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Topic Covered: **Is A Cram-down Revision Harmful or Helpful to Families Attempting to Save Their Home through the option of Bankruptcy?**

Author: Sandra D. Delgado

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ISSUE:

Is A Cram-down Revision Harmful or Helpful to Families Attempting to Save Their Home through the option of Bankruptcy?

PROPOSED LAW HR 3609 TO UPDATE TITLE 11 OF THE UNITED STATES BANKRUPTCY CODE quoted:

"**SEC. 2. DETERMINATION OF SECURED STATUS**. Section 506(b) of Title 11, the United States Code, is amended by adding at the end the following: `While a case is pending, no fee, costs, or charges may be added to a debt that is provided for in a chapter 13 plan and is secured by the debtor's principal residence unless the holder of the secured claim gives timely notice of such fee, costs, or charge to the debtor and to the trustee.'. **SEC. 3. LIMITATION OF 1978 EXEMPTION THAT PREVENTS FEDERAL BANKRUPTCY COURTS FROM MAKING MODIFICATIONS TO THE TERMS OF A MORTGAGE ON A DEBTOR'S PRINCIPAL RESIDENCE**. Section 1322(b)(2) of title 11, United States Code, is amended by striking `, other than a claim secured only by a security interest in real property that is the debtor's principal residence,'. **SEC. 4. MODIFICATION OF CLAIMS SECURED BY DEBTOR'S PRINCIPAL RESIDENCE**. (a) Contents of Plan- Section 1322(b) of title 11, the United States Code, is amended-- (1) in paragraph (10) by striking `and' at the end, (2) by redesignating paragraph (11) as paragraph (12), and (3) by inserting after paragraph (10) the following: `(11) provide for payment of allowed claims secured by the debtor's principal residence consistent with section 1325(a)(5), over a period exceeding the period permitted under section 1322(d); and'. (b) Confirmation of Plan- Section 1325(b)(5) of title 11, the United States Code, is amended by inserting `except as otherwise provided in section 1322(b),' after `(5)'. **SEC. 5. ELIMINATION OF CREDIT COUNSELING REQUIREMENT FOR CHAPTER 13 DEBTORS FACING FORECLOSURE**. Section 109(h) of title 11, United States Code, is amended by adding at the end the following: `(5) The requirements of paragraph (1) shall not apply with respect to a debtor in a case under chapter 13 who submits to the court a certification that the holder of a claim secured by the debtor's principal residence has initiated a judicial or non-judicial foreclosure on the debtor's principal residence.'. **SEC. 6. CONFIRMATION OF PLAN**. Section 1325(a) of title 11, the United States Code, is amended-- (1) in paragraph (8) by striking `and' at the end, (2) in paragraph (9) by striking the period at the end and inserting `; and', and (3) by inserting after paragraph (9) the following: `(10) notwithstanding paragraph (5)(B)(i)(I), the holder of a claim that is paid pursuant to section 1322(b)(11) shall retain the lien securing such claim until payment of such claim.'. **SEC. 7. DISCHARGE**. Section 1328 of title 11, the United States Code, is amended-- (1) in subsection (a)-- (A) by inserting `(other than payments to holders of allowed claims provided for under section 1322(b)(11)' after `paid' the 1st place it appears, and (B) in paragraph (1) by inserting `or 1322(b)(11)' after `1322(b)(5)', and (2) in subsection (c)(1) by inserting `or 1322(b)(11)' after `1322(b)(5)'."

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HR 3609 IH, *Emergency Home Ownership and Mortgage Equity Protection Act of 2007*, 110th Congress, 1st Sess., September 20, 2007. Library of Congress, Thomas, http://thomas.loc.gov/cgi-bin/query/z?c110:h3609.

I. AN INDIVIDUAL'S FINANCIAL LIFELINE.

Troubled times often lead to declining values in the American dollar, real estate and loan/credit defaults and then Bankruptcy. Bankruptcy can be traced back as far as the Old Testament, "every seven years, debts are forgiven." (Deuteronomy 15:1-2). The root of the word Bankruptcy comes from "bancus ruptus," Latin for bench and broken, respectively. Freund, William; Lewis, Charlton T; et al, *A Latin Dictionary*, Clarendon Press, 1966. For decades, Bankruptcy has allowed consumers room to legally declare an incapacity to settle debts owed to creditors. Most view a Bankruptcy in a poor light, however, when it comes to someone who relies on Bankruptcy, as a interim measure to restructure or get back on their feet, sometimes Bankruptcy is the sole option. Federal Law, Title 11 of the United States Code governs the Law of Bankruptcy, which is the law affected with the proposed bill H.R. 3609.

Corporations are downsizing, adding to one's economic hardships. According to the Bureau of Labor and Statistics, today we have an 8.5% National Unemployment rate[1]. As such, during a period of unemployment, bills are probably not getting paid and Credit Ratings are only becoming increasingly lower. Credit Ratings are composed of a statistical analysis of whether a person is creditworthy or not. Lenders use this score to calculate interest rates, whether to lend to the individual based on the determination of whether the person will be able to pay them back. Many employers look at a person's credit rating and obligation to determine one's eligibility for a job. Even with solid references and employment history, someone can be denied employment if their Credit Report consists of subjective adverse information. Thus, a Bankruptcy becomes a practical option since employers cannot deny a person employment because they are in Bankruptcy. (§525. Protection against discriminatory treatment, United States Bankruptcy Code prohibits employers from discriminating against insolvency.)[2] Credit counseling is offered and mandated to help debtors manage their credit and spending.

