Nathan Quach
Associate - Binder Malter Harris & Rome-Banks LLP
CBF Panel Notes: Modifications of Claims Secured by the Debtor's Principal Residence

**Why would debtors want to be able to modify claims secured by the debtor's principal residence?**

Debtors are permitted to modify the rights of secured creditors by splitting secured claims into secured and unsecured portions. 11 U.S.C. § 1322(b)(2). This process, known as a "cramdown" or "lien strip," is governed by section 506 of the Code, which provides that a claim secured by a lien on property of the bankruptcy estate is a secured claim equal to the value of the property and an unsecured claim to the extent the claim exceeds the value of the property. 11 U.S.C. § 506(a)(1); *see also Assocs. Com. Corp. v. Rash*, 520 U.S. 953, 955 (1997). The significance of this is that unsecured claims are typically only paid cents on the dollar, whereas holders of secured claims are generally entitled to "the benefit of their bargain" through priority payment out of their collateral. *See* H.R. REP. NO. 595, 95th Cong., 1st Sess. 338–40 (1977); *Mission Prod. Holdings v. Tempnology, LLC*, 587 U.S. 370, 374 (2019)

In short, the ability to modify secured claims through cramdowns and lien strips give debtors more flexibility in reorganization.

**What does the Bankruptcy Code say about modifying claims secured by the debtor's principal residence?**

Under 11 U.S.C § 1322(b)(2), although a Chapter 13 plan can modify a creditor's secured claims, a Chapter 13 plan cannot modify claims secured only against the Debtor's principal residence.[1] The same is true for Chapter 11 plans under 11 U.S.C. § 1123(b)(5), which echoes the same sentiment as 11 U.S.C. § 1322(b)(2).[2]

Plans filed under Subchapter V of the bankruptcy code distinguish themselves from Chapter 13 and Chapter 11 plans for this reason. Unlike Chapter 13 and Chapter 11 plans, Subchapter V plans may explicitly modify claims secured only by an interest in the Debtor's principal residence. Under 11 U.S.C. § 1190(3), a Subchapter V debtor's plan of reorganization "may modify the rights of the holder of a claim secured only by a security interest in real property that is the principal residence of the debtor if the new value received in connection with the granting on the security interest was – (A) not used primarily to acquire the real property; and (B) used primarily in connection with the small business of the debtor."[3]

WHAT EXACTLY IS A "PRINCIPAL RESIDENCE?"

[1] 11 U.S.C § 1322(b)(2).
[2] 11 U.S.C. § 1123(b)(5).
[3] 11 U.S.C. § 1190(3).

11 U.S.C. §§ 1322(b)(2), 1123(b)(5), and 1190(3) all govern the debtor's right (or lack of right) to modify claims secured only by an in interest in the "d*ebtor's principal residence*." So, first and foremost, a potential debtor should consider whether the lien that they seek to modify is secured by the "*debtor's principal residence*" within these Sections.

Under 11 U.S.C. § 101(13A)(A), "principal residence" is defined within the Bankruptcy Code as a "residential structure if used as the principal residence by the debtor, including incidental property, without regard to whether that structure is attached to real property."[4] In their interpretations of Section 1123(b)(5) and Section 1322(b)(2), courts have widely understood that the "principal residence" is at least the property of which the debtor inhabits or lives in.

The major dispute between courts when interpreting "principal residence" within these Sections, however, is over whether the anti-modification provisions should apply to property used exclusively for residential purposes or whether the provisions should extend to mixed-use properties in which the debtor also happens to reside.[5] These two approaches are dubbed the "Bright-Line Only" approach and the "Bright-Line Includes" approach.

The Bright-Line Only approach is the approach that is adopted by the majority of courts. Under the Bright-Line Only approach, the anti-modification provisions of Section 1322(b)(2) and Section 1123(b)(5) *only* apply to principal residences where the property securing the claim simply serves a residential purpose and no commercial purpose.[6] This approach is more debtor-friendly since it provides a soft exception for debtors to modify loans secured by the debtor's primary residence.

Alternatively, the Bright-Line Includes approach is the approach that is adopted by the minority of courts, including the 9th Circuit. Under the Bright-Line Includes approach, the anti-modification provisions of Section 1322(b)(2) and Section 1123(b)(5) applies so long as the property securing the claim serves a residential purpose, whether or not the property also serves a commercial purpose. This approach is less debtor-friendly since it does not provide debtors with any exceptions under Chapter 11 or Chapter 13 to modify loans secured by the debtor's primary residence. In jurisdictions that follow the Bright-Line Includes approach, the only avenue for debtors to modify loans secured against their primary residences is under Subchapter V.[7]

**So, what options do we have in the Ninth Circuit?**

If we're to follow the Bright-Line Includes approach, which the Ninth Circuit does follow, what are our options for modifying claims secured against primary residences? 11 U.S.C. § 1190(3) of Subchapter V seems like the only avenue, but even its power is not unlimited.

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[4] 11 U.S.C. § 101(13A)(A).
[5] *See In re Scarborough*, 461 F.3d 406 (3d Cir. 2006); *see also Wages v. J.P. Morgan Chase Bank, N.A. (In re Wages)*, 508 B.R. 161 (B.A.P. 9th Cir. 2014).
[6] *In re Scarborough,* 461 F.3d 406 (3d Cir. 2006).
[7] Both approaches are outlined in *In re Lister*, 593 B.R. 587 (Bankr.S.D.Ohio 2018).

WHAT SECURITY INTERESTS CAN BE MODIFIED UNDER 11 U.S.C. § 1190(3)?

Although 11 U.S.C. § 1190(3) grants Subchapter V debtors the power to modify claims secured against the debtor's primary residences, the power is seemingly limited by two conditions: 11 U.S.C. § 1190(3)(A); and 11 U.S.C. § 1190(3)(B). Largely, this would seemingly apply to most home equity loans and some mortgages, where the funds received in return are used toward the debtor's business.

Facially, because of 11 U.S.C. § 1190(3)(A), one would presume that even a Subchapter V debtor would not be able to modify purchase-money mortgages, since purchase-money mortgages are, by definition, granted in exchange for the funds necessary to purchase the real property collateral. And that presumption would generally be true. However, in one of the United States bankruptcy court's first readings of the provisions of Subchapter V of the Code, the court applied a liberal interpretation of Section 1190(3)'s prerequisites to allow a debtor to modify a purchase-money mortgage secured by her residence.

*In re Ventura*, which was decided on April 10, 2020, in the Bankruptcy Court of the Eastern District of New York, was one of the first, if not the first, case to interpret Section 1190(3).[8] In *Ventura*, in applying Subchapter V retroactively to a Chapter 11 bankruptcy, the court considered whether the debtor could modify a purchase-money mortgage secured by the debtor's residence under Section 1190(3) when that residence was also used for the debtor's bed and breakfast business ("B&B").

The court, "armed" with the principals of statutory interpretation, found that "subparagraphs (A) and (B) do not bar the Debtor outright from using this provision to modify" a purchase-money mortgage.[9] In its interpretations of subparagraphs (A) and (B), the court focused on the word "primarily" to distinguish Section 1190(3)'s loan-securing-residence requirement from Section 1123(b)(5)'s loan-securing-residence requirement.[10] The court held that "both of these subparagraphs direct the Court to conduct a qualitative analysis to determine whether the principal purpose of the debt was not to provide the debtor with a place to live, and whether the mortgage proceeds were primarily for benefit of the debtor's business activities."[11]

The court proposed the following considerations in its qualitative determination of whether Section 1190(3) modification should apply to a loan:[12]

1. Were the mortgage proceeds used primarily to further the debtor's business interests;
2. Is the property an integral part of the debtor's business;
3. The degree to which the specific property is necessary to run the business;
4. Do customers need to enter the property to utilize the business; and

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[8] *In re Ventura,* No.8-18-77193-reg, at 31 (Bankr. E.D.N.Y. 2020)
[9] *In re Ventura*, at 32.
[10] *Id*.
[11] *Id*. at 33.
[12] *Id*. at 33-34.

5. Does the business utilize employees and other businesses in the area to run its operations.

The court further emphasized that a flexible qualitative analysis rather than a bright-line rule is more consistent with the Small Business Reorganization Act's spirit "to keep small business owners in business, and to benefit the employees, suppliers, customers and others who rely on that business."[13]

It is important to note that *In re Ventura* was subsequently reversed on appeal, but not on the ground that the *In re Ventura* court's interpretation of Section 1190(3) was incorrect. On appeal, the district court only held that the bankruptcy court should not have retroactively applied Subchapter V to the debtor's initially filed Chapter 11, as doing so would have prejudiced creditors.[14] The district court did not address the bankruptcy court's interpretation of Section 1190(3).

Presently, *In re Ventura* stands as the only case to interpret the language of Section 1190(3). *In re Ventura* was also decided in a circuit that also follows the Bright-Line Includes Approach like the Ninth Circuit, so Section 1190(3) was also the debtor's only option to modifying a claim secured by the debtor's primary residence.

**BOTTOMLINE**

Assuming that the debtor qualifies for a Subchapter V filing, the debtor should consider the following to determine if the debtor should file a Subchapter V to take advantage of Section 1190(3):

- Does the debtor have a creditor who has a secured claim against the debtor's primary residence?
- What is the likelihood that the debtor can repay the full amount of the secured claim?
- Is the secured claim secured ONLY against the debtor's primary residence?
- Is the property used for anything other than the debtor's primary residence?
- The *In re Ventura* qualitative factors:
    - Were the mortgage proceeds used primarily to further the debtor's business interests;
    - Is the property an integral part of the debtor's business;
    - The degree to which the specific property is necessary to run the business;
    - Do customers need to enter the property to utilize the business; and
    - Does the business utilize employees and other businesses in the area to run its operations.

[13] *Id*. at 33.
[14] *See generally Gregory Funding v. Ventura*, 638 B.R. 499 (2022).

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# Scarborough v. Chase Manhattan Mortg. Corp. (In re Scarborough)

United States Court of Appeals for the Third Circuit

July 27, 2006, Argued ; August 28, 2006, Filed

No. 04-4298

**Reporter**
461 F.3d 406 *; 2006 U.S. App. LEXIS 21939 **; 56 Collier Bankr. Cas. 2d (MB) 1026; Bankr. L. Rep. (CCH) P80,696

IN RE: FRANCES SCARBOROUGH, FRANCES SCARBOROUGH, Appellant v. CHASE MANHATTAN MORTGAGE CORPORATION

**Subsequent History:** Adversary proceeding at, Remanded by *In re Scarborough, 2009 U.S. Dist. LEXIS 4279 (E.D. Pa., Jan. 22, 2009)*

**Prior History: [**1]** Appeal from the United States District Court for the Eastern District of Pennsylvania. (D.C. Misc. No. 03-mc-00228). District Judge: James McGirr Kelly).

*In re Scarborough, 2004 U.S. Dist. LEXIS 21701 (E.D. Pa., Oct. 28, 2004)*

## Core Terms

mortgage, real property, principal residence, anti-modification, modify, security interest, collateral, rend, chase, rental property, plain language, income-producing, residential, multi-unit, holder, interest in real property, secured claim, lender, modify, legislative history, property value, dwell, personal property, rider

## Case Summary

**Procedural Posture**

Appellant debtor, during Chapter 13 bankruptcy proceedings, sought under *11 U.S.C.S. § 506(a)* to bifurcate appellee mortgage holder's claim. The bankruptcy court found that *11 U.S.C.S. § 1322(b)(2)* precluded the debtor from bifurcating the claim, and the United States District Court for the Eastern District of Pennsylvania affirmed. The debtor appealed.

