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22 Years in the Making: 4th Circuit's *Hurlburt* Decision Allows for Bifurcation of Short-Term Mortgages[1]

By Kathryne M. Shaw

In March of 2019, the Fourth Circuit Court of Appeals issued its decision in *Hulburt v. Black*,[2] which reversed 22 years of precedent set by its previous decision in *Witt v. United Cos. Lending Corp.*[3] *Witt*, disagreed with by every other circuit to consider the issues, forbad the bifurcation and cramdown of short-term mortgages that mature during the term of a Chapter 13 plan.[4]

In 1993, the Supreme Court issued its decision in *Nobelman v. American Savings Bank*,[5] clarifying the relationship between bifurcation of secured claims under 11 U.S.C. § 506(a)(1) and the anti-modification provisions of 11 U.S.C. § 1322(b)(2). Section 506(a)(1) states that a creditor with a lien on property has a secured claim to the extent of the value of that property and an unsecured claim as to the remainder that is unsupported by value in the property.[6] In others words,§ 506(a) bifurcates a creditor's claim into secured and unsecured portions. Section 506 is not self-executing, however. In Chapter 13, the bifurcation statute works in tandem with 11 U.S.C. § 1325(a)(5)(B) to "cramdown" the bifurcated claim to its secured amount only and stripping the lien of its unsecured portion.[7] Section 506(a)(1)'s bifurcation is limited by the provisions of 11 U.S.C. § 1322(b)(2), which prohibits Chapter 13 debtors from "modifying the rights of holders of secured claims . . . secured only by a security interest in the real property that is the debtor's principal residence."[8] *Nobelman* held, for the purposes of Section 1322(b)(2), a debtor is unable to utilize Section 506(a)(1)'s bifurcation provisions to modify or reduce the claim of a mortgage on a principal residence to the fair market value of the property.[9]

After *Nobelman*, Congress passed the Bankruptcy Reform Act of 1994 which amended § 1322 and added subsection (c), which states in part:

> Notwithstanding subsection (b)(2) and applicable nonbankruptcy law—
>
> (2) in a case in which the last payment on the original

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> 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 as modified pursuant to section 1325(a)(5) of this title.[10]

After the 1994 Reform Act, the Fourth Circuit issued its decision in *Witt*, holding that Chapter 13 debtors could not bifurcate a narrow subset of undersecured mortgage loans that mature during a Chapter 13 plan into an unsecured claim and a "cramdown" secured claim.[11] The *Witt* Court reviewed the language of Section 1322(c)(2) and the legislative history of its enactment.[12] Specifically, the Court debated the meaning of the phrase "as modified pursuant to section 1325(a)(5) of this title" and whether it should be read as applying to "claim" or "payment."[13] The Court reviewed the ambiguous grammatical construction of the statute as well as the legislative history of subsection (c), specifically mentioning that the legislative history lacked any intent or discussion by Congress to overrule *Nobelman*.[14] The Court held that § 1322(c)(2) did not permit the bifurcation of an undersecured loan into secured and unsecured claims if the loan is secured by the debtor's principal residence.[15] However, the Court determined that § 1322(c)(2) did allow the modification of payment terms only of matured (or maturing) mortgages over the life of the Chapter 13 plan.[16]

Many courts have criticized *Witt's* reasoning and reliance on legislative history to support its holding.[17] Both the Eleventh and Sixth Circuit Court of Appeals rejected *Witt's* interpretation of § 1322(c)(2) and determined that it does allow for the bifurcation of short-term mortgages into secured and unsecured claims. In *In re Eubanks*, the Sixth Circuit reviewed the *Witt* decision and stated that it "makes nonsense of the cross reference to § 1325(a)(5)" and criticized Witt's reading of the legislative history.[18] Additionally, in *In re Paschen*, the Eleventh Circuit stated that *Witt's* reading of the statute was a "grammatically strained reading of the statute" and "contradicts the rule of the last antecedent."[19] *Witt* resulted in severe limitations on what debtors could do regarding matured, or maturing, loans during the term of a Chapter plan.[20] Until now, the only option for debtors in the Fourth Circuit for handling matured or maturing mortgage loans has been to modify the payments terms by extending the repayment through end of the 36-to-60 month Chapter 13 plan term.[21] Any attempt to modify the interest rate or to bifurcate the claim into secured and unsecured amounts in order to repay less was not allowed under § 1322(c)(2).[22]

After 22 years under *Witt*, the *Hulburt* decision now aligns the Fourth Circuit with the majority of the courts in the interpretation of Section 1322(c)(2). The Court, as it stated, did not "lightly overrule" its precedent but, instead, provided a detailed explanation as to why *Witt* was inconsistent with the natural reading of § 1322(c)(2) and the statute as a whole.[23] The Court states that the most natural reading of the statute is "permitting the modification of claims, not payments" and when "the most natural reading of statutory language supports a particular construction of that language, courts should be wary of adopting an alternative construction."[24]