Insurance Agencies also use the credit rating to determine insurance eligibility and price based on their assessment of uncertainty and insurance loss. House

[1] "Persons are classified as unemployed if they do not have a job, have actively looked for work in the prior 4 weeks, and are currently available for work. Persons who were not working and were waiting to be recalled to a job from which they had been temporarily laid off are also included as unemployed. The unemployment rate represents the number unemployed as a percent of the labor force." (Bureau of Labor and Statistics, as of May 4th, 2009)

[2] "No private employer may terminate the employment of, or discriminate with respect to employment against, an individual who is or has been a debtor under this title, a debtor or bankrupt under the Bankruptcy Act, or an individual associated with such debtor or bankrupt, solely because such debtor or bankrupt" (Title 11 sec. 525 (b) U.S. Bankruptcy Code)

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representatives continue to discuss legislation that will regulate the value of credit score insurance valuation. H.R. 5633 proposed the following and is quoted as follows:

> "To amend the Fair Credit Reporting Act to prohibit certain discriminatory uses of consumer reports and consumer information in connection with certain personal lines of insurance, and for other purposes. Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,
>
> SECTION 1. SHORT TITLE. SEC. 2. USE OF CONSUMER REPORTS AND CONSUMER INFORMATION IN A DISCRIMINATORY MANNER PROHIBITED.
>
> (a) In General- Section 604 of the Fair Credit Reporting Act (15 U.S.C. 1681b) is amended-- (1) in subsection (a), by striking `Subject to subsection (c)' and inserting `Subject to subsections (c) and (h)'; and (2) in subsection (c)(1), by striking `A consumer reporting agency' and inserting `Subject to subsection (h), a consumer reporting agency'. (b) Prohibition on Certain Discriminatory Uses of Consumer Reports and Consumer Information in Connection With Insurance- Section 604 of the Fair Credit Reporting Act (15 U.S.C. 1681b) is amended by adding at the end the following new subsection:
>
> (h) Prohibition on Certain Discriminatory Uses of Consumer Reports and Consumer Information in Connection With Insurance- `(1) IN GENERAL- No consumer reporting agency may furnish a consumer report or consumer information with respect to any consumer to any person for use in making any decision to underwrite or rate any personal lines of insurance, and no person shall use or obtain a consumer report or consumer information with respect to any consumer in connection with the underwriting or rating of any personal line of insurance, for which the Commission determines, including any finding or determination made in any study for which a report is submitted to the Congress, that any such use of the consumer report or the consumer information-- `(A) results in racial or ethnic discrimination; or `(B) represents a proxy or proxy effect for race or ethnicity. `(2) INSURANCE INFORMATION NOT INCLUDED- Information derived from the following data bases shall not be treated as a consumer report or consumer information for purposes of paragraph (1): `(A) Databases that contain information on property loss data regarding personal lines of insurance, such as the Comprehensive Loss Underwriting Exchange (CLUE) and Automobile-Property Loss Underwriting System (A-PLUS). `(B) Databases that contain information on driver history, such as accidents or moving violations, typically maintained at State departments of motor vehicles. `(C) Databases that contain information on a consumer's medical history, to the extent such access and use for purposes described in paragraph (1) is consistent with the requirements of section 604(g). `(3) EFFECT ON STATE LAWS- Notwithstanding section 625(b)(3)(C), no provision of this section shall be construed as limiting or superseding the application of any State laws or regulations that restrict or prohibit the use of consumer reports or consumer information in the underwriting or rating of any personal lines of insurance. `(4) DEFINITIONS- For purposes of this subsection, the following definitions shall apply: `(A) CONSUMER INFORMATION- The term `consumer information'

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> means any information from the file on any consumer at a consumer reporting agency, or any product derived from any such information. `(B) PERSONAL LINE OF INSURANCE- The term `personal line of insurance' means any personal automobile or homeowners line of insurance, as defined in the Uniform Property and Casualty Product Coding Matrix established and maintained by the National Association of Insurance Commissioners (or any successor to such document). `(C) PROXY FOR RACE OR ETHNICITY- The term `proxy for race or ethnicity' means a substitute or stand-in for race or ethnicity, either by design or in effect, without regard to the extent of the effect.'".

H.R. 5633 IH, *Nondiscriminatory Use of Consumer Reports and Consumer Information Act of 2008*, 110th Congress, 1st Sess., March 13, 2008.

H.R. 5633 was presented to the House Finance Committee to offer a non-discriminatory use of consumer confidence reports and providing limiting and prohibitory measures. The House members for the bill argued "credit-score ratings penalize consumers because of the business decisions of the lenders, unfairly penalizes consumers who are victims of medical and natural catastrophes, has an adverse and disparate impact on low-income families and credit reports often have incomplete and inaccurate information." Hunter, Robert J. Consumer Federation of America*, The Impact of Credit-Based Scoring on the Availability and Affordability of Insurance*, Hearing Committee in Financial Services Subcommittee on Oversight and Investigations – House of Representatives, May 21, 2008. Those members opposed to the bill argue the requirement for credit scoring risk since "[l]ending institutions use credit to determine the likelihood of repayment… The most significant difference between insurers and lending institutions is that insurers never consider income… The latest survey shows that 90.2 percent of automobile insurance policyholders and 90.8 percent of homeowners insurance policyholders either received a discount or were otherwise unaffected by the use of credit." Neeson, Charles, Westfield Group on behalf of Property Casualty Insurers Association of America, Hearing before the House Financial Services Subcommittee on Oversight and Investigations, *The Impact of Credit-Based Insurance Scoring on the Availability and Affordability of Insurance*, May 21, 2008. The H.R. 5633 bill never passed. However, bills are often revisited.

A majority of our states have already enacted some statute which limits the application of credit scores when predicting risk, thus reflecting the issue that consumers are often harmed without restrictions and cram-down provisions. In *Folks v. Tuscaloosa County Credit Union*, 989 So. 2d 531, 538 (Ala. Civ. App. 2007), an action for a deficiency claim was filed by debtor's automobile lending company after his vehicle was repossessed. The state of Alabama enacted a statute limiting the use of debtor's credit score to determine interest rates, in that a setoff approach is used in order to settle the deficiency. The Alaska Supreme Court decided against the request of an insurance companies use a debtor's credit score in order to renew insurance, interpreting Alaska Statute § 21.36.460, Uses of and restrictions on credit history or insurance scoring applicable to personal insurance. See *State v. Progressive Cas. Ins. Co*., 165 P.3d 624 (Alaska 2007).