**Overview**

The debtor signed a mortgage that granted a lien against the debtor's two-unit dwelling; the debtor resided in one apartment and rented the other to a tenant. The mortgage also granted an interest in rents. The bankruptcy court and the district court found that the anti-modification provision of *§ 1322(b)(2)* precluded bifurcation of the holder's claim into secured and unsecured portions, but the appellate court disagreed. *Section 1322(b)(2)* prohibited modification of a claim if a mortgage was secured only by an interest in real property that was a debtor's principal residence. As the mortgage at issue was secured by income-producing rental property in addition to the debtor's principal residence, *§ 1322(b)(2)* was inapplicable, and modification of the holder's claim was permitted. In *§ 1322(b)(2)*, Congress had equated the terms "real property" and "principal residence"; therefore, a claim secured even in part by real property that was not the debtor's residence did not fall under *§ 1322(b)(2)*, which was interpreted literally and narrowly. The character of the collateral at the time of the mortgage transaction determined whether *§ 1322(b)(2)* applied.

**Outcome**
The district court's judgment was reversed, and the case was remanded.

## LexisNexis® Headnotes

Bankruptcy Law > ... > Types of Claims > Secured Claims & Liens > General Overview

Bankruptcy Law > Individuals With Regular Income > Plans > Plan Contents

***HN1*** **Types of Claims, Secured Claims & Liens**

11 U.S.C.S. § 1322(b)(2) protects a mortgagee from having its claim in a Chapter 13 bankruptcy proceeding modified if the mortgage is secured only by a security interest in real property that is the debtor's principal residence. A mortgage secured by property that includes, in addition to the debtor's principal residence, other income-producing rental property is secured by real property other than the debtor's principal residence and, thus, modification of the mortgage is permitted.

Civil Procedure > Appeals > Standards of Review > De Novo Review

Governments > Legislation > Interpretation

Civil Procedure > Appeals > Standards of Review > Questions of Fact & Law

**HN2** **Standards of Review, De Novo Review**

An appellate court's standard of review is plenary where the issues before it involve statutory interpretation and conclusions of law.

Bankruptcy Law > ... > Types of Claims > Secured Claims & Liens > General Overview

Bankruptcy Law > ... > Plan Confirmation > Confirmation Criteria > Nonconsensual Confirmations

Bankruptcy Law > Individuals With Regular Income > Plans > Plan Contents

**HN3** **Types of Claims, Secured Claims & Liens**

The normal rule in bankruptcy is that a claim that is secured by a lien on property is treated as a secured claim only to the extent of the value of the property on which the lien is fixed. To the extent that the amount of the claim is greater than the value of the property, it is considered unsecured. 11 U.S.C.S. § 506(a)(1). Thus, a claim that is not fully collateralized can be modified, and the creditor said to be "crammed down" to the value of the collateral. 11 U.S.C.S. § 1322(b)(2) of the Bankruptcy Code carves out an exception to this general rule.

Bankruptcy Law > ... > Types of Claims > Secured Claims & Liens > General Overview

**HN4** **Types of Claims, Secured Claims & Liens**

See 11 U.S.C.S. § 506(a)(1).

Bankruptcy Law > Individuals With Regular Income > Plans > Plan Contents

**HN5** **Plans, Plan Contents**

11 U.S.C.S. § 1322(b)(2) permits a debtor in a Chapter 13 case to 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. The purpose of § 1322(b)(2) is to encourage the flow of capital into the home lending market by affording anti-modification protection to home mortgage lenders. The legislative history of § 1322(b)(2) indicates that it is designed to protect and promote the increased production of homes and to encourage private individual ownership of homes.

Real Property Law > Landlord & Tenant > General Overview

**HN6** **Real Property Law, Landlord & Tenant**

A federal court looks to state law to determine whether rents are deemed to be real property.

Bankruptcy Law > Individuals With Regular Income > Plans > Plan Contents

Real Property Law > Landlord & Tenant > General Overview

Real Property Law > Financing > Mortgages & Other Security Instruments > Mortgagee's Interests

**HN7** **Plans, Plan Contents**

Under Pennsylvania law, real property is defined to include rents. 21 Pa. Cons. Stat. § 3. Accordingly, the grant of an interest in rents does not render a claim secured by anything other than the real property. Thus, a mortgagee is not denied the protection of 11 U.S.C.S.

§ 1322(b)(2) merely by taking an interest in rents derived from the mortgaged property.

Bankruptcy Law > ... > Types of Claims > Secured Claims & Liens > General Overview

Bankruptcy Law > Individuals With Regular Income > Plans > Plan Contents

**HN8** **Types of Claims, Secured Claims & Liens**

Based on the plain language of 11 U.S.C.S. § 1322(b)(2), a creditor does not receive anti-modification protection for a claim secured by real property that includes both the debtor's principal residence and other rental property that is not the debtor's principal residence.

Bankruptcy Law > ... > Types of Claims > Secured Claims & Liens > General Overview

Bankruptcy Law > Individuals With Regular Income > Plans > Plan Contents

**HN9** **Types of Claims, Secured Claims & Liens**

Under 11 U.S.C.S. § 1322(b)(2), by using the word "is" in the phrase "real property that is the debtor's principal residence," Congress has equated the terms "real property" and "principal residence." Put differently, this use of "is" means that the real property that secures the mortgage must be only the debtor's principal residence in order for the anti-modification provision to apply. Section 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. A claim secured by real property that is, even in part, not the debtor's principal residence does not fall under the terms of § 1322(b)(2). Consequently, real property which is designed to serve as the principal residence not only for the debtor's family but for other families is not encompassed by the clause. The use of "is" without any modifier (e.g., "in whole" or "in part") does not evince an intent by Congress to apply the anti-modification provision to real property that includes, but is more than, a debtor's residence. The plain language of § 1322(b)(2) permits modification of a claim secured by a debtor's residence and property which has inherently income-producing power.

Bankruptcy Law > Individuals With Regular Income > Plans > Plan Contents

Governments > Legislation > Interpretation

**HN10** **Plans, Plan Contents**

The United States Court of Appeals for the Third Circuit reads 11 U.S.C.S. § 1322(b)(2) literally and narrowly. On the several occasions that the Third Circuit has had the opportunity to apply § 1322(b)(2), it has focused on the plain language of the section. The court's reasoning has followed what might be described as a plain meaning approach to the application of § 1322(b)(2). That is, the court has read § 1322(b)(2) to mean what its language literally states. Thus, the Third Circuit has repeatedly rejected a de minimis exception to § 1322(b)(2) and has consistently held that a creditor who takes a security interest in any collateral that is not real property does not receive anti-modification protection. Likewise, the Third Circuit has eschewed reliance on legislative intent in analyzing § 1322(b)(2) and has also held that the subjective intent of the parties is irrelevant under the provision.

Bankruptcy Law > ... > Types of Claims > Secured Claims & Liens > General Overview

Bankruptcy Law > Individuals With Regular Income > Plans > Plan Contents

**HN11** **Types of Claims, Secured Claims & Liens**

Where the anti-modification protection of 11 U.S.C.S. § 1322(b)(2) is at issue, a court's sole concerns are (1) whether the claim is secured only by real property, and (2) whether the real property is the debtor's principal residence. Just as a creditor who takes any interest in personal property forfeits the benefit of § 1322(b)(2), so does a creditor whose claim is secured by any real property that is not the debtor's principal residence. If a mortgage includes language that is effective to grant an interest in such collateral, the mortgagee is at its peril in not deleting it.

Bankruptcy Law > ... > Types of Claims > Secured Claims & Liens > General Overview

Bankruptcy Law > Individuals With Regular Income > Plans > Plan Contents

**HN12** **Types of Claims, Secured Claims & Liens**

For purposes of 11 U.S.C.S. § 1322(b)(2), the critical moment is when a creditor takes a security interest in collateral. It is at that point in time that the underwriting decision is made and it is therefore at that point in time that the lender must know whether the loan it is making may be subject to modification in a Chapter 13 proceeding at some later date.

Bankruptcy Law > ... > Types of Claims > Secured Claims & Liens > General Overview

Bankruptcy Law > Individuals With Regular Income > Plans > Plan Contents

**HN13** **Types of Claims, Secured Claims & Liens**

For purposes of 11 U.S.C.S. § 1322(b)(2), when considering whether a mortgagee has taken a security interest in any property other than real property, a court looks to the terms of the mortgage. The language of the mortgage and its effect are key. Similarly, in considering whether the real property is the debtor's principal residence, a court looks to the character of the collateral at the time of the mortgage transaction. When a mortgagee takes an interest in real property that includes, by its nature at the time of transaction, income-producing rental property, the mortgage is also secured by property that is not the debtor's principal residence and the claim may be modified in a debtor's later Chapter 13 proceeding. A mortgage secured by an interest in a multi-unit dwelling, one unit of which will be used to generate income, falls within this category of modifiable claims.

Bankruptcy Law > ... > Types of Claims > Secured Claims & Liens > General Overview

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**HN14** **Types of Claims, Secured Claims & Liens**

A handful of courts have found that the text of 11 U.S.C.S. § 1322(b)(2) is clear, but that it clearly says the opposite of what the United States Court of Appeals for the Third Circuit concludes, namely, that the word "is" means "includes." Under this reading, the anti-modification provision does not exclude other uses of the property besides the debtor's principal residence. Yet another line of decisions adopts a case-by-case approach to the issue of whether a mortgage receives anti-modification protection. In these cases, courts have employed a flexible, multi-factor test to determine whether the parties intended the loan to be residential or commercial in nature at the time it was made. Loans that are commercial in nature may be modified, whereas residential loans may not. In the Third Circuit's view, the plain language of 11 U.S.C.S. § 1322(b)(2) equates the real property that collateralizes a mortgage with a debtor's principal residence. Where a creditor takes an interest in real property that is not the debtor's principal residence, such as property that will be used as income-generating rental property, the anti-modification provision does not apply.

Bankruptcy Law > ... > Types of Claims > Secured Claims & Liens > General Overview

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**HN15** **Types of Claims, Secured Claims & Liens**

A claim that is secured by any interest in personal property or real property that is not the debtor's principal residence may be modified in a Chapter 13 bankruptcy.

**Counsel:** Frances Scarborough [ARGUED], Philadelphia, PA, Pro Se Litigant.

Scott F. Waterman Black, Stranick & Waterman, Media, PA; Irwin Trauss [ARGUED], Philadelphia Legal Assistance, Philadelphia, PA, Counsel for Amicus-Appellant National Association of Consumer Bankruptcy Attorneys.

Kristina G. Murtha [ARGUED], Leslie E. Smilas-Puida Goldbeck, McCafferty & McKeever, Philadelphia, PA, Counsel for Appellee.

**Judges:** Before: RENDELL, AMBRO and ROTH, Circuit Judges.

**Opinion by:** RENDELL

## Opinion

**[*408]** OPINION OF THE COURT

RENDELL, Circuit Judge.

In this appeal, we must determine whether a mortgage on a multi-unit dwelling in which the debtor resides qualifies for the anti-modification protection afforded by 11 U.S.C. § 1322(b)(2). ***HN1*** That provision protects a mortgagee from having its claim in a Chapter 13 bankruptcy proceeding modified if the mortgage is secured "only by a security interest in real property that is the debtor's principal residence." We conclude that a mortgage secured by property that includes, in **[**2]** addition to the debtor's principal residence, other income-producing rental property is secured by real property *other than* the debtor's principal residence and, thus, that modification of the mortgage is permitted. Consequently, we will reverse the order of the District Court affirming the order of the Bankruptcy Court and remand the case for further proceedings consistent with this opinion.

I.

The facts relevant to this appeal are not in dispute. On May 10, 1988, Appellant Frances Scarborough signed a mortgage ("Mortgage") in favor of Meritor Savings Bank, granting a mortgage lien against her property located at 5116 North Warnock Street, Philadelphia, Pennsylvania ("Property"). The Mortgage secured a note to Meritor Savings Bank executed on the same date in the amount of $ 30,400.00. **[*409]** The parties agree that the Mortgage was thereafter assigned and that Chase Manhattan Mortgage Corp. is the current holder of the Mortgage.

