



Bankruptcy bill could result in 'tsunami' of filings

By Julia Reischel [Bacon Wilson's Justin H. Dion weighs in below](#)

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Local practitioners predict that a bill currently wending its way through Congress will be passed, granting bankruptcy judges the power to modify home-mortgage terms and prompting a deluge of new bankruptcy filings in Massachusetts.

"I'm expecting a doubling, if not a tripling, of the number of Chapter 13 filings," said consumer and business bankruptcy attorney Richard N. Gottlieb of Boston.

"It's going to be a tsunami that's going to hit," added Gottlieb, who worked in the Boston office of the Federal Deposit Insurance Corp. in the 1990s. "There's so much pent-up demand for this legislation that a lot of bankruptcy lawyers and bankruptcy judges are going to have to move very quickly in terms of implementing details associated with this legislation."

Justin H. Dion, a lawyer at Bacon Wilson in Springfield and chairman of the Hampden County Bar Association's bankruptcy section, was more restrained in his forecast but agreed on the fundamentals.

"I don't think it's going to be a catastrophic tidal wave of filings, but from

my own practice, I do encounter people who are a round peg in a square hole," Dion said. "They simply don't fit into a bankruptcy model. And you will find some of these people who have slipped through the cracks will now finally be able to maybe get restructured mortgages."

Proposed legislation giving bankruptcy judges the power to modify the terms of a debtor's mortgage has been circulating for years but has always languished in the Republican-controlled Congress. Now that Democrats hold the majority, according to bankruptcy experts who have followed the issue, they are likely to lift the Bankruptcy Code's prohibition on home-mortgage modifications in hopes of aiding homeowners floundering in the economic crisis.

"We anticipate some type of bill being passed," U.S. Bankruptcy Court Judge Joan N. Feeney said, adding that guidelines will be available to judges in Massachusetts "promptly after a bill is enacted."

Feeney further said that passage of some sort of measure will likely result in an increase in new and "old" bankruptcy filings.

"Many Chapter 13 debtors who have home mortgages which are currently not modifiable would voluntarily dismiss their cases and re-file with the new law in effect," she said. "I think that individuals

with home mortgages which exceed the value of their property will have to evaluate the bankruptcy option and determine whether Chapter 13 or 11 is in their best interest."

Band-Aid on bad wound

Bankruptcy judges currently have the power to reset the amount a debtor owes on most assets, including cars and even second homes, in what is commonly known as "cram-downs" or, more accurately, "strip-downs."

But 11 U.S.C. §1322(b)(2) specifically exempts a debtor's primary residence from such modification, resulting in an untenable situation at a time when the real estate market is tanking and mortgage payments are ballooning, debtors' attorneys say.

"The problem is, as the laws are written now, if you go into bankruptcy with a bad mortgage, you come out of bankruptcy with a bad mortgage," Dion explained. "It's almost the equivalent of putting a Band-Aid on a bad wound."

A bill that would give bankruptcy judges the power to modify mortgages, H.R. 200, sped through the Judiciary Committee of the U.S. House of Representatives the last week of January, sparking renewed debate around the country about the pros and cons of the potential change to bankruptcy law.

The legislation is sponsored by Rep. John Conyers Jr. of Michigan; a twin version in the Senate is awaiting debate on the House floor.

Concerned that the proposed legislation will grant bankruptcy judges extraordinary power, lenders and mortgage servicers have lobbied hard against the bill.

Attorneys representing mortgage holders in Massachusetts refused to comment on the issue when contacted by Lawyers Weekly, but bankruptcy practitioners who represent debtors are wholeheartedly in favor of the strip-down bill.

"Contrary to a lot of ballyhoo by the financial services roundtable and the mortgage bankers, this is not a question of an unelected bankruptcy judge destroying the use of contracts," Gottlieb said, adding that such arguments are "frivolous to the point of being stupid."

Gottlieb emphasized that banks "are going to suffer a loss one way or the other. The reason banks hate this bill is that it forces them to acknowledge that they suffer a loss on a timeframe that they don't control."