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Under our current Administration and economic situation, views of a person's insolvency are quickly changing. Analysts believe Bankruptcy filings will only increase should the new cram-down measures implement. Looking at the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA –amendments to the U.S. Bankruptcy Code) which impacted the way consumer debts are processed by adding more restrictions and measures to alleviate the Bankruptcy process, and how this new proposed law will reverse some of these restrictions, legislators are quickly recommending and voicing their opinions and perspectives. Our legislators address what a person's eligibility is for bankruptcy and who decides which assets the debtor will keep. Since the intent BAPCPA introduced was to make a less desirable way to file Bankruptcy (as some say it was too easy), the new proposed act today impacts individuals filing Bankruptcy by requiring now a credit counseling certificate and a segregation of individuals by median income levels.[3] According to the American Bankruptcy Committee, there is not enough historical data to rely on legislator's true intent, and we must then rely on case history and policy when determining meaning and intent of the statute. *Hollowell* at 175. Since there is conflict in interpretation among the courts, it is well established this means the analytical framework is not sufficient. *Hollowell* at id. The required computation called the means test (§1325(b)(3)) – or projected disposable income, determines eligibility. Anyone having an excess of $166 over household expenses is now required to file a Chapter 13, rather than a Choice of either Chapter 13 (reorganization) or Chapter 7 (total liquidation); thus raising the bar of expectation courts have on the debtor and a more complex path to confirming a debtor's reorganization plan in order to prevent Chapter 7 abuse.[4]

Normally a Chapter 11 Bankruptcy reserves application for a Business Entity reorganization. However, under the proposed Bankruptcy Code, debtors who do not qualify for Chapter 7 or 13, may only have a Chapter 11 option. (See *Toibb v. Radloff*, 501 U.S. 157 (1991)). §1115, 1123(a)(8), and 1129(a)(15) provide a requirement where a debtor must withhold a percentage of future income to creditors.) This may introduce problems for debtors where there is more flexibility – a good problem to have.

II. ACTIONS A DEBTOR HAS TODAY THAT MAYBE AFFECTED BY H. R. 3609.

A. Mortgages and Foreclosure

California and other state statutes recognize ways real property may guarantee the payment of debt or plan for some other obligation: 1) mortgage (Cal. Civ. Code §2922); and deed to secure debt; and deed of trust sometimes called the grant deed, or trust deed.

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[3] See Hollowell, Eileen W., Levitt, Kathleen, et al; *First This Way, Then That Way –Conflicting Interpretations of BACPA, American Bankruptcy Institute, Consumer Bankruptcy Committee*, Volume 4, Number 2 (2007); http://www.abiworld.org/committees/newsletters/legis/vol4num2/1.pdf. A bankruptcy judge and Chapter 13 Trustee and others came together to discuss the importance of using plain language statutes provide and when ambiguous, a statute should be revisisted.

[4] See *In re Hardacre*, 338 B.R. 718. The court here sorts out the meaning of projected disposable income and actual disposable income and the means test applied.

Cal Civ Code §1092 provides the benefit of grant deeds to transfer ownership to property. Grant deeds are the most popular instrument used in California. With the proposed law, now valuation will be determinative whether the property guarantees full payment of debt or not. The following explains the relationship between property and security deed.

A mortgage secures an obligation (debtor to pay) with a lien against the debtor's real estate. Should the debtor default on her mortgage, debtor is still lawfully in possession and control of the title and the lender only has an interest in her property (Cal. Civ. Code §2923). A security deed transfers the title to the lender/mortgagee with an opportunity to direct a foreclosure or take the property. A mortgage would force lenders to proceed through judicial foreclosure, which can be time consuming and expensive. So long as there is a reasonable default, as stated in *Ghirardo v. Antonioli*, 14 Cal 4th 39, 57 Cal Rptr 2d 687 (Cal. 1996) "there may be only one action for the recovery of a debt secured by a trust deed, which action is one of foreclosure. Although an exception to this one action rule has developed in cases where foreclosure would be an idle act because the security has been destroyed or has become worthless, the exception does not apply if the beneficiary is responsible for the loss of security. When the mortgagee, by his or her own act or neglect, deprives himself or herself of the right to foreclose the mortgage, he or she no longer has a right to an action upon the note." (See also Cal. Code Civ. Proc. §726.) Lenders prefer to apply the non-judicial method security deed's require.

While a security deed (grant deed a.k.a deed of trust) is mostly preferred and used routinely in almost residential and business real estate transactions, a mortgage can be used by someone unfamiliar with California law. Fortunately, laws governing security deeds and mortgages are similar. If the mortgage contains a provision that authorizes sale, it may be foreclosed through a non-judicial exercise foreclosure sale; like the same manner as a deed of trust.

From a Debtor-Borrower's perspective, if she goes into foreclosure, she may only have a few options. A borrower may choose to sell the property, provide a Deed in lieu[5] of foreclosure, work out some arrangement/loan modification, file bankruptcy[6] and finally go into foreclosure proceedings. The threat of foreclosure brings lenders to an option to negotiate a defaulted loan. July 8, 2008, California legislators passed an

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[5] Deed in lieu of foreclosure. This is usually feasible only if the property is free from junior liens and encumbrances. There is, however, a risk of the conveyance being subsequently set aside by a bankruptcy court as a preferential transfer if the property was worth substantially more than the indebtedness. If this method is used, the mortgagor should be required to sign an estoppel and solvency affidavit in addition to the deed. The mortgagee may also want to consider including non-merger language in the deed and not releasing its security deed for some time after the transfer to insure that it as least retains its secured position in the event a bankruptcy court should set aside the conveyance. *GBJ, Inc., II v. First Ave. Inv. Corp*., 520 N.W.2d 508 (Minn. Ct. App. 1994).