Scarborough sought protection under Chapter 13 of the Bankruptcy Code on October 31, 2001. In her proceedings, she filed a complaint seeking to bifurcate the claim of Chase Manhattan into a secured claim and an unsecured claim pursuant to 11 U.S.C. § 506(a) **[**3]** and to determine the correct amount of the mortgage arrearage. Scarborough subsequently filed an amended complaint to revise the alleged amounts of the secured and unsecured portions of Chase Manhattan's claim, and to bifurcate Chase Manhattan's lien on her residence to reflect the current market value of the property, with the remainder of the debt becoming unsecured. The Bankruptcy Court held a trial on this adversary proceeding and concluded that Scarborough was barred from bifurcating the secured claim of Chase Manhattan pursuant to the "anti-modification" provision of 11 U.S.C. § 1322(b)(2). The District Court affirmed the ruling of the Bankruptcy Court.

The form of the Mortgage is a "Pennsylvania -- Single Family -- FNMA/FHLMC Uniform Instrument," which contains a conveyance clause that grants the lender an interest in the Property, as well as "all the improvements now or hereafter erected on the [P]roperty, and all easements, rights, appurtenances, rents, royalties, mineral, oil and gas rights and profits, water rights and stock and all fixtures now or hereafter a part of the [P]roperty." On the same day that Scarborough executed the Mortgage, she **[**4]** also signed a "2-4 Family Rider (Assignment of Rents)" to "amend and supplement the Mortgage" and further secure her note to Meritor Savings Bank. The Family Rider provides that "Borrower unconditionally assigns and transfers to Lender all rents and revenues of the Property" and that, "[u]pon Lender's request, Borrower shall assign to Lender all leases of the Property."

The Property is a two-story semi-detached residence that was converted to a multi-unit dwelling prior to Scarborough's purchase, with one apartment on the first floor and one apartment on the second floor. Scarborough lives on the first floor of the Property and rents the second floor apartment to a tenant pursuant to a lease agreement. She testified at trial that she purchased the Property with the intent of living in one unit and renting the other, and with a goal of eventually acquiring other investment properties. Scarborough further testified that she informed the bank she was buying the Property, in part, as an investment.

Scarborough testified at trial that the value of the Property was $ 13,000.00. Chase Manhattan submitted the City of Philadelphia's Board of Revision of Taxes Property Record, which listed **[**5]** the value of the Property as $ 26,500.00. Scarborough has appealed the Board of Revision of Taxes' valuation, but her appeal had not been decided as of the date of trial.

II.

The District Court had jurisdiction over Scarborough's appeal from the Bankruptcy Court pursuant to 28 U.S.C. § 158(a). We have jurisdiction under 28 U.S.C. § 158(d). ***HN2*** Our standard of review is plenary because the issues before us involve statutory interpretation and conclusions of law. *In re Cellnet Data Sys., Inc., 327 F.3d 242, 244 (3d Cir. 2003)*.

III.

***HN3*** The normal rule in bankruptcy is that a claim that is secured by a lien on property is treated as a secured claim "only to the extent of the value of the property on

which the lien is fixed." *United States v. [*410] Ron Pair Enters., Inc., 489 U.S. 235, 239, 109 S. Ct. 1026, 103 L. Ed. 2d 290 (1989)*. To the extent that the amount of the claim is greater than the value of the property, it is considered unsecured. *11 U.S.C. § 506(a)(1)*. [1] "Thus, a claim that is not fully collateralized can be modified, and the creditor said to be 'crammed down' to the value of the collateral." **[**6]** *1st 2nd Mortgage Co. of NJ., Inc. v. Ferandos (In re Ferandos), 402 F.3d 147, 151 (3d Cir. 2005)*.

*Section 1322(b)(2) of the Bankruptcy Code* carves out an exception to this general rule. ***HN5*** That provision permits a debtor in a Chapter 13 case to "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* **[**7]** , or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims." *11 U.S.C. § 1322(b)(2)* (emphasis added). The purpose of *§ 1322(b)(2)* is "to encourage the flow of capital into the home lending market" by affording anti-modification protection to home mortgage lenders. *Nobelman v. Am. Sav. Bank, 508 U.S. 324, 331, 113 S. Ct. 2106, 124 L. Ed. 2d 228 (1993)* (Stevens, J., concurring); *see also Ferandos, 402 F.3d at 151* ("The legislative history of *§ 1322(b)(2)* 'indicates that it was designed to protect and promote the increased production of homes and to encourage private individual ownership of homes . . . .'" (quoting *In re Davis, 989 F.2d 208, 210 (6th Cir. 1993)*)).

Scarborough argues there are two reasons that the anti-modification protection of *§ 1322(b)(2)* does not apply here. First, she contends that the Mortgage and Family Rider grant Chase Manhattan an interest in collateral that is not real property, namely, rents derived from the Property. Second, she argues that the anti-modification provision does not apply to a claim secured by a multi-unit property in which one unit is the **[**8]** debtor's principal residence and the other is an income-producing rental unit.

A.

We have little trouble rejecting Scarborough's first argument based on our reasoning in *Ferandos*. ***HN6*** We look to state law to determine whether rents are deemed to be real property. *Ferandos, 402 F.3d at 155*. ***HN7*** Under Pennsylvania law, real property is defined to include rents. *See 21 Pa. Cons. Stat. Ann. § 3* (West 2001); *In re Abruzzo, 245 B.R. 201, 209 (Bankr. E.D. Pa. 1999)*, *vacated on other grounds, 2000 U.S. Dist. LEXIS 4936, 2000 WL 420635 (E.D. Pa. Apr. 10, 2000)*; *Marine Nat'l Bank v. Nw. Pennsylvania Bank & Trust Co., 308 Pa. Super. 154, 454 A.2d 67, 70 (Pa. Super. Ct. 1982)*. "Accordingly, the grant of an interest in rents does not render the claim secured by anything other than the real property." *Ferandos, 402 F.3d at 155*. Thus, Chase Manhattan is not denied the protection of *§ 1322(b)(2)* merely because it took an interest in rents derived from the Property.

B.

Scarborough's second argument presents a question of first impression for our Court: whether a claim secured by an interest in real property that includes **[**9]** the debtor's principal residence *as well as* other income-producing rental property is "a **[*411]** claim secured only by a security interest in real property that is the debtor's principal residence." *11 U.S.C. § 1322(b)(2)*. ***HN8*** Based on the plain language of *§ 1322(b)(2)*, we conclude that a creditor does not receive anti-modification protection for a claim secured by real property that includes both the debtor's principal residence and other rental property that is not the debtor's principal residence.

***HN9*** By using the word "is" in the phrase "real property that *is* the debtor's principal residence," Congress equated the terms "real property" and "principal residence." Put differently, this use of "is" means that the real property that secures the mortgage must *be only* the debtor's principal residence in order for the anti-modification provision to apply. We thus agree with the reasoning of the Bankruptcy Court for the District of Connecticut when it noted 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 **[**10]** residence, and not real property *on which the debtor resides*." *In re Adebanjo, 165 B.R. 98,*

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[1] *Section 506(a)(1)* states in pertinent part:

> ***HN4*** An allowed claim of a creditor secured by a lien on property in which the estate has an interest, or that is subject to setoff under section 553 of this title, is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, or to the extent of the amount subject to setoff, as the case may be, and is an unsecured claim to the extent that the value of such creditor's interest or the amount so subject to setoff is less than the amount of such allowed claim.

*11 U.S.C. § 506(a)(1)*.

104 (Bankr. D. Conn. 1994). A claim secured by real property that is, even in part, *not* the debtor's principal residence does not fall under the terms of § 1322(b)(2). Consequently, "real property which is designed to serve as the principal residence not only for the debtor's family but for other families is not encompassed by the clause." Id.; *see also* In re Maddaloni, 225 B.R. 277, 280 (D. Conn. 1998) ("[T]he use of 'is' without any modifier (*e.g.*, 'in whole' or 'in part') does not evince an intent by Congress to apply the antimodification provision to real property that includes, but is more than, a debtor's residence."); In re McGregor, 172 B.R. 718, 720 (Bankr. D. Mass. 1994) (relying on plain language of § 1322(b)(2) to permit modification of claim secured by "the debtor's residence and property which has 'inherently income producing' power"); In re Legowski, 167 B.R. 711, 714 (Bankr. D. Mass. 1994) (same).

This analysis is consistent with our pattern in previous cases of **HN10** reading § 1322(b)(2) literally **[**11]** and narrowly. "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 . . . ." Ferandos, 402 F.3d at 151; *see also* id. at 154 ("We note . . . that our Court's reasoning to date has followed what we might describe as a plain meaning approach to our application of [§ 1322(b)(2)]. That is, . . . we have read section 1322(b)(2) to mean what its language literally states . . . ."). Thus, we have repeatedly rejected a *de minimis* exception to § 1322(b)(2) and consistently held that a creditor who takes a security interest in *any* collateral that is not real property does not receive anti-modification protection. *See* In re Johns, 37 F.3d 1021, 1024 (3d Cir. 1994); In re Hammond, 27 F.3d 52, 56-57 (3d Cir. 1994); Sapos v. Provident Inst. of Sav., 967 F.2d 918, 925 (3d Cir. 1992); Wilson v. Commonwealth Mortg. Corp., 895 F.2d 123, 128-29 (3d Cir. 1990). Likewise, we have eschewed reliance on legislative intent in analyzing § 1322(b)(2), Ferandos, 402 F.3d at 155, and have also held that the subjective intent **[**12]** of the parties is irrelevant under the provision, Wilson, 895 F.2d at 129.

**HN11** Where the anti-modification protection of § 1322(b)(2) is at issue, our sole concerns are (1) whether the claim is secured only by real property, and (2) whether the real property is the debtor's principal residence. Just as a creditor who takes *any* interest in personal property forfeits the benefit of § 1322(b)(2), so does a creditor whose claim is secured by *any* real property that is not the debtor's principal residence. If a mortgage includes language that "is effective to grant an interest in such collateral, the mortgagee **[*412]** is at its peril in not deleting it." Ferandos, 402 F.3d at 155.

One objection to this reading of § 1322(b)(2) is that "a debtor could easily sidestep the . . . home mortgage exception by adding a second living unit to the property on the eve of the commencement of his Chapter 13 proceeding." In re Bulson, 327 B.R. 830, 846 (Bankr. W.D. Mich. 2005); *see also* In re Guilbert, 176 B.R. 302, 305 (D.R.I. 1995) (arguing that, under the approach we adopt, "homeowners poised to file for protection under Chapter 13 **[**13]** would, as a matter of course, seek temporary tenants prior to their filing"). However, **HN12** for purposes of § 1322(b)(2), the critical moment is when the creditor takes a security interest in the collateral. "It is at that point in time that the underwriting decision is made and it is therefore at that point in time that the lender must know whether the loan it is making may be subject to modification in a Chapter 13 proceeding at some later date." Bulson, 327 B.R. at 846.

We have noted that, **HN13** when considering whether a mortgagee has taken a security interest in any property other than real property, we look to the terms of the mortgage. *See* Ferandos, 402 F.3d at 155 ("[T]he language [of the mortgage] and its effect [are] key . . ."); Wilson, 895 F.2d at 129 ("Having listed personal property as collateral, [the creditor] has a secured interest in it."). Similarly, here, we look to the character of the collateral at the time of the mortgage transaction. When a mortgagee takes an interest in real property that includes, by its nature at the time of transaction, income-producing rental property, the mortgage is also secured by property **[**14]** that is not the debtor's principal residence and the claim may be modified in a debtor's later Chapter 13 proceeding. A mortgage secured by an interest in a multi-unit dwelling, one unit of which will be used to generate income, falls within this category of modifiable claims. [2]

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[2] For purposes of bankruptcy cases commenced after October 17, 2005, a "debtor's principal residence" is defined as "a residential structure, including incidental property, without regard to whether that structure is attached to real property." Bankruptcy Abuse Prevention and Consumer Protection Act, Pub. L. 109-8, § 306(c) (2005) (codified at 11 U.S.C. § 101(13A)). In such cases, "incidental property" includes "property commonly conveyed with a principal residence in the area where the real property is located." *Id.* (codified at 11 U.S.C. § 101(27A)). We need not decide whether a rental unit located in a multi-unit dwelling could fit within this definition of "incidental property," and therefore be part of a debtor's principal residence under 11 U.S.C. § 101(13A). Because Scarborough commenced the instant case four years prior to

**[**15]** There is no question in the instant case that the Mortgage and Family Rider granted Chase Manhattan an interest in real property that was not the debtor's residence. Chase Manhattan cannot, and does not, claim surprise, as it was well aware that the Property was a multi-unit dwelling and that Scarborough would occupy only one of the units while she rented the other. This was precisely why Chase Manhattan required Scarborough to execute the Family Rider, which included an assignment of leases and an assignment of rents. We have no hesitation in concluding that Chase Manhattan's claim is not "secured only by a security interest in real property that is the debtor's principal residence." *11 U.S.C. § 1322(b)(2)*.