The Court looked at the prefatory phrase to subsection (c), "notwithstanding subsection (b)(2)," and determined that Congress indicated for § 1322(c)(2) to be an "exception to or limitation on Section 1322(b)(2)'s anti-modification provision."[25] As the Court stated, "most significantly—Section 1322(c)(2) provides that a Chapter 13 plan 'may provide for the payment of the claim as modified *pursuant to section 1325(a)(5) of this title*'" meaning that by this specific reference, § 1322(c)(2) authorizes the modification of the claim itself, including the bifurcation and cramdown of the unsecured portions, and not just payment terms.[26] As the Court pointed out, "*Witt* nowhere addressed the import of Section 1322(c)(2)'s reference to a claim-modification, as opposed to a payment-modification provision."[27]

The Court discussed *Witt's* prior reliance on the legislative history and determined that, because the plain language of § 1322(c)(2) allowed bifurcation, it did "not believe that it is proper to rely on legislative history to 'muddy [the] clear statutory language'" nor did it believe "that the legislative history carries much interpretive weight."[28] The Court stated that *Witt's* reliance on the absence of discussion

relating to *Nobelman* was misplaced and "does not constitute a basis for rejecting the plain meaning of [Section 1322(c)(2)], which . . . authorizes the modification of claims, not just payments."[29] As the Court cited twice in its decision, "silence in the legislative history, no matter how clanging, cannot defeat the better reading of the text and statutory context."[30] *Witt's* "interpretive" reliance in the legislative history on the absence of discussion about *Nobelman* "rests on a faulty premise—that Section 1322(c)(2), in fact, overruled *Nobelman's* holding" prohibiting bifurcation of home mortgage claims.[31] The Court construes § 1322(c)(2) not as overruling *Nobelman* but, rather, exempting a narrow class of home mortgages in which the final contractual payment is due prior to the last Chapter 13 payment from § 1322(b)(2)'s anti-modification provisions.[32]

With *Hurlburt*, the Fourth Circuit has corrected a severe limitation in the flexibility of Chapter 13 plans and has bolstered a debtor's arsenal of reorganization options to help debtors retain their homes. In combination with other recent decisions, *Hurlburt* makes the Fourth Circuit perhaps the most homeowner friendly circuit for all debtors seeking Chapter 13 protection.[33] Although unusual, the Fourth Circuit did not lightly overturn its prior settled precedent. However, the reversal of *Witt* brings the Fourth Circuit into step with other circuits and allows financially strapped debtors who would otherwise have no recourse to resolve a maturing mortgage on their principal residence an avenue to achieve the "fresh start" intended by the Bankruptcy Code.

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Endnotes

1. The author gratefully acknowledges the editorial assistance of her colleague at the Boleman Law Firm, P.C., Mark C. Leffler, Esquire.
2. 925 F.3d 154 (4th Cir. 2019).
3. 113 F.3d 508 (4th Cir. 1997).
4. *Hurlburt*, 925 F.3d at 156.
5. 508 U.S. 324 (1993).
6. *Hurlburt*, 925 F.3d at 159.
7. *Id.*
8. *Id.*
9. *Id.* 159-60.
10. 11 U.S.C. § 1322(c)(2).
11. *Witt*, 113 F.3d at 509.
12. *Witt*, 925 F.3d at 510-11.
13. *Id.* at 511.
14. *Id.* at 511-13.
15. *Id.* at 514.
16. *Id.*
17. *See generally, In re Tekavec*, 476 B.R. 555, 556 n. 2 (Bankr. E.D. Wis 2012); *In re Latimer*, 395 B.R. 304 (Bankr. W.D.N.Y. 2008); *In re Reeves*, 221 B.R. 756, 760 (Bankr. C.D.Ill. 1998); *In re Sexton*, 230 B.R. 346 (Bankr. E.D. Tenn 1998); *In re Mattson*, 210 B.R. 157, 158-59 (Bankr. D. Minn. 1997).
18. 219 B.R. 468, 473, 478-79 (B.A.P. 6th Cir. 1998).
19. 296 F.3d 1203, 1209 (11th Cir. 2002).
20. *In re Varner*, 530 B.R. 621 (Bankr. M.D.N.C 2015).
21. *Id.* at 624.
22. *Id.*
23. *Witt*, 925 F.3d at 161-62.
24. *Id.* at 162.
25. *Id.*
26. *Id.* at 163.
27. *Id.*
28. *Id.* at 164 (quoting Milner v. Dep't of Navy, 562 U.S. 562, 572 (2011)).
29. *Id.* at 164-65.
30. *Id.* at 164, 166 (quoting *Encino Motorcars, LLC v. Navarro*, 138 S. Ct. 1134, 1143 (2018)).
31. *Id.* at 165.
32. *Id.*
33. *See also Burkhart v. Grigsby*, 886 F.3d 434 (4th Cir. 2018) (allowing strip-off of unsecured mortgages even where the creditor fails to file a proof of claim) and *In re Davis*, 716 F.3d 331 (4th Cir. 2013) (permitting the stripping off of valueless junior liens against "Chapter 20" debtors' residences when the debtor is ineligible for discharge).