[6] The filing of a bankruptcy petition automatically enjoins a foreclosure against property of the debtor and of the bankruptcy estate (11 U.S.C.A §362(a) – automatic stay). All foreclosure activities should be dropped upon proper notification the current owner has filed bankruptcy. Failure to stop the foreclosure could result in the lender's (and possibly the attorney) being held in contempt of court. Furthermore, a foreclosure sale conducted in violation of the stay is void. Before proceeding with foreclosure the lender must either obtain a court order lifting the stay or wait until the stay otherwise terminates under 11 U.S.C.A §362.

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amendment of California Civil Code 2923.6, now requiring lenders in the State of California to accept loan modifications if borrowers qualify under the recent requirements. California Civil Code 2923.6 applies to loans made from January 1, 2003, to December 31, 2007, and secured by residential real estate and are owner-occupied.[7]

B. Stay Period, ultimately delaying the Foreclosure

California Senate Bill 1137 is a result of the sub-prime loan market collapse and as an urgency measure. Until this bill, mortgage lenders were under no statutory requirement to communicate its intention to act on a non-judicial foreclosure. This law applies to loans secured by an owner occupying residential real property and loans made between January 1, 2003 and December 31, 2007. These laws will stay in force until January 1, 2013. A new component added to the California Civil Code as follows:

> "Until January 1, 2013, and as applied to residential mortgage loans made from January 1, 2003, to December 31, 2007, inclusive, that are for owner-occupied residences, this bill would, among other things, require a mortgagee, trustee, beneficiary, or authorized agent to wait 30 days after contact is made with the borrower, or 30 days after satisfying due diligence requirements to contact the borrower, as specified, before filing a notice of default. The bill would require contact with the borrower, as defined, in order to assess the borrower's financial situation and explore options for the borrower to avoid foreclosure. The bill would require the mortgagee, beneficiary, or authorized agent to advise the borrower that he or she has the right to request a subsequent meeting within 14 days, and to provide the borrower the toll-free telephone number made available by the United States Department of Housing and Urban Development (HUD) to find a HUD-certified housing counseling agency. The bill would require the notice of default to include a specified declaration from the mortgagee, beneficiary, or authorized agent regarding its contact with the borrower or that the borrower has surrendered the property. If a notice of default had already been filed prior to the enactment of this act, the bill would instead require the mortgagee, trustee, beneficiary, or authorized agent, as part of the notice of sale, to include a specified declaration regarding contact with the borrower.

[7] California Civil Code 2823.6(a) states that "a servicer acts in the best interest of all parties if it agrees to or implements a loan modification where the (1) loan is in payment default, and (2) anticipated recovery under the loan modification or workout plan exceeds the anticipated recovery through foreclosure on a net present value basis." California Civil Code 2823.6(b) now provides "that the mortgagee, beneficiary, or authorized agent offer the borrower a loan modification or workout plan if such a modification or plan is consistent with its contractual or other authority."

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> The bill would authorize a borrower to designate a HUD-certified housing counseling agency, attorney, or other advisor to discuss with the mortgagee, beneficiary, or authorized agent, on the borrower's behalf, options for the borrower to avoid foreclosure. The contact and meeting requirements of these provisions would not apply if a borrower has surrendered the property or the borrower has contracted with an organization, as specified. The bill would also require specified mailings to the resident of a property that is the subject of a notice of sale, as specified. In addition, the bill would make it a crime to tear down the notice of sale posted on a property within 72 hours of posting, thereby imposing a state-mandated local program.
>
> Until January 1, 2013, this bill would require a legal owner to maintain vacant residential property purchased at a foreclosure sale, or acquired by that owner through foreclosure under a mortgage or deed of trust." (Cal. Civ. Code §2923.5) (See also *American Housing Rescue and Foreclosure Prevention Act of 2008*, H.R. 3221, 110th Cong. §§ 401-402 (2008).

The stay period will only delay the foreclosure, in my opinion, according to what I have witnessed working in my Law Firm. The issue that the debtor still does not have a job, has not been resolved. Without a job, regardless of the stay period, the debtor will still not be able to pay the mortgage. However, with a stay period, the debtor has time until the new provisions are passed which then the debtor will have the option to file bankruptcy and cram-down the mortgage loan.

C. Deficiency Actions

When potentially-to-be-foreclosed property incurs a lien, at the judgment of foreclosure sells with a deficiency of proceeds to cover the lien, a lender may file a deficiency judgment against a debtor or anyone else liable within the foreclosure of the mortgage (Cal. Code §3151).

"California's anti-deficiency laws do not preclude a creditor from pursuing all security given to collateralize an indebtedness. Thus, a guarantor of a security deed is not protected against a deficiency judgment." *Hodges v. Mark*, 49 Cal. App. 4th 651, 656 (Cal. App. 2d Dist. 1996). Cal Code Civ Proc § 580b lists prohibitory conditions applying deficient judgments .

In order to place a deficiency action after a foreclosure sale, the lender must, within 30 days of the sale, report the transaction to the court and file with the clerk an application for an order confirming the sale. (Cal. Civ. Proc. §580(b)) The mortgagee must prove the land sold for its true market value. In order to carry this burden of proof, the lender should have the property appraised shortly before sale by at least one MAI

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certified real estate appraiser and be willing to bid on the property in an amount comparable to the appraised value. The foreclosure bid will repay the indebtedness to that extent; therefore; it is imperative the lender bid the appraised value of the property in a deficit situation with a correct legal description. (*Clayton Development Company v. Michael P. Falvey*, 206 Cal. App. 3d 438)

Unless the debtor appears financially sound, it is probably not helpful waste efforts obtaining an appraisal, pursing confirmation and filing a deficiency action. However, some lenders may be under instructions from governmental agencies (Fannie Mae, Freddie Mac, etc.) or mortgage insurers to cure the deficiency rights in all cases.