**[*413]** We recognize that other courts have found the language of *§ 1322(b)(2)* to be less than clear. Most notably, the Court of Appeals for the First Circuit concluded that "[t]he 'plain meaning' approach to *§ 1322(b)(2)* appears . . . to be, in the end, inconclusive." *Lomas Mortgage, Inc. v. Louis, 82 F.3d 1, 4 (1st Cir. 1996)*; *see also Bulson, 327 B.R. at 839* ("Congress left undefined the phrase 'real property that is the **[**16]** debtor's principal residence.'"). Accordingly, the *Lomas* Court turned to legislative history for guidance in interpreting *§ 1322(b)(2)*. Although we do not believe that the text of *§ 1322(b)(2)* is ambiguous, and therefore need not rely on legislative history to resolve this case, the reasoning of *Lomas* further bolsters our conclusion that Chase Manhattan should not receive anti-modification protection.

The *Lomas* Court resolved the textual ambiguity it perceived in *§ 1322(b)(2)* by examining the legislative history of the Bankruptcy Reform Act of 1994, *Pub. L. No. 103-394, 108 Stat. 4106 (1994)*, which amended Chapter 11 of the Bankruptcy Code. *Lomas, 82 F.3d at 6*. Among the changes that the Act made to Chapter 11 was to add a home mortgage anti-modification provision that is identical to *§ 1322(b)(2)*. *See 11 U.S.C. § 1123(b)(5)* (permitting a Chapter 11 debtor to "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"). With the addition of this provision, Congress sought to "conform[] the treatment of residential mortgages **[**17]** in [C]hapter 11 to that in [C]hapter 13." H.R. Rep. No. 835, at 46 (1994), *reprinted in* 1994 U.S.C.C.A.N. 3340, 3354.

The House Judiciary Committee's Report on the Act stated that *§ 1123(b)(5)* "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." H.R. Rep. No 835, at 46. To support this proposition, the Committee cited *In re Ramirez, 62 B.R. 668 (Bankr. S.D. Cal. 1986)*. *Id.* at 46 n.13. The *Lomas* Court believed that the reliance on *Ramirez* was significant because that case "squarely holds that the antimodification provision of *§ 1322(b)(2)* does not apply to multi-unit houses where the security interest extends to the rental units." *Lomas, 82 F.3d at 7*; *see also Ramirez, 62 B.R. at 669-70*. The citation to *Ramirez* was a "clear expression of congressional intent" that anti-modification protection should not be afforded in Chapter 11 to mortgages on multi-unit dwellings. *Lomas, 82 F.3d at 7*. Because Congress intended to give the same anti-modification protection to residential **[**18]** mortgages in Chapter 11 as in Chapter 13, the *Lomas* Court concluded that this expression of legislative intent applied to *§ 1322(b)(2)* as well as *§ 1123(b)(5)*. *Id.*

The Committee Report's citation to *Ramirez* undoubtedly supports our conclusion that where a creditor's "security interest extends to . . . rental property[,]" the creditor's "claim is not secured only by property that is the debtor's principal residence." *Ramirez, 62 B.R. at 670*. Though we believe that the plain language of *§ 1322(b)(2)* leads to this result, the legislative history on which *Lomas* relied is further evidence that our conclusion is consistent with congressional intent.

***HN14*** A handful of courts have found that the text of *§ 1322(b)(2)* is clear, but that it clearly says the opposite of what we conclude, namely, that the word "is" means "includes." Under this reading, the anti-modification provision does not exclude other uses of the property besides the debtor's principal residence. *See In re Macaluso, 254 B.R. 799, 800 (Bankr. W.D.N.Y. 2000)* ("[T]he statute does not limit its application to property that is **[*414]** used *only* as a principal residence, but refers **[**19]** generally to any parcel of real property that the debtor uses for that purpose."); *Guilbert, 176 B.R. at 306* ("[T]he language of *§ 1322(b)(2)* 'does not say, nor does it in any way imply that if the debtor's principal residence is also used to house other tenants, paying or otherwise, that [the mortgagee's claim] may be open to

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their effective date, these statutory definitions do not apply here. *See* Bankruptcy Abuse Prevention and Consumer Protection Act *§ 1501(a)*. Consequently, we leave for another day the question of whether, or how, the Bankruptcy Abuse Prevention and Consumer Protection Act altered the scope of the anti-modification provision of *§ 1322(b)(2)*.

modification by the home owner.'" (alteration in original) (quoting *In re Guilbert, 165 B.R. 88, 89 (Bankr. D.R.I. 1994)))*.

Yet another line of decisions adopts a case-by-case approach to the issue of whether a mortgage receives anti-modification protection. In these cases, courts have employed a flexible, multi-factor test to determine whether the parties intended the loan to be residential or commercial in nature at the time it was made. Loans that are commercial in nature may be modified, whereas residential loans may not. *See* *Litton Loan Servicing, LP v. Beamon, 298 B.R. 508, 511-12 (N.D.N.Y. 2003)*; *In re Brunson, 201 B.R. 351, 353 (Bankr. W.D.N.Y. 1996)*. Both the District Court and Bankruptcy Court followed this approach.

Our reasons for not adopting the positions expressed in these **[**20]** cases should be evident from our discussion above. In our view, the plain language of *§ 1322(b)(2)* equates the real property that collateralizes a mortgage with a debtor's principal residence. Where a creditor takes an interest in real property that is *not* the debtor's principal residence, such as property that will be used as income-generating rental property, the anti-modification provision does not apply. We also believe that the multi-factor test introduces uncertainty and unpredictability to residential mortgage transactions because it requires courts to engage in a subjective, hindsight analysis as to the intent of the parties. Not only is such uncertainty harmful to the residential lending market, *see* *Bulson, 327 B.R. at 842*, it is unnecessary in light of the plain language of *§ 1322(b)(2)*.

IV.

***HN15*** A claim that is secured by any interest in personal property or real property that is not the debtor's principal residence may be modified in a Chapter 13 bankruptcy. Because Chase Manhattan took an interest in real property that was income-producing rental property, not Scarborough's principal residence, its claim can be modified. Accordingly, we will reverse **[**21]** the order of the District Court affirming the order of the Bankruptcy Court and remand the case for further proceedings consistent with this opinion.

Caution
As of: April 20, 2026 12:29 AM Z

# Wages v. J.P. Morgan Chase Bank, N.A. (In re Wages)

United States Bankruptcy Appellate Panel for the Ninth Circuit

November 22, 2013, Argued and Submitted; March 7, 2014, Filed

BAP No. ID-12-1397-JuKiKu

**Reporter**
508 B.R. 161 *; 2014 Bankr. LEXIS 1151 **; 59 Bankr. Ct. Dec. 69; 2014 WL 1133924

In re: CLAYTON HOYT WAGES and ANDREA S. WAGES, Debtors.CLAYTON HOYT WAGES; ANDREA S. WAGES, Appellants, v. J.P. MORGAN CHASE BANK, N.A.; UNITED STATES TRUSTEE, Appellees.

**Prior History: [**1]** Appeal from the United States Bankruptcy Court for the District of Idaho. Bk. No. 8:11-bk-40249-JDP. Honorable Jim D. Pappas, Bankruptcy Judge, Presiding.

*In re Wages, 479 B.R. 575, 2012 Bankr. LEXIS 3399 (Bankr. D. Idaho, 2012)*

## Core Terms

principal residence, real property, anti-modification, mortgage, bankruptcy court, security interest, appellate panel, modify, statutory language, secured loan, confirm, equate, truck, plain language, secured claim, residential, waive, statutory construction, loan transaction, commercial use, second issue, bright-line, livestock, modify, harsh

## Case Summary

**Overview**

HOLDINGS: [1]-The U.S. Bankruptcy Court for the District of Idaho did not err when it found that a husband and wife who declared Chapter 11 bankruptcy were not allowed under *11 U.S.C.S. § 1123(b)(5)* to modify the terms of a mortgage a bank held on real property they used as their residence and to operate a home-based trucking business because the property was their "principal residence" under *§ 1123(b)(5)*; [2]-Although courts had taken three approaches when deciding whether real property that had both a residential and a commercial use was a debtor's "principal residence" under *§ 1123(b)(5)*, the best approach was a bright-line approach which applied *§ 1123(b)(5)* to any property a debtor used as his or her principal residence, even if the debtor also used the property for commercial activities.

**Outcome**
The appellate panel affirmed the bankruptcy court's decision.

## LexisNexis® Headnotes

Business & Corporate Compliance > ... > Plans > Plan Contents > Discretionary Provisions

Bankruptcy Law > ... > Plans > Plan Contents > Discretionary Provisions

Real Property Law > Bankruptcy > Secured Claims

***HN1*** The anti-modification provision in *11 U.S.C.S. § 1123(b)(5)* applies to any loan secured only by real property that a debtor uses as a principal residence.

Bankruptcy Law > ... > Judicial Review > Standards of Review > De Novo Standard of Review

Business & Corporate Compliance > ... > Plans > Plan Contents > Discretionary Provisions

Bankruptcy Law > ... > Plans > Plan Contents > Discretionary Provisions

Governments > Legislation > Interpretation

***HN2*** The United States Bankruptcy Appellate Panel for the Ninth Circuit reviews a bankruptcy court's statutory construction of *11 U.S.C.S. § 1123(b)(5)* de novo.

Bankruptcy Law > Procedural Matters > Judicial

Review > Bankruptcy Appeals Procedures

Civil Procedure > Appeals > Reviewability of Lower Court Decisions > Preservation for Review

***HN3*** The rule the United States Bankruptcy Appellate Panel for the Ninth Circuit adopted in *Marshack v. Orange Commercial Credit (In re Nat'l Lumber & Supply, Inc.), 184 B.R. 74, 1995 Bankr. LEXIS 989*, was abrogated by the United States Court of Appeals for the Ninth Circuit's holding in Office of the U.S. Trustee v. Hayes (In re Bishop, Baldwin, Rewald, Dillingham & Wong, Inc.). There, the Ninth Circuit held that arguments not specifically listed in a Statement of Issues ("SOI") are not waived. The Ninth Circuit reasoned that an SOI required by *Fed. R. Bankr. P. 8006* does not impact upon issue statements required by the court of appeals. The two are separate in nature and distinct in result. The Ninth Circuit's reasoning is equally applicable to appeals in the Bankruptcy Appellate Panel for the Ninth Circuit.

Bankruptcy Law > Individuals With Regular Income > Plans > Plan Contents

Business & Corporate Compliance > ... > Plans > Plan Contents > Discretionary Provisions

Bankruptcy Law > ... > Plans > Plan Contents > Discretionary Provisions

Governments > Courts > Judicial Precedent

Real Property Law > Bankruptcy > Secured Claims

***HN4*** In In re Abdelgadir, the United States Bankruptcy Appellate Panel for the Ninth Circuit held that the petition date is the appropriate date for determining whether the anti-modification provision of *11 U.S.C.S. § 1123(b)(5)* applies to a secured claim. The appellate panel later applied the same reasoning to the identical wording in *11 U.S.C.S. § 1322(b)(2)* in Benafel v. One W. Bank, FSB (In re Benafel). The Bankruptcy Appellate Panel for the Ninth Circuit is bound to follow its published decisions, and it uses the petition date, rather than a loan transaction date, for determining whether the anti-modification provision of *§ 1123(b)(5)* applies to a creditor's claim.

