a technical one, hinging upon close interpretation of language used in the statutes. Justice Stephens, in a separate concurrence, points out the obvious -- that the legislative history behind Sec. 1322 (b) (2) clearly indicated "favorable treatment of residential mortgagees was intended to encourage the flow of capital into the home lending market." Thus, he found the Court's decision in favor of mortgage holders faithful to the intent of Congress.

The Court's holding is clearly good news for mortgage lenders everywhere. □

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