“California's anti-deficiency laws do not preclude a creditor from pursuing all security given to collateralize an indebtedness. Thus, a guarantor of a promissory note secured by a deed of trust is not protected against a deficiency judgment.” *Hodges v. Mark*, 49 Cal. App. 4th 651, 656 (Cal. App. 2d Dist. 1996).

In order to file a deficiency action after a foreclosure sale, the lender must, within 30 days of the sale, report the sale to the court and file with the clerk an application for an order confirming the sale. (Cal. Civ. Proc. §580(b)) The mortgagee must prove the property sold for its true market value. In order to carry this burden of proof, the lender should have the property appraised shortly before sale by at least one MAI certified real estate appraiser and be prepared to bid on the property in an amount equal to the appraised value. The foreclosure bid will satisfy the indebtedness to that extent; therefore; it is imperative the lender bid the appraised value of the property in a deficiency situation. (206 Cal App 3d 438)

Unless the debtor appears financially sound, it is probably not worthwhile to expend the time and money involved in obtaining an appraisal, pursing confirmation and filing a deficiency action. However, some lenders may be under instructions from governmental agencies (Fannie Mae, Freddie Mac, etc.) or mortgage insurers to preserve the deficiency rights in all cases.

A probable effect of the H.R. 3609 is the new proposed law will cram-down any deficiency above actual (appraised) value of the property.

D. Priorities

Home loans are always given a priority over other types of loans since they have high collateral value (a secured claim based on the value of the home). This means the priority of a lien applied in a home loan will generally be first. Lien priorities are charged on a property for payment of a debt on the property. Federal and state laws determine the priority of liens, i.e. federal tax liens will typically be given top priority (paid first); see *Slodov v. United States*, 436 U.S. 238, 257-58, 56 L. Ed. 2d 251, 98 S. Ct. 1778 (1978). “[S]tate law dictates the existence of property interests, but the priority of those interests with respect to other portions of the tax law is an issue of federal law.” *Bednarowski & Michaels Dev., L.L.C. v. Wallace*, 293 F. Supp. 2d 728, 732 (E.D. Mich.

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2003). “A preexisting lien, i.e., a tax lien, encumbers whatever property the lienee thereafter acquires.” *Wallace*, 293 F. Supp. 2d at 733.

Lien Priorities are dealt with repeatedly in Foreclosure actions. Today, real estate property may contain multiple types of liens filed against it including a Trust Deed, a Federal Tax Lien, a Construction or Mechanics Lien. Some properties may also include a First and Second Mortgage Trust Deed, Homeowner Association (HOA) lien, or Delinquent Property taxes. Generally, lien priority attaches when the lien is recorded and expressly prioritized with the County Recorder. As such any transactions occurring during a loan re-work or foreclosure sale, it is necessary to search for any liens attached to the property.

In the United States we fight to retain our right to own property over any other right. Prioritizing home loans over all others clearly supports this policy. The cram-down goal is to give the home owner incentive to pay as much to their home loan as possible by reducing their lower priority – unsecured debt in order to free up extra cash to pay down the mortgage/home loan.

E. Loan Modifications

The decline of the American economy has led to an increase of loan modifications in order to put lender's assets back into a working-asset rather than a loss and write-off. When a loan is modified, usually a) the loan maturity date shortens (the loan is due at an earlier date), b) the interest rate increases, or c) the entire amount of debt owed is increased. This is considered a material modification that would adversely affect the debtor and any subordinate lien holder on account.

“Despite the waiver as to application of loan proceeds, the court held that public policy requires protection of subordinating sellers and that a lender and a borrower may not bilaterally make a material modification in the loan to which the seller has subordinated, without the knowledge and consent of the seller to that modification, if the modification materially affects the seller's rights.” *Gluskin v. Atl. Sav. & Loan Assn*., 108 Cal. Rptr. 318, (Ct. App. 1973). In *Gluskin*, Jack Gluskin owned 172 lots of land which he sold to the corporation Pathfinder under a promissory note secured by the Trust Deeds for the land plus fifty percent of profits on the sale of these new developments. Pathfinder then borrowed money from Atlantic Savings and Loan in order to construct a housing development on the land. And thus when Pathfinder defaulted, the issue ascended on whether a loan modification made without Gluskin's consent, created a priority Atlantic has over Gluskin since in the Gluskin Trust Deed contained a subordination provision expressly stating Gluskin subordinated under Atlantic's Trust Deeds and that loans were given in reliance on the subordination. Here the Appellate Court reversed the lower court's ruling for Atlanta since there was no finding of the fact that Gluskin had consented to this modification.

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Shane v. Winter Hill Fed. Sav. & Loan Assn.[8] raised the question about a loan modification where interest raised on a first mortgage applies to the second mortgage. In this Massachusetts court, trustee Richard Ross provided a $450,000 mortgage and deed for the Winter Hill Federal Savings and Loan Association for a property on Turnpike Street, Canton, Mass. Two years later, Ross executed a second mortgage for $100,000 on the aforementioned property, to a Realty company. The realty company had agreed to take on an option to cure a default by Winter Hill, by increasing the first mortgage's interest rate. When Winter Hill defaulted again, they also notified the realty company of its intent to foreclose. The realty company also purchased the property subject to the first mortgage, and then filed claims against Winter Hill for the raise in interest. The realty's interest was only that they had a claim in the security of the property, and had requested notice of any default and then have the option to rectify it and not be bound by any interest rate agreements she was a junior interest thereto. The court held that the interest rate increase agreed between the Ross and Winter Hill without notice to the Realty company, did prejudice the Realty company and they will not remain bound to that agreement as they were the second mortgagees.

Courts seem to stay more lenient applying loan modifications that have minimum impact on the debtor and may in some cases be of benefit to junior liens. Where loan modifications a) extend the maturity date, b) defer interest, c) reduce the interest rate or d) reduce the loan amount, the extensions seemingly put a lender's property back to a working and active status. Also, these types of modifications should not adjust the lender's priority.