Bankruptcy Law > Individuals With Regular Income > Plans > Cramdowns

Bankruptcy Law > ... > Plan Confirmation > Prerequisites > Plan Compliance With Code

Business & Corporate Compliance > ... > Plans > Plan Contents > Discretionary Provisions

Bankruptcy Law > ... > Plans > Plan Contents > Discretionary Provisions

Real Property Law > Bankruptcy > Secured Claims

***HN5*** A bankruptcy court shall confirm a Chapter 11 bankruptcy plan only if it complies with the applicable provisions of Chapter 11. *11 U.S.C.S. § 1129(a)(1)*. One such applicable provision is *11 U.S.C.S. § 1123(b)(5)*, which states that subject to *§ 1123(a)*, 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 a debtor's principal residence. This provision, known as the "anti-modification provision," prevents a debtor from modifying claims that are secured only by the debtor's primary residence.

Bankruptcy Law > Individuals With Regular Income > Plans > Plan Contents

Business & Corporate Compliance > ... > Plans > Plan Contents > Discretionary Provisions

Bankruptcy Law > ... > Plans > Plan Contents > Discretionary Provisions

Governments > Courts > Judicial Precedent

Real Property Law > Bankruptcy > Secured Claims

***HN6*** The wording of *11 U.S.C.S. § 1123(b)(5)* is identical to the anti-modification provision in *11 U.S.C.S. § 1322(b)(2)*. Since these sections contain the same statutory language, the United States Bankruptcy Appellate Panel for the Ninth Circuit considers the decisions interpreting either provision as persuasive in interpreting the other.

Governments > Legislation > Interpretation

***HN7*** Where a statute's language is plain, the inquiry ends and a court's sole function is to enforce the statute according to its terms.

Business & Corporate Compliance > ... > Plans > Plan Contents > Discretionary Provisions

Bankruptcy Law > ... > Plans > Plan Contents > Discretionary Provisions

Real Property Law > Bankruptcy > Secured Claims

**HN8** According to its plain language, the prohibition against modification of the rights of the holders of secured claims in 11 U.S.C.S. § 1123(b)(5) has three distinct requirements: first, the security interest must be in real property; second, the real property must be the only security for the debt; and third, the real property must be the debtor's principal residence.

Business & Corporate Compliance > ... > Plans > Plan Contents > Discretionary Provisions

Bankruptcy Law > ... > Plans > Plan Contents > Discretionary Provisions

Real Property Law > Bankruptcy > Secured Claims

**HN9** Courts have taken different approaches in resolving whether real property should be considered a "debtor's principal residence" when the property also has a commercial use. Courts disagree on what factors should be applied, how they should be applied, and even what they mean. One line of cases, which is reflected in the United States Court of Appeals for the Third Circuit's decision in Scarborough v. Chase Manhattan Mortg. Corp. (In re Scarborough), equates the term "real property" with "debtor's principal residence." The United States Bankruptcy Appellate Panel for the Ninth Circuit disagrees with the Third Circuit's parsing of the words of the statute in Scarborough because it disregards the Bankruptcy Code's definition of "debtor's principal residence" in 11 U.S.C.S. § 101(13A). Section 101(13A) provides that the term "debtor's principal residence" means a residential structure if used as the principal residence by a debtor, including incidental property, without regard to whether that structure is attached to real property. The definition avoids defining "real property" and also clarifies that whether a structure is a principal residence is independent of whether it might be real property. Simply put, the definition does not equate the term "real property" with "debtor's principal residence." Therefore, an analysis which equates the two is misplaced.

Bankruptcy Law > ... > Types of Claims > Secured Claims & Liens > General Overview

Real Property Law > Bankruptcy > Secured Claims

**HN10** 11 U.S.C.S. § 101(13A) was amended in December 2010 pursuant to the Bankruptcy Technical Corrections Act of 2010, Pub. L. No. 111-327, 124 Stat. 3557. The 2010 amendment added the phrase "if used as the principal residence by the debtor," and was intended to clarify that this definition pertains to a structure used by the debtor as a principal residence.

Business & Corporate Compliance > ... > Plans > Plan Contents > Discretionary Provisions

Bankruptcy Law > ... > Plans > Plan Contents > Discretionary Provisions

Real Property Law > Bankruptcy > Secured Claims

**HN11** Another line of cases that has interpreted 11 U.S.C.S. § 1123(b)(5) follows a "totality of the circumstances" or "case-by-case" approach. Under this approach, the intention of the parties is what matters most, and courts which follow this interpretation hold that such intent may be discerned by examining the underlying mortgage documents. The United States Bankruptcy Appellate Panel for the Ninth Circuit rejects this approach as it is inconsistent with the panel's case law. The Bankruptcy Appellate Panel for the Ninth Circuit does not delve into the parties' intentions on the loan transaction date when the appropriate time for determining whether property is a debtor's principal residence is the petition date.

Bankruptcy Law > Individuals With Regular Income > Plans > Plan Contents

Business & Corporate Compliance > ... > Plans > Plan Contents > Discretionary Provisions

Bankruptcy Law > ... > Plans > Plan Contents > Discretionary Provisions

Real Property Law > Bankruptcy > Secured Claims

**HN12** In In re Macaluso, the United States Bankruptcy Court for the Western District of New York took a bright-line approach to interpreting 11 U.S.C.S. § 1322(b)(2). The court held that the anti-modification exception in § 1322(b)(2) applies to any property that is used as a debtor's principal residence, notwithstanding the fact that the debtor's property in that case included a second residential unit and a store. The United States Bankruptcy Appellate Panel for the Ninth Circuit concludes that the bright-line approach is most consistent with the plain language of 11 U.S.C.S. § 1123(b)(5).

Business & Corporate Compliance > ... > Plans > Plan

Contents > Discretionary Provisions

Bankruptcy Law > ... > Plans > Plan Contents > Discretionary Provisions

Governments > Legislation > Interpretation

Real Property Law > Bankruptcy > Secured Claims

***HN13*** The plain language of *11 U.S.C.S. § 1123(b)(5)* does not protect from modification claims secured only by a security interest in real property that is exclusively a debtor's principal residence, or claims secured only by a security interest in real property that is a debtor's principal residence, unless the debtor also uses the property for significant commercial purposes. There is nothing in the Bankruptcy Code indicating that once a commercial use of a property becomes sufficiently "significant," that property ceases being the debtor's principal residence—either a property is a debtor's principal residence or it is not. The adoption of an objective rule eliminates line drawing and promotes certainty in the home mortgage lending market. However, the downside is that a bright-line rule may sometimes lead to harsh results. Nonetheless, the potential for harsh results can not be used as an excuse by a court to torture the Bankruptcy Code's language to reach a different rule. Even if a court does not agree with all of the possible outcomes produced by the statutory language, it is Congress, not the courts, that must repair any problems with the Bankruptcy Code.

Business & Corporate Compliance > ... > Plans > Plan Contents > Discretionary Provisions

Bankruptcy Law > ... > Plans > Plan Contents > Discretionary Provisions

Real Property Law > Bankruptcy > Secured Claims

***HN14*** The anti-modification exception that appears in *11 U.S.C.S. § 1123(b)(5)* applies to any loan secured only by real property that a debtor uses as a principal residence, even if that real property also serves additional purposes.

**Counsel:** Brent Taylor Robinson, Esq., Robinson, Athone & Tribe, argued for appellants Clayton Hoyt Wages and Andrea S. Wages.

Jon A. Stenquist, Esq., Moffatt Thomas Barrett Rock & Fields, Chtd., argued for appellee J.P. Morgan Chase Bank, N.A.

**Judges:** Before: JURY, KIRSCHER, and KURTZ, Bankruptcy Judges. Opinion by Judge Jury. Dissent by Judge Kurtz.

**Opinion by:** JURY

## Opinion

**[*162]** JURY, Bankruptcy Judge:

Debtors, Clayton Hoyt Wages and Andrea S. Wages, appeal from the bankruptcy court's order denying confirmation of their chapter 11[1] plan in which they sought to modify the terms of a mortgage on their real property held by appellee-creditor, J.P. Morgan Chase Bank, N.A. (Creditor).

At issue is whether the anti-modification provision under *§ 1123(b)(5)* applies to any loan secured only by real property that the debtor uses as a principal residence or whether it is limited to those claims secured by **[**2]** property used only as a debtor's principal residence. The issue is one of statutory construction and of first impression in this Circuit. We hold that ***HN1*** the anti-modification **[*163]** provision in *§ 1123(b)(5)* applies to any loan secured only by real property that the debtor uses as a principal residence. Accordingly, we AFFIRM.

### I. FACTS[2]

In 1999, debtors purchased property consisting of a house, buildings and eleven acres near Heyburn, Idaho (property). Initially, they used approximately four acres for raising feed or crops, five acres for pasturing livestock and two acres for residential purposes. At that time, debtors' employment consisted of raising roping stock on the property to rent out for rodeos and roping events. About a year later, debtors purchased a truck to haul their livestock, and income from use of their truck became a component of their business income.

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[1] Unless otherwise indicated, all chapter and section references are to the Bankruptcy Code, *11 U.S.C. §§ 101-1532*, and "Rule" references are to the Federal Rules of Bankruptcy Procedure.

[2] Many of the undisputed underlying facts are taken from the bankruptcy court's decision *In re Wages, 479 B.R. 575 (Bankr. D. Idaho 2012)*.

Between 2004 and 2006, debtors sold all their livestock to raise money to stave off a foreclosure against the property.[3] Since then, debtors have not used the property at all to generate income **[**3]** from livestock. Debtors leased an additional truck and began hauling commodities for others.

At some time, their former livestock/trucking business became a trucking-only business. Mr. Wages drives one of the trucks; Mrs. Wages secures permits, keeps the books for the business, and handles other administrative chores from an office in debtors' home. When they are not being used on the road, debtors park the two trucks and trailers on the property.

On March 4, 2011, debtors filed their chapter 11 petition to allow them to retain their residence. At the time, they were using a portion of the property to operate the business, including a small office in the house and enough adjoining space to park two truck tractors and up to three trailers.

In May 2011, Creditor[4] filed a $127,418.31 secured claim in debtors' bankruptcy case based on a mortgage debt. Under the mortgage note's terms, debtors agreed to make monthly payments through April 1, 2029, at an annual interest rate of 7.5%. The debt was secured by a mortgage on the property.

In November 2011, debtors filed a chapter 11 plan. Under the plan, debtors proposed to modify the terms of Creditor's mortgage by reducing the interest rate to 5.0% per year and extending the payoff date to March 1, 2032. Creditor objected to confirmation of the plan, arguing that it does not meet the confirmation requirements of §§ 1129(a)(1) and 1123(b)(5).

On June 12, 2012, the bankruptcy court held an evidentiary hearing on the confirmation of debtors' proposed plan. At the end of the hearing, the court took the matter under advisement.

On July 24, 2012, the bankruptcy court entered its Memorandum of Decision, sustaining Creditor's objection to confirmation of debtors' proposed chapter 11 plan. On the same day, the court entered the order denying confirmation of debtors' chapter 11 plan. Debtors timely appealed and filed a motion for leave to appeal with this court. On September 10, 2012, a motion's panel granted leave to appeal.

## II. JURISDICTION

The bankruptcy court had jurisdiction over this proceeding under 28 U.S.C. §§ 1334 and 157(b)(2)(L). We have jurisdiction under 28 U.S.C. § 158.

## [*164] III. ISSUES

A. Whether the anti-modification **[**5]** provision under § 1123(b)(5) applies to any loan secured only by real property that the debtor uses as a principal residence; and

B. Whether the bankruptcy court erred when it used the petition date as the date to determine whether the deed of trust or mortgage could be modified.[5]

## IV. STANDARD OF REVIEW

***HN2*** We review the bankruptcy court's statutory construction of § 1123(b)(5) de novo. BAC Home Loans Serv., LP v. Abdelgadir (In re Abdelgadir), 455 B.R. 896, 900 (9th Cir. BAP 2011).