Consumer bankruptcy lawyer David G. Baker of Boston, co-chairman of the Massachusetts branch of the National Association of Consumer Bankruptcy Attorneys, traveled to Washington, D.C., earlier this month to lobby for the legislation.

"For me, it's the most important issue in my practice at the moment," he said. "From my perspective, it makes no sense that someone's principal residence should be singled out for special and unfavorable treatment. It's the only security that you can't modify. Bankruptcy judges are well situated and well accustomed to dealing with that sort of issue."

Feeney confirmed that bankruptcy judges in Massachusetts have extensive experience with modifying home mortgages, something they did until the U.S. Supreme Court ruled that the language of §1322(b)(2) prohibited home-mortgage modification in 1993.

"We're prepared to do what it takes to meet the challenge of new filings to take advantage of any mortgage modification," she said. "We allowed lien avoidance of home mortgages until the Supreme Court interpreted section 1322(b)(2) as prohibiting strip-downs. We have done this before."

'Disaster' for trustees?

While the main thrust of the proposed legislation is clear - the modification of home mortgages by bankruptcy judges - the details of the measure, which is still a work in progress, are less certain. One point, in particular, worries Chapter 13 trustees, the lawyers who manage money on behalf of debtors and are funded by fees they levy on the trusts.

According to Carolyn A. Bankowski, the Chapter 13 trustee for eastern Massachusetts, her counterparts across the country are concerned about a provision that would allow debtors to make payments directly to creditors. That would leave the offices of the Chapter 13 trustees underfunded at a time when they would be flooded with a massive increase in cases, she said.

"If you had a huge number of people filing, and they were proposing to pay the payments direct, we wouldn't receive any fees," she said. "You'd have this huge crush of cases and no money that is available to the trustee."

Bankowski, whose office has handled an average of 250 to 290 cases per month for the past two years, said that if a strip-down bill passes, she expects the number of cases her office handles to double.

"It would be a disaster if we weren't getting any money," she said.

Representatives of the National Association of Chapter 13 Trustees are currently negotiating with members of Congress to add language to the bill allowing the trustees to collect a reduced commission on home-mortgage modifications, Bankowski said.

'Weapons in the arsenal'

If a strip-down bill becomes law this year, it may change the landscape for non-bankruptcy attorneys as well.

Some lawyers hope that the legislation will help stem the tide of foreclosures that has brought the global economy to its knees by giving attorneys more leverage to negotiate favorable outcomes for debt-ridden clients and avoid Bankruptcy Court altogether.

If bankruptcy judges can strip down the value of a mortgage debt to the value of the vastly depreciated house that anchors it, creditors might become more willing to avoid Bankruptcy Court altogether, said Mark W. Powers, who practices at Bowditch & Dewey in Worcester and chairs the bankruptcy section of the Worcester County Bar Association.

"I think it could give non-bankruptcy lawyers more weapons in their arsenal to help negotiations over distressed properties for their clients," he said. "They might have greater success in negotiation outcomes that are favorable to their clients simply by virtue that the legislation has passed."

For example, Powers said that real estate lawyers could rely on the specter of involuntary modifications of home mortgages to convince lenders to agree to a short sale of a property.

"I could see a situation where I could say, 'I could refer my client to a bankruptcy lawyer and then cram down the mortgage, or you could take your loss now,'" he said.

Judge Feeney said she also expects passage of strip-down legislation to prompt lenders to be more willing to modify loans outside of a courtroom.

"I would expect that mortgagees would have more incentive to do a voluntary modification," she said.

But Gottlieb said that only lenders who have not dabbled in mortgage-backed securities would respond to such incentives, because mortgages that have been chopped up and sold around the world as securities are owned by faraway bondholders who are unlikely to negotiate with the debtor, or even be aware of the potential strip-down.

"If the loan is being held by a bank itself, I agree, the bank will be able to make more decisions," he said.

"On the other hand, if the loan is being held by a mortgage-backed trust, I don't think it's going to make a difference."