In *Resolution Trust Corporation v. BVS Development, Inc.*[9], land developers sold land in exchange for deeds of trust for construction financing with subordinate interests, from Concord-Liberty Savings and Loan Assn. who partnered with Resolution Trust Corporation. When the development project soured, and the land developer's defaulted on a $2.6 million loan, the lenders filed a foreclosure action. Defendant land developers argued that when their maturity date was extended, the subordinate clause was not appropriate and also cite the rule from *Gluskin* that the extension loan modification had not been consented had thus adversely affected their lien position. Here however, the amendment did not expand the chance of default, like it did in *Gluskin*. The land developers in fact, had more time to pay at the equivalent rate, unlike *Gluskin* where time was reduced and interest was increased.

“[T]he extension was made at a time when the borrower was in difficulty; it could be reasonably argued the extension gave the borrower a chance to turn itself around and pay off its debts. By itself, the extension cannot be said to be a material modification requiring an adjustment of priorities as a matter of law.” *Lennar Northeast Partners v. Buice*, 49 Cal. App. 4th 1576, 1584 (Cal. App. 3d Dist. 1996). Here the interest rate

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[8] 397 Mass. 479; 492 N.E.2d 92; 1986 Mass. LEXIS 1291

[9] 42 F.3d 1206, *; 1994 U.S. App. LEXIS 34123, **; 94 Cal. Daily Op. Service 9295; 94 Daily Journal DAR 17208

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changed from a variable to a set rate. The maturity date was extended as well as the principal amount in order to support the Trust company-debtor regain control of payments. The lower court ruled Trust company no longer had a priority claim since they modified the terms of the agreement. This Appellate court reversed ruling no material modification or prejudice to the subordinate lien holders.

The current 1322 (b) statement striken "other than a claim secured only by a security interest in real property that is the debtor's principal residence[,]" modifications will be allowed to a debtor's principal residence. We are looking at cramming down the value of the property to what its actual value is today in order to free up extra cash applied to other unsecured and lower priority loans. This should not be considered a material modification since it is a best-effort to pay those we owe in the fairest way possible.

F. Title Insurance

Since valuation is at stake here and title insurance covers the actual value of the property, two major organizations should be discussed regarding insurance related to real estate; The American Land Title Association (ATLA) and the California Land Title Association (CLTA). ATLA and CLTA provide title insurance endorsing that the property at issue is free and easy to transfer and provides certain assurances. When mortgage loans are modified, ATLA will not guarantee any subsequent agreements than the first policy contracted on the land. There are other coverage options that will require extra protection and endorse modifications set forth in ATLA Form 11 and CLTA Form 110.5. However, as mentioned in Gluskin, Shane and RTC, courts do not favor material modifications that prejudice junior lien holders; so long as Form 11 and Form 110.5 do not contain a material modification, the title insurance coverage value should be ascertainable.

To be exhaustively diligent, the title to the property should be examined early in a foreclosure proceeding. A full title examination would, of course, be the most useful in that it would reveal any defects in the mortgagor's title existing when the security deed was executed. However, where an attorney is provided with a mortgage title insurance plan (obtained when the security deed was executed) it is customary to conduct a restricted title examination coming forward from the date of the security deed (2008 Cal ALS 80, Cal. Code Civ. Proc.§880.020(a)(4)). The title insurance policy should be provided to an attorney at the outset (Cal Ins Code §1063.1).

The limited title examination should include a search of the following public records; 1) deed records, 2) federal tax lien docket, 3) lis pendens docket, 4) bankruptcy records and 5) possibly probate records. It is also recommended to check the bankruptcy records shortly before a foreclosure sale. These factors are simply a guideline and to be sure all bases are covered, and to be sure your property does not contain any hindering constructs that Title Insurance may not cover.

I will highlight important factors to know:

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1. Deed Records.

The deed records kept by the Clerk of the Superior court in the count which the land lies should be examined to ascertain the names of all persons who have held right to the property since the execution of the security deed. A chain of title is needed in order to preserve evidence of ownership.

Only litigation which goes to the validity of the security deed or the right to foreclose should stop the foreclosure sale. Any other litigation regarding the property concerns rights of parties which are subject to the security deed and thus subject to foreclosure (Cal. Code Civ. Proc.§ 880.260 (a)(1)).

If the lis pendens docket reveals the property in foreclosure is in the custody of a receiver, the foreclosure should immediately cease. Such property is in the custody of the court appointing the receiver, and its assets may not be interfered with unless the mortgagee intervenes in the proceeding and obtains authorization to foreclose. Where the due date is ascertainable from the record, the 10-year limitations period of Civ. Code §82.020(a)(1), applies. Any recorded document that contains the due date of the note secured by the trust deed in question will suffice. *Slintak v. Buckeye Retirement Co., L.L.C., Ltd.*, 139 Cal. App. 4th 575 (Cal. App. 2d Dist. 2006).

2. Bankruptcy Records.

The filing of a bankruptcy petition automatically enjoins a foreclosure against property of the debtor and of the insolvency estate (11 U.S.C.A §362(a) – automatic stay). All foreclosure activities should be dropped upon proper notification the present owner has filed bankruptcy. Failure to end the foreclosure could result in the lender's (and perhaps the attorney) being held in contempt of court. Furthermore, a foreclosure sale conducted in defiance of the stay is void. Before proceeding with foreclosure, the lender must either achieve a court order lifting the stay or wait until the stay otherwise terminates under 11 U.S.C.A §362. Debtors or their attorneys generally notify the foreclosing lender of a bankruptcy filing, but not always. Therefore, it is recommended to check the Bankruptcy Court records to ensure the present owner has not filed. Since bankruptcy filings are often take place at the eleventh hour, the bankruptcy records should be checked shortly before the foreclosure sale date.