## V. DISCUSSION

### A. Amended Statement Of Issues Is Proper

Appellants' Statement of Issues (SOI) on appeal filed on December 5, 2012, listed only the first issue stated above, but their opening brief contained both issues. Appellee argued that the second issue was waived because it had not been included in Appellants' SOI. In response, Appellants amended their SOI to include the second issue and filed it with the bankruptcy court. Appellee objected to the amended SOI again asserting that issues not included in an SOI are waived under the holding in Marshack v. Orange Commercial Credit (In re Nat'l Lumber & Supply, Inc.), 184 B.R. 74 (9th Cir. BAP 1995). A motions **[**6]** panel deferred resolution of the waiver issue to the hearing on the merits.

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[3] Apparently in an effort to stop the foreclosure process, debtors filed for bankruptcy protection in 2005 and in 2006. Both of those cases were dismissed.

[4] Creditor **[**4]** purchased the loans and other assets of Washington Mutual Bank.

[5] The propriety of this second issue is addressed below.

We conclude that Appellants did not waive the second issue. ***HN3*** The rule in In re Nat'l Lumber was abrogated by the Ninth Circuit's holding in *Office of the U.S. Tr. v. Hayes (In re Bishop, Baldwin, Rewald, Dillingham & Wong, Inc.), 104 F.3d 1147, 1148 (9th Cir. 1997)*. There, the Ninth Circuit held that arguments not specifically listed in an SOI are not waived. The court reasoned that an SOI required by *Rule 8006* "does not impact upon issue statements required by the court of appeals. The two are separate in nature and distinct in result." Id. The Ninth Circuit's reasoning is equally applicable to appeals in this court. Therefore, the second issue is not waived and will be addressed on the merits. However, for purposes of flow, since this second issue has impact on the first, the order will be reversed in this opinion.

**B. The Bankruptcy Court Did Not Err When It Used the Petition Date As the Date to Determine Whether The Deed Of Trust Could Be Modified**

Debtors raise an issue that is now settled in this court. ***HN4*** In *In re Abdelgadir, 455 B.R. at 902-903*, this court held that the petition date is the appropriate date **[**7]** for determining whether the anti-modification provision of *§ 1123(b)(5)* applies to a secured claim. We later applied the same reasoning to the identical wording in *§ 1322(b)(2)* in *Benafel v. One W. Bank, FSB (In re Benafel), 461 B.R. 581 (9th Cir. BAP 2011)*. As we are bound to follow our published decisions, *Salomon N. Am. v. Knupfer (In re Wind N' Wave), 328 B.R. 176, 181 (9th Cir. BAP 2005)*, we use the petition date, rather than the loan transaction date, for determining whether the anti-modification provision of *§ 1123(b)(5)* applies to Creditor's claim.

**C. The Anti-Modification Provision Under §1123(b)(5) Applies To Any Loan Secured Only By Real Property That The Debtor Uses As A Principal Residence**

***HN5*** A bankruptcy court shall confirm a plan only if it complies with the applicable provisions **[*165]** of chapter 11. See *§ 1129(a)(1)*. One such applicable provision is *§ 1123(b)(5)* which 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 . . . .

This provision, known as the anti-modification provision, prevents a debtor **[**8]** from modifying claims that are secured only by a debtor's primary residence.[6]

Our task of resolving the parties' dispute over the meaning of *§ 1123(b)(5)* begins with the language of the statute itself. *United States v. Ron Pair Enters., Inc., 489 U.S. 235, 241, 109 S. Ct. 1026, 103 L. Ed. 2d 290 (1989)*. ***HN7*** Where the statute's language is plain, the inquiry ends and our sole function is to enforce it according to its terms. Id.

***HN8*** According to its plain language, the prohibition against modification of the rights of the holders of secured claims in *§ 1123(b)(5)* has three distinct requirements: first, the security interest must be in real property; second, the real property must be the only security for the debt; and third, the real property must be the debtor's principal residence. Here, there is no dispute that the first two requirements have been met. Creditor's claim is secured by debtors' real property and debtors do not assert **[**9]** that anything other than the real property secures the claim. Therefore, our focus is on the last requirement — whether the real property is debtors' principal residence. If it is, debtors may not modify the claim secured by their property.

Debtors do not dispute that the house on the property was being used as their principal residence on the petition date. Under our plain meaning analysis, the inquiry should end there. Nonetheless, relying on non-binding case law, debtors contend there is an uncodified exception to *§ 1123(b)(5)* that applies when the property is used not only as the debtors' residence, but also for a commercial use. In this case, debtors use part of their residence for a home office to run their business and they also park trucks and trailers that they use in the business on the property.

Straying from the plain words of the statute, ***HN9*** courts have taken different approaches in resolving whether

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[6] ***HN6*** The wording of *§ 1123(b)(5)* is identical to the anti-modification provision in chapter 13's *§ 1322(b)(2)*. Since these sections contain the same statutory language, the panel considers the decisions interpreting either provision as persuasive in interpreting the other. See *Benafel, 461 B.R. at 586-87*.

real property should be considered a "debtor's principal residence" when the property also has a commercial use. Parties are subject to these different approaches and hence different results. Courts disagree on what factors should be applied, how they should be applied, and even **[**10]** what they mean.

One line of cases equates the term "real property" with "debtor's principal residence." See *Scarborough v. Chase Manhattan Mortg. Corp. (In re Scarborough), 461 F.3d 406, 411 (3d Cir. 2006)* (focusing on Congress' use of the word "is" in the phrase "real property that is the debtor's principal residence," and finding that, by using "is," Congress equated "real property" and "principal residence," meaning that, for the anti-modification provision to apply, the property "must be only the debtor's principal residence" and have no other use (emphasis in original)); *Adebanjo v. Dime Sav. Bank of N.Y., FSB (In re **[*166]** Adebanjo), 165 B.R. 98, 103-04 (Bankr. D. Conn. 1994)* (same).

We disagree with the Third Circuit's parsing of the words of the statute in Scarborough because it disregards the bankruptcy code's definition of "debtor's principal residence" in *§ 101(13A)*.[7] The term "means a residential structure if used as the principal residence by the debtor, including incidental property, without regard to whether that structure is attached to real property."[8] The definition avoids defining "real property" and also clarifies that whether a structure is a principal residence is independent **[**11]** of whether it might be real property. Simply put, the definition does not equate the term "real property" with "debtor's principal residence." Therefore, an analysis which equates the two is misplaced.

***HN11*** Another line of cases follows a totality of the circumstances or case-by-case approach. Under this approach, the intention of the parties is what matters most. See *Brunson v. Wendover Funding, Inc. (In re Brunson), 201 B.R. 351, 353 (Bankr. W.D.N.Y. 1996)* **[**12]** ("each case must turn on the intention of the parties").[9] Such intent may be discerned by examining the underlying mortgage documents.

> The Court must focus on the predominant character of the transaction, and what the lender bargained to be within the scope of its lien. If the transaction was predominantly viewed by the parties as a loan transaction to provide the borrower with a residence, then the antimodification provision will apply. If, on the other hand, the transaction was viewed by the parties as predominantly a commercial loan transaction, then stripdown will be available.

*Id. at 354*. See also *In re Zaldivar, 441 B.R. 389 (Bankr. S.D. Fla. 2011)* ("character of the transaction" and substance of what the lender bargained for are paramount).

We reject this approach as it is inconsistent with our recent case law. We do not delve into the parties' intentions on the loan transaction date when the appropriate time for determining whether property is a debtor's principal residence is the petition date. See **[**13]** *Benafel, 461 B.R. at 585* and *Abdelgadir, 455 B.R. at 898*; compare *Lievsay v. W. Fin. Sav. Bank, F.S.B. (In re Lievsay), 199 B.R. 705, 709 (9th Cir. BAP 1996)* (modification under *§ 1123(b)(5)* was denied when debtor failed to show that a home office added significant value to his property, or that the bank relied on the additional security offered by his home office in making the loan secured by the property).

Finally, ***HN12*** there is the bright-line approach taken by the bankruptcy court in *In re Macaluso, 254 B.R. 799, 800 (Bankr. W.D.N.Y. 2000)*. The court held that the anti-modification exception in *§ 1322(b)(2)* **[*167]** applies to any property that is used as the debtor's principal residence, notwithstanding the fact that the debtor's property in that case included a second

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[7] ***HN10*** *Section 101(13A)* was amended in December 2010 pursuant to the Bankruptcy Technical Corrections Act of 2010. See ***Pub.L. 111-327, 124 Stat. 3557 (Dec. 22, 2010)***. The 2010 amendment added the phrase "if used as the principal residence by the debtor," and was intended to clarify "that [this] definition pertains to a structure used by the debtor as a principal residence." See *Pawtucket Credit Union v. Picchi (In re Picchi), 448 B.R. 870, 872 (1st Cir. BAP 2011)* (citing 156 Cong. Rec. H7158 (daily ed. Sept. 28, 2010)).

[8] *Section 101(13A)(B)* states that the "debtor's principal residence" includes an individual condominium or cooperative unit, a mobile or manufactured home, or trailer if used as the principal residence by the debtor. Neither party asserts that this section applies to this matter.

[9] The Brunson court also developed a long list of factors to use in case-by-case determinations of whether property is commercial or the debtor's principal residence. *201 B.R. at 353*.

residential unit and a store.[10] We conclude that the bright-line approach is most consistent with the plain language of § 1123(b)(5).

As noted by the bankruptcy court, **[**14]** HN13 the plain language of § 1123(b)(5) does not protect from modification "claim[s] secured only by a security interest in real property that is exclusively the debtor's principal residence," or "claim[s] secured only by a security interest in real property that is the debtor's principal residence, unless the debtor also uses the property for significant commercial purposes." Wages, 479 B.R. at 581 (emphasis in original). We agree with the bankruptcy court's assessment that there is nothing in the bankruptcy code indicating that, once a commercial use of a property becomes sufficiently "significant," that property ceases being the debtor's principal residence — either a property is a debtor's principal residence or it is not.

The adoption of an objective rule eliminates line drawing and promotes certainty in the home mortgage lending market. Wages, 479 B.R. at 582 (citing In re Bulson, 327 B.R. 830, 842 (Bankr. W.D. Mich. 2005)). However, the downside is that a bright line rule may sometimes lead to harsh results. Nonetheless, "the potential for harsh results can not be used as an excuse by the Court to torture the Code's language to reach a different rule in this case. Even if the Court **[**15]** does not agree with all of the possible outcomes produced by the statutory language, it is Congress, not this Court, that must repair any problems with the Code." Wages, 479 B.R. at 583 (citing Lamie v. U.S. Tr., 540 U.S. 526, 538, 542, 124 S. Ct. 1023, 157 L. Ed. 2d 1024 (2004) ("Our unwillingness to soften the import of Congress' chosen words even if we believe the words lead to a harsh outcome is longstanding. It results from deference to the supremacy of the Legislature, as well as recognition that Congressmen typically vote on the language of a bill. . . . If Congress enacted into law something different from what it intended, then it should amend the statute to conform to its intent. It is beyond our province to rescue Congress from its drafting errors, and to provide for what we might think . . . is the preferred result.") (internal quotation marks and citations omitted)).

[10] Macaluso employed a simple two part test compared to our three prong analysis; the claims excepted from modification under § 1322(b)(2) are those (1) secured only by a parcel of real estate which (2) the debtor uses for his principal residence. 254 B.R. at 800.

Finally, in support of their argument, debtors contend that the bankruptcy court's bright line construction of § 1123(b)(5) "seems to eliminate the use of the word 'only'." This textual argument is unpersuasive. Essentially debtors add a second "only" into the statutory language to further limit the application of § 1123(b)(5).

> Although the statute **[**16]** uses "only" to require the secured creditor to have no other security for the debt, the Debtors construe the statute also to require that the residential structure serve only one function, that of being their principal residence. . . . The Debtor's argument finds no support in the plain language of the Code. There simply is no second "only" in the statutory language of § 1123(b)(5), nor any way to read the one usage of that term to limit the use of the property rather than limiting the extent of the collateral for the secured debt.

In re Schayes, 483 B.R. 209, 215 (Bankr. D. Ariz. 2012).

**[*168]** Because the language in § 1123(b)(5) is plain and unambiguous, we have no need to look at legislative history or a policy-driven analysis. We hold that HN14 the anti-modification exception applies to any loan secured only by real property that the debtor uses as a principal residence property, even if that real property also serves additional purposes.