3. Federal Tax Liens.

A tax lien against anyone in the chain of title recorded must be dealt with in a specific manner. The trust deed will maintain its priority over subsequently filed federal tax lien. 26 U.S.C.A §7425 (b). Without IRS notice or consent, the federal lien will remain on the property superior to the purchaser’s title obtained at sale. The purchaser may apply for a Certificate of Discharge From Federal Tax Lien, however. 26 U.S.C.A §6325 (b).

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4. Probate Records Need Not Be Examined.

A right of sale in the security deed is a power coupled with an interest and is therefore irrevocable so that the power may be exercised regardless of the death of the mortgagor. In California, a trust state, when a trustor has died, the successors in interest are entitled to receive notice of default under certain circumstances. Essentially, proof of interest must be filed in the county where the land is located. It must provide constructive notice to the trustee prior to the recording of the notice of default. Further, it must supply an address to which notices may be mailed. The trustee should try to track down successor's but does not include the duty to. See *Estate of Yates*, 25 Cal. App. 4th, 511 (1994).

In light of the title, with a due diligent search, the proposed cram-down should not have any affect on the insured amount of your property so long as modifications made have not been determined material.

III. AN UNREGULATED INDUSTRY LEADS TO FRAUD

The Real Estate Settlement Procedures Act (RESPA) section 6, 12 U.S.C. 2605, provides consumer protection with the mortgage-industry loans. The debtor may send a Qualified Written Request[10] to the lender who in return must provide a written acknowledgment. During a suspension period, the lender cannot report to any consumer credit agencies (i.e. Equifax, etc). A debtor may also file a private lawsuit for a RESPA violation and noncompliance. The problem is that these written requests are often ignored and usually a strategy to obtain a stay order.[11]

In my opinion, Consumer Protection is thinly spread between too many agencies. The Consumer Protection Agency, the Federal Trade Commission and the Securities and Exchange Commission all stake claims on protecting consumers. Loan servicers are usually a secondary party working for a profit. When a loan goes into foreclosure, more fees are tacked on. Because of little to no regulation in the mortgage industry abusive behavior tends to generate and fuel the already-stressed housing crisis.

Frustrated Homeowners deal with tacked on fee after fee, some services which have not even been performed (i.e. pre-paid charges for future overdue fees and inspection costs). Law Firms, such as mine, see these fees have a immediate impact on the increase of foreclosures since those fees only add to their monthly payments which keep increasing, the homeowner can no longer pay their monthly rate and thus default.

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[10] "For purposes of this subsection, a qualified written request shall be a written correspondence, other than notice on a payment coupon or other payment medium supplied by the servicer, that--(i) includes, or otherwise enables the servicer to identify, the name and account of the borrower; and(ii) includes a statement of the reasons for the belief of the borrower, to the extent applicable, that the account is in error or provides sufficient detail to the servicer regarding other information sought by the borrower." (12 U.S.C 2605 (e)(1)(B)).

[11] Better Business Bureau, report # unknown, author unknown, submitted March, 2009.

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With further regulation which will be added with the new proposed bill, I believe new administration will be able to identify, manage and address complaints with ease. I also believe ignored complaints will lessen since these complaints will now be moot if the court will now be addressing the root of the problem – valuation of the total debt.

IV. CRAM-DOWN EFFECTS.

This proposed bill may encourage more Chapter 13 bankruptcy filings. The Helping Families Save their Homes Act and HOPE for Homeowners is a rescue plan. President Obama is initiating so borrowers will have an opportunity to re-work their loan payments and pay all their debts without losing a home in foreclosure. The bill offers that legislation reimburse lenders part of their loss should a debtor is in a Chapter 13 and sells the property. Director Peter R. Orszag, of the Congressional Budget Office, analyzed forthcoming legislation and believes "the bill as a whole… would increase the budget deficit over the next decade, incur larger losses… higher coverage levels and insured deposits… gradually offset with higher future premiums." Orszag, Peter R., Congressional Budget Office, *Letter to Chairman Christopher J. Dodd- Chairman on Committee on Banking, Housing and Urban Affairs- United States Senate*, October 1, 2008. The plan, designed to secure and manage failing and troubled assets will require additional administrative costs. The resale values will be hard to ascertain. Orszag believes proceeds gained in sales and future valuation increases will be less than the entire acquisition cost this government will continue making.

While Chairman Orszag proves a reasonable point, the solutions used today cannot be applied in today's world economy. It is clearly failing. Without some change that will jumpstart our economy, we will continue on the spiral downward turn. A different strategy will produce a novel mechanism (i.e. The Energy Improvement and Extension Act of 2008 is another method to move our economy). The key here is to conserve where we never have before in order to unlock new avenues of financing and spending.

As you see, the tide of foreclosure is bringing heavy, quick-moving change. Presently, Bankruptcy Judges do not have the right or authority to unilaterally create mortgage loan modifications. Also, now loan modifications are usually worked by private consumer companies and law firms, mine included. Cram-down supporters say a cram-down is the ideal tool that encourages lenders to provide loan modifications for their borrowers. The cram-down bill allows federal judges to modify note terms, decrease interest rates and mortgage loan balances of bankrupt homeowners. It also will permanently extend the Federal Deposit Insurance Corp.'s insured coverage to $250,000. Nay-sayers believe cram-downs will create higher interest rates (higher costs to procure a loan) and an even-tighter credit market.

Those opposed against the proposed bill say these additions are unnecessary provisions. One provision allows bankruptcy judges the authority to change the mortgage

loan terms, like the loan balance, in a Chapter 13 bankruptcy proceeding. When we allow judges to deliver these changes, a question arises as to how the collateral value of the property at issue is calculated. Many fear an economic impact. Most of the lending community (including the American Bankers Association and other Republicans) stands against the proposal declaring mortgage rates will increase, forcing lenders to require larger payments up front in order to account for the newly added risk.

I will discuss.

Bifurcation

Bifurcation means a forking; a division into two branches.[12] Section 506 of the title 11 United States Code (a.k.a. cram-down provision) authorizes bankruptcy claims to be bifurcated or split into secured and unsecured claims. §506 (a) maybe applied to Chapters 7, 11 and 13 claims. Courts are split, however, as whether to allow bifurcation or not. See *In re Mordred J. Richards et al. v. Federal Home Loan Mortgage Corp.*, 151 B.R. 8, *; 1993 Bankr. LEXIS 284, **; Bankr. L. Rep. (CCH) P75, 145; 28 Collier Bankr. Cas. 2d (MB) 626. 11 U.S.C 506 provides the following:

"(d) To the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such line is void, unless –

(1) such claim was disallowed only under section 502(b)(5) or 502(e) of this title; or
(2) such claim in not an allowed secured claim due only to the failure of any entity to file a proof of such claim under section 501 of this title."

Applied to section 1325 (a)(5) as follows:

"(a) Except as provided in subsection (b), the court shall confirm a plan if -- …

(5) with respect to each allowed secured claim provided for by the plan -- …

(B)(ii) the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim…"

Judge Feeny in *Richards* cites and summarizes various district court decisions in conflict with the interpretation –thus clearly ambiguous-- the "denial of bifurcation would be a windfall to mortgagees whose worthless unsecured mortgages would continue to encumber debtors homes to the extent of the debt after Chapter 13. This result would counter to the reorganization provision of Chapter 13 premised upon the retention of assets and the fresh start policy of the Bankruptcy Code." With the new provision the conflict of whether to bifurcate claims or not will likely be resolved since the courts will now be able to revise the actual secured claim amount.

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[12] Bifurcation. *Webster's Dictionary*, Merriam-Webster 11th Edition (2007).

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Valuation of the property is "fixed at the time of plan confirmation," *Richards* at 30. The result then under HR 3609, would be current asset value of homes will be significantly lower than what was originally mortgaged. The cram-down value will then be lower and the debtor pays less. Then, of course various arguments arise as to whether the loan is really secured or not since the actual value is much lower. I will not address these arguments here. My goal is to simply answer the question at issue which I do not believe security is at issue – only valuation and added costs.

Filing Bankruptcy

"Under chapter 13 of the Bankruptcy Code, unless the debtor surrenders the property securing the lien to the holder of an allowed secured claim provided for by the plan or such holder accepts the plan, a chapter 13 plan that provides for a secured claim may not be assured of confirmation without a cram down provision comporting with section 1325(a)(5)(B). Chapter 13 cram down is comprised of two essential elements, lien retention and equivalent value, distributed in accordance with certain rules each of which must be provided for under the chapter 13 plan itself." *Collier on Chapter 13 Cramdown*, 2008 Emerging Issues 1253. In today's market, with declining housing markets, unemployment rates rising steadily our legislators are taking action in order to stabilize what we already know is a declining economy. Most understand the definition of cram-down as "a court-ordered reduction of the secured balance due on a home mortgage loan, granted to a homeowner who has filed for personal bankruptcy." *Finance and Business Terminologies*, http://www.answers.com/topic/cram-down.

A judge will then identify the actual value of the home as the secured value, and the deficient balance as unsecured, then prioritized as such. *Example*: A bankruptcy judge considers a $400,000 property value that contains a $350,000 first mortgage and $50,000 unsecured debt. He can then allow $350,000 to the first mortgage holders, and cram-down the $50,000 unsecured debt to $10,000. With proposed law HR 3609 a judge may alter the secured and unsecured debt as he sees it and to justify what the debtor actually owes maybe too much. If a debtor is making payments on a $200,000 mortgage on a home valued at $120,000, that debtor is paying over-the-top an unjust amount and thus not in compliance with §1325 (a)(5)(B)(ii).

Basic Contract rules provides when asset valuation declines rapidly due to unforeseen market changes, parties to that contract may be excused from performance due to commercial impracticability or courts tend to support contract modifications. "When the occurrence of an unforeseen event would cause a promisor to bear and unexpectedly large loss in performing her contractual obligation, the parties might renegotiate and modify the promisor's contract… The common law doctrines of impossibility and commercial impracticability release the promisor from her obligation on the grounds of an unforeseeable supervening event that increases the cost of either literal performance or damages liability to a level beyond the anticipated values at the time of contracting." Triantis, George G., *Unforeseen Contingencies. Risk Allocation in Contracts*, University of Virginia Law School (1999). It is clear with today's market

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changes, the debtor's value has significantly decreases and must be allowed and addressed with modification.

Section 5, H.R. 3609 Elimination of credit counseling requirement for chapter 12 debtors facing foreclosure, offers to strike from section 109 (h) of Title 11 "shall not apply with respect to a debtor in a case under chapter 13 who submits to the court a certification that the holder of a claim secured by the debtor's principal residence." This somewhat loosens the restrictions for what may or may not be of benefit to the debtor. Under credit counseling advisement, a person must understand the root of the financial problem. Sometimes it may only be a hardship where no matter how much credit counseling one gets, you would still have to file bankruptcy (i.e. medical costs for an unexpected accident or sickness).

V. Conclusion

H.R. 3609's biggest impact here will be actual property valuation. Declines in property values are at the forefront. Homes that mortgaged at $200,000 may only be worth $120,000 today. While the new administration maybe and probably will be required to manage activity proposed here, I am not convinced this will negatively impact the current Mortgage business today. Will it stop excessive fees? Probably. Does that impact mortgagees? Yes. However, the leverage of these new rules will only help manage fraudulent activity. Will title insurance coverage be affected? Yes, but only in the sense of what property will be automatically valued by the court. Credit Counseling will no longer be another hurdle to jump. Since managing a credit report should be a job in itself, and identity fraud is at it highest, we cannot solely rely on credit report updates. That said, I believe opponents of the bill provide reasonable arguments; but do not address any other avenues resolving the conflict. If we march forward under the same rules and regulations, we will continue to spiral downward. I believe the change will a better influence and will allow debtor/homeowners the relief they need to save their most prized-possession—their home.

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