### VI. CONCLUSION

For all these reasons, we AFFIRM.

**Dissent by:** KURTZ

## Dissent

KURTZ, Bankruptcy Judge, Dissenting:

I respectfully dissent. I disagree with the majority's interpretation of the so-called plain meaning of the statute. In my view, the majority takes the statutory phrase "claim **[**17]** secured only by a security interest in real property that **is** the debtor's principal residence" and recasts it as if the phrase actually read "claim secured only by a security interest in real property that **includes** the debtor's principal residence."

In lieu of the majority's analysis, I find persuasive and would follow the reasoning and holding of Scarborough

v. Chase Manhattan Mortg. Corp. (In re Scarborough), 461 F.3d 406, 410-13 (3d Cir. 2006). In Scarborough, the Third Circuit Court of Appeals held that the anti-modification provisions in § 1322(b)(2) and § 1123(b)(5) do not apply to mortgaged real property on which the debtor principally resides if the debtor uses another part of the mortgaged real property to generate income. Id.

Like the majority decision, supra, Scarborough considered the statutory language to be unambiguous. However, Scarborough reached a much different conclusion on the plain meaning of the statute. Whereas the majority here has construed the anti-modification provisions to apply to any mortgaged real property the debtor uses as his or her principal residence, Scarborough effectively construed the anti-modification provisions to apply only to mortgaged real **[**18]** property the debtor uses exclusively as his or her principal residence. That two appellate courts could, after careful analysis, come to such divergent conclusions on the plain meaning of the statute tends to support the notion that the statute actually is ambiguous. In any event, Scarborough points out that the legislative history supports its construction of the statute. Id. at 413. The majority decision herein makes no such claim.

The majority considered Scarborough but ultimately rejected the Third Circuit's analysis. According to the majority, Scarborough's construction of the statute conflicts with the statutory definition of "debtor's principal residence" contained in § 101(13A). The majority asserts that a conflict exists because Scarborough's construction of § 1322(b)(2) and § 1123(b)(5) equates the "debtor's principal residence" solely with real property whereas the statutory definition of "debtor's principal residence" may include personal property. But the majority does not explain the practical significance of this so-called conflict, nor do I perceive any. More importantly, to the extent there is any tension between § 1322(b)(2) and § 1123(b)(5) on the one hand and § 101(13A) **[**19]** on the other hand, Congress created this tension — not Scarborough. Put another way, Congress limited the scope of the anti-modification provisions to real property by including in both provisions the term "real property" but chose not to similarly limit the definition of "debtor's principal residence." Thus, the difference between the anti-modification provisions and the statutory definition is a direct result of the different language Congress chose to use in each instance. That Scarborough's construction gives meaning to the different language **[*169]** Congress used is not a persuasive basis for rejecting Scarborough.

For the reasons set forth above, I respectfully dissent.[1]

End of Document

[1] I also prefer Scarborough's ruling that the relevant date for considering how the debtor uses the property is the loan transaction date rather than the petition date. Id. at 412. Nonetheless, I do not base my dissent on this ground. Rather, I agree with the majority that our prior decisions in Benafel v. One W. Bank, FSB (In re Benafel), 461 B.R. 581 (9th Cir. BAP 2011), and BAC Home Loans Serv., LP v. Abdelgadir (In re Abdelgadir), 455 B.R. 896 (9th Cir. BAP 2011), are controlling on this point and answer this question **[**20]** in favor of the petition date. Even so, regardless of which date is used, the result in this case would be the same because the mortgaged real property was used for income generating purposes on both the loan transaction date and the petition date.

and costs in defending themselves against Elbar.

Counsel for MacKenzie and United Sentry has seven (7) days to provide to counsel for Elbar all invoices that his two clients believe represent the reasonable fees and costs incurred in defending themselves against Elbar's TTLA claim. If counsel for MacKenzie and United Sentry fails to deliver these invoices within the seven (7) day deadline, then the fees and costs will be deemed waived. If they are timely delivered, then counsel for Elbar has seven (7) days to file a certificate setting forth that Elbar either does object or does not object to the reasonableness of the requested fees and expenses.[138] If Elbar's counsel files a certificate that Elbar does not object to the reasonableness, then no further hearings will be held and the Court will enter a judgment consistent with these findings of fact and conclusions of law. Elbar's certification that it does not object to reasonableness will **not** constitute a waiver of Elbar's right to appeal any of this Court's rulings, including that Elbar is liable to MacKenzie and United Sentry for their reasonable fees and costs as the prevailing parties in Elbar's TTLA claim against them.

If Elbar's counsel certifies that Elbar does object to the reasonableness of the requested fees and costs of MacKenzie and United Sentry, then this Court will hold a hearing on solely this issue, and thereafter will render a ruling on reasonableness and then enter a judgment consistent with these findings of fact and conclusions of law.

Finally, with respect to Elbar's fees and costs for prosecuting its TTLA claim against Prins, Elbar's counsel has seven (7) days to submit to this Court all invoices that Elbar believes represent its reasonable fees and expenses. The Court will review these invoices *in camera* and then issue a ruling on the amount it finds to be reasonable. As with the fees and costs of MacKenzie and United Sentry, Elbar's fees and costs will be incorporated into the judgment.[139]

**IN RE: James M. LISTER, Amy F. Lister, Debtor**

**Case No. 17-12377**

United States Bankruptcy Court, S.D. Ohio, Western Division.

Signed September 25, 2018

**Background:** Mortgagee objected to confirmation of debtors' proposed Chapter 13 plan as impermissibly modifying its rights in alleged violation of antimodification provision.

**138.** On September 12, 2018, this Court orally announced on the record its ruling regarding the adversary proceeding, and informed the parties that it would subsequently be entering this Memorandum Opinion on the docket to explain its ruling in detail. In issuing its oral ruling, the Court set forth deadlines for counsel to deliver invoices representing the reasonable fees and costs. In fact, counsel for MacKenzie and United Sentry timely delivered its invoices to counsel for Elbar and, in the aggregate, seeks to recover fees and costs of $60,725.00 and $1,851.45, respectively. [*See* Adv. Doc. No. 249].

**139.** After this Court issued its oral ruling on September 12, 2018, Elbar's counsel subsequently filed a certificate expressly setting forth that Elbar waives its attorneys' fees and expenses for prosecuting its TTLA claim against Prins. [*See* Adv. Doc. No. 250]. Hence, the judgment will set forth that Elbar shall recover only $716,084.58 from Prins.

**Holdings:** The Bankruptcy Court, Beth A. Buchanan, J., held that:

(1) as long as the real property that secures a creditor's claim includes Chapter 13 debtor's personal residence on petition date, creditor's claim will be protected by antimodification provision;

(2) that debtors used property for purposes other than as home did not mean that mortgagee was not protected by antimodification provision; and

(3) mortgagee was protected by antimodification provision, though its mortgage lien attached to multiple parcels.

Objection sustained.

**1. Bankruptcy ⚿3708(9)**

As long as the real property that secures a creditor's claim includes Chapter 13 debtor's personal residence on petition date, even if property is mixed-use property that is used for purposes other than as site of debtor's principal residence, creditor's claim will be protected by antimodification provision. 11 U.S.C.A. § 1322(b)(2).

**2. Bankruptcy ⚿3708(9)**

Time for determining whether creditor's claim is secured only by security interest in real property used by Chapter 13 debtor as principal residence, such that antimodification provision applies and prevents debtor from modifying creditor's rights, is petition date, and not date of secured loan or some other date. 11 U.S.C.A. § 1322(b)(2).

**3. Bankruptcy ⚿3708(9)**

Antimodification provision is ambiguous as to how it applies to creditors whose claims are secured by mixed-use property, which is used as more than just a principal residence by Chapter 13 debtors, such that it is appropriate for bankruptcy court to look to legislative history for assistance in construing statute. 11 U.S.C.A. § 1322(b)(2).

**4. Statutes ⚿1242**

When statutory language is ambiguous, courts turn to legislative history to interpret meaning of statute.

**5. Bankruptcy ⚿3715(7)**

Burden of proof is on creditor asserting that its claim is protected from modification to show that the anti-modification provision of Chapter 13 applies. 11 U.S.C.A. § 1322(b)(2).

**6. Bankruptcy ⚿3715(7)**

Creditor claiming protection of antimodification provision of Chapter 13 must demonstrate that provision applies by a preponderance of evidence. 11 U.S.C.A. § 1322(b)(2).

**7. Bankruptcy ⚿3708(9)**

Mere fact that, from the time that creditor held a mortgage on their property, Chapter 13 debtors had used property, not just as their home, but as site of child care business, or fact that debtors rented out another structure on property to third party, did not mean either that creditor's claim was secured other than just by real property used by Chapter 13 debtors as their principal residence, or that creditor was not protected by antimodification provision from having its rights modified in debtors' Chapter 13 plan. 11 U.S.C.A. § 1322(b)(2).

**8. Bankruptcy ⚿3708(9)**

Mere fact that Chapter 13 debtor's home sits on a large tract or on multiple lots does not automatically lead to conclusion that a creditor whose claim is secured by these lots is not protected by antimodification provision, as not being a creditor whose claim is secured only by security interest in real property used by debtor as principal residence. 11 U.S.C.A. § 1322(b)(2).

**9. Bankruptcy ⇨3708(9)**

Court must engage in fact-intensive analysis to determine whether multiple parcels of real property securing a creditor's claim together constitute a Chapter 13 debtor's principal residence, such that creditor, despite having a security interest in multiple parcels, is nonetheless protected by antimodification provision. 11 U.S.C.A. § 1322(b)(2).

**10. Bankruptcy ⇨3708(9)**

Creditor that had mortgage lien, not only on parcel of real property which was site of Chapter 13 debtors' home, but on second, U-shaped parcel surrounding the first on which were located a garage used by debtors and structure that they rented out to third-party tenant, was creditor whose claim was secured only by real property used by debtors as principal residence, so as to be protected by antimodification provision; both parcels together constituted debtors' principal residence, given that they were acquired at same time, by same conveyance, that garage located on second parcel, which was only garage on either parcel, supported debtors' residence, and that U-shaped nature of second parcel suggested that it functioned more as "expanded backyard" than as separate and distinct property. 11 U.S.C.A. § 1322(b)(2).

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Nicholas A. Zingarelli, Zingarelli Law Office, LLC, Cincinnati, OH, for Debtor.

**DECISION SUSTAINING U.S. BANK TRUST, NA'S OBJECTION TO CONFIRMATION [Docket Number 18]**

Beth A. Buchanan, United States Bankruptcy Judge

U.S. Bank Trust, NA (the "Creditor") argues that the proposed cramdown of the Creditor's secured claim by Debtors Amy and James Lister ("Debtors") in their chapter 13 plan [Docket Number 17] is prohibited by the anti-modification provision of 11 U.S.C. § 1322(b)(2). The Debtors maintain that the anti-modification provision does not apply because Creditor's claim is secured by real property that is not solely the Debtors' principal residence. For the reasons that follow, this Court finds that 11 U.S.C. § 1322(b)(2) precludes the modification of the Creditor's claim.

## I. FINDINGS OF FACT

The parties stipulated [Docket Number 24] to the following facts:

1. Debtors own the real property located at and commonly referred to as 10038 State Route 775, Scottown, Ohio 45678 (the "Property").

2. Debtors have owned the Property since 1996.

3. The Property consists of two adjacent parcels of real estate that are both pledged as collateral through a consensual mortgage for the debt owed to Creditor. The mortgage in question was executed on May 16, 2005 and was recorded with the Lawrence County Recorder's office on May 26, 2005. The mortgage fully matures on May 16, 2025.

4. The Debtors have owned and operated a home childcare on the premises for the past twenty-one years. This encompasses the entirety of the time that Creditor has held a mortgage against the Property.

5. Debtors receive monthly rent in the amount of approximately $600.00 for the rental of a separate structure that exists on the Property. The separate structure serves as a residence for a third-party.

Debtors began the rental of this separate structure in October of 2014.

6. Debtors and Creditor agree that the information presented in the stipulations is submitted in lieu of testimony of the Debtors and such information is accepted as truthful and accurate. Creditor waives its rights to cross examination of the Debtors as witnesses.

7. Debtors obtained an appraisal of the entirety of the Property on April 25, 2017, with such appraisal being completed by licensed appraiser Jeffrey Hunter. A copy of the appraisal has been filed with the Court as ECF No. 9 and shall be considered Joint Exhibit 1 (the "Appraisal"). This Appraisal shall be admitted as evidence.[1]

The parties further stipulated [Docket Number 43] to the admission of the following additional exhibits, which were attached to the parties' respective briefs:

a. Debtors' Exhibits
   i. Exhibit A – Deed
   ii. Exhibit B – Mortgage
   iii. Exhibit C – Lawrence County Auditor Property Cards
b. Creditor's Exhibits
   i. Exhibit A – Lawrence County Auditor Property Cards
   ii. Exhibit B – Debtors' 2016 Bankruptcy Petition
   iii. Exhibit C – Debtors' 2016 Bankruptcy Docket
   iv. Exhibit D – Foreclosure Complaint
   v. Exhibit E – Answer to Foreclosure Complaint
   vi. Exhibit F – Debtors' Notice of Filing Real Estate Appraisal
   vii. Exhibit G – Creditor's Proof of Claim

## II. ANALYSIS

Jurisdiction over this matter is vested in this Court by virtue of 28 U.S.C. § 1334(b) and the General Order of Reference entered in this District. This is a core proceeding under 28 U.S.C. § 157(b)(2)(L).

Section 1322(b)(2) [2] provides that a chapter 13 "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) (emphasis added). This is known as the anti-modification provision or exception.

The two threshold legal issues before this Court are: (1) whether the anti-modification provision of § 1322(b)(2) applies to a security interest in real property that is the debtor's principal residence, if that property also hosts commercial activities—so called "mixed-use properties;" and, (2) the point in time for determining the debtor's "principal residence" status under § 1322(b)(2). Courts have grappled with these issues for the past twenty-plus years. Before weighing in, this Court will endeavor to summarize the divergent approaches.

### A. Section 1322(b)(2) and "mixed-use property"

There are three differing approaches for determining the applicability of the anti-

1. At the time of the stipulations, Creditor was in the process of completing its appraisal of the subject Property, which the parties had contemplated being Joint Exhibit 2. For the reasons stated in this Court's *Order Denying U.S. Bank Trust, NA's Motion to Obtain Appraisal Out of Time* [Docket Number 34], Creditor's request to obtain its own appraisal of the Property was denied.

2. Use of the terms "Bankruptcy Code," "Section" or "§" are references to provisions of Title 11 of the United States Code.

modification provision where the real property at issue serves as more than the debtor's principal residence. The vast majority of the cases in the mixed-use context involve real property that includes the debtor's principal residence as well as other income-producing rental property.

1. Approach # 1: Real property that is ***only*** the debtor's principal residence (the "Bright-Line Only Approach")

The "majority" of courts have adopted a bright-line approach concluding that the antimodification provision does not apply unless the real property is only the debtor's principal residence. *See e.g.*, *Scarborough v. Chase Manhattan Mortg. Corp. (In re Scarborough)*, 461 F.3d 406, 411 (3rd Cir. 2006); *Lomas Mortg., Inc. v. Louis*, 82 F.3d 1, 7 (1st Cir. 1996); *In re Abrego*, 506 B.R. 509, 515 (Bankr. N.D. Ill. 2014) (adopting and describing this approach as the majority approach); *In re Bulson*, 327 B.R. 830, 845 (Bankr. W.D. Mich. 2005). Two circuit courts adopt this approach, although for different reasons.

The Court of Appeals for the Third Circuit looked to the plain language of § 1322(b)(2) in concluding that the antimodification provision does not extend to mixed-use property. *In re Scarborough*, 461 F.3d at 411.

> By using the word "is" in the phrase "real property that is the debtor's principal residence," Congress equated the terms "real property" and "principal residence." Put differently, this use of "is" means that the real property that secures the mortgage must be only the debtor's principal residence in order for the anti-modification provision to apply. We thus agree with the reasoning of the Bankruptcy Court for the District of Connecticut when it noted 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*." *In re Adebanjo*, 165 B.R. 98, 104 (Bankr. D. Conn. 1994). A claim secured by real property that is, even in part, not the debtor's principal residence does not fall under the terms of § 1322(b)(2).

*Id.* (emphasis in original).

In contrast, the Court of Appeals for the First Circuit looked to the legislative history for reaching the conclusion that § 1322(b)(2) does not apply to mixed-use property. *Lomas*, 82 F.3d at 4.

> [The creditor in *Lomas* argues] that the term "only" modifies "by a security interest in real property" and the term "that is the debtor's principal residence" further modifies "real property." [The creditor's] reading results in § 1322(b)(2) applying when (1) the security interest is only in real property (as opposed to personal, intangible or other non-real property) and (2) the real property is the "debtor's principal residence." Under this reading, there is no need that the real property be "only" the debtor's principal residence.
>
> The [debtors], in contrast, argue (1) that "only" modifies the entire phrase "by a security interest in real property that is the debtor's principal residence"; and (2) that the word "is" requires complete and exclusive identity between "real property" and "principal residence."
>
> [The creditor] criticizes the [debtors'] reading on the ground that the statutory language does not explicitly state that the real property must be "exclusively" the debtor's principal residence. The [debtors] criticize [the creditor's] reading on the ground that the statutory language does not explicitly state that

> the real property must merely "contain" or "include" the principal residence.

*Id.* at 3-4. Concluding that the " 'plain meaning' approach to § 1322(b)(2) appears to us to be, in the end, inconclusive," *id.* at 4, the *Lomas* court conducted an extensive review of the legislative history behind § 1322(b)(2), ultimately concluding that the anti-modification provision does not reach multi-unit properties even where the debtor resides in one of the units. *Id.* at 7.

Critics of this approach note that it is too easy for the debtor to manipulate the outcome by converting their residential property to a commercial use on the eve of bankruptcy. *See e.g.*, *In re Zaldivar*, 441 B.R. 389, 390 (Bankr. S.D. Fla. 2011) ("The problem with this approach is that it would permit security interests to be modified on a debtor's primary residence when the debtor decides to rent out a garage apartment or convert a basement into a rentable apartment.").

2. Approach # 2: Real property that ***includes*** the debtor's principal residence (the "Bright-Line Includes Approach")

An "emerging" minority of courts have adopted a similar bright-line test reaching the opposite conclusion of the courts adopting the Bright-Line Only Approach. The courts following this approach conclude that § 1322(b)(2) applies as long "as the debtor principally resides in *some portion* of the real property." *In re Brooks*, 550 B.R. 19, 24-25 (Bankr. W.D.N.Y. 2016) (emphasis in original); *see also Wages v. J.P. Morgan Chase Bank, N.A. (In re Wages)*, 508 B.R. 161, 167 (9th Cir. BAP 2014) (interpreting identical language under § 1123(b)(5) ); *In re Hock*, 571 B.R. 891, 898 (Bankr. S.D. Fla. 2017) (interpreting identical language under § 1123(b)(5) ); *In re Macaluso*, 254 B.R. 799, 800 (Bankr. W.D.N.Y. 2000).

Also looking to the plain language of the statute, these courts conclude that the placement of the word "only" in the phrase "secured only by a security interest in real property that is the debtor's principle residence," is an adverb modifying "secured"—not "the debtor's principle residence." *In re Macaluso*, 254 B.R. at 800. As such, these courts note that the plain language of § 1322(b)(2)—

> does not protect from modification "claim[s] secured only by a security interest in real property that is exclusively the debtor's principal residence," or "claim[s] secured only by a security interest in real property that is the debtor's principal residence, unless the debtor also uses the property for significant commercial purposes." . . . [T]here is nothing in the bankruptcy code indicating that, once a commercial use of a property becomes sufficiently "significant," that property ceases being the debtor's principal residence—either a property is a debtor's principal residence or it is not.

*In re Wages*, 508 B.R. at 167 (citations omitted) (emphasis in the original) (discussing the identical anti-modification provision under chapter 11).

Courts opposing this approach note that it can lead to absurd results when applied to loan transactions that are predominantly commercial in nature. *See In re Zaldivar*, 441 B.R. at 390 (noting that this approach "could conceivably be applied to, for example, a large factory in which the debtor maintains a small apartment as his or her residence."); *Lomas*, 82 F.3d at 6 (noting that "[i]t is unlikely Congress intended the antimodification provision to reach a 100-unit apartment complex simply because the debtor lives in one of the units.").

3. Approach # 3: Case-By-Case Approach

Finally, a third line of cases rejects both bright-line approaches in favor of a case-by-case test focused on the intention of the parties. *See e.g.*, *Litton Loan Servicing, LP v. Beamon*, 298 B.R. 508, 512 (N.D.N.Y. 2003); *In re Zaldivar*, 441 B.R. at 390; *In re Baker*, 398 B.R. 198, 203 (Bankr. N.D. Ohio 2008); *Brunson v. Wendover Funding, Inc. (In re Brunson)*, 201 B.R. 351, 353 (Bankr. W.D.N.Y. 1996). These courts look to a totality of the circumstances, focusing on:

> the predominant character of the transaction, and what the lender bargained to be within the scope of its lien. If the transaction was predominantly viewed by the parties as a loan transaction to provide the borrower with a residence, then the antimodification provision will apply. If, on the other hand, the transaction was viewed by the parties as predominantly a commercial loan transaction, then stripdown will be available.

*In re Brunson*, 201 B.R. at 354.

Courts that disfavor this approach note that it "introduces uncertainty and unpredictability to residential mortgage transactions because it requires courts to engage in subjective, hindsight analysis as to the intent of the parties." *In re Scarborough*, 461 F.3d at 414.

## B. Point in time for determining "principal residence" status under § 1322(b)(2)

Similar to the divide regarding the applicability of § 1322(b)(2) to mixed-use property, there are three approaches to deciding the date used to determine whether real property is the debtor's principal residence for purposes of § 1322(b)(2).

1. Approach # 1: Petition Date (the "Petition Date Approach")

Under the first line of cases, courts use the petition date to determine the debtor's principal residence status. *See e.g.*, *In re Wages*, 508 B.R. at 164; *In re Brinkley*, 505 B.R. 207, 213 (Bankr. E.D. Mich. 2013); *In re Christopherson*, 446 B.R. 831, 835 (Bankr. N.D. Ohio 2011); *see also In re Berkland*, 582 B.R. 571, 577 (Bankr. D. Mass. 2018) (interpreting identical language under § 1123(b)(5) ). This approach is viewed as the majority approach. *See Benafel v. One West Bank, FSB (In re Benafel)*, 461 B.R. 581, 589 (9th Cir. BAP 2011); *In re Brinkley*, 505 B.R. at 213.

Courts relying on this approach conclude that use of the petition date for determining the debtor's principal residence status is consistent with the language of § 1322(b)(2). Noting that:

> [While] § 1322(b)(2) lacks explicit reference to its timing, the use of the word "claim" within the antimodification clause has been held to signify that the petition date should be the court's focus, since a "claim" in bankruptcy arises at the date of the filing of the petition. Also from a temporal standpoint, it has been observed that, looking to the circumstances as they exist at the time the petition is filed, conforms to the provision's use of the present tense "is"—with the antimodification clause providing "other than a claim secured only by a security interest in real property that *is* the debtor's principal residence."

*In re Baker*, 398 B.R. at 203 (quotation marks and citations omitted) (emphasis in original).

2. Approach # 2: Date the security interest is created (the "Loan Date Approach")

A second line of cases uses the date when the creditor takes a security interest

in the real property as the relevant date for determining the debtor's principal residence status. *See e.g.*, *In re Scarborough*, 461 F.3d at 412; *In re Abrego*, 506 B.R. at 516; *In re Bulson*, 327 B.R. at 846.

Certain courts adopt this approach for the temporal component of § 1322(b)(2) as a way to bolster the use of the Bright-Line Only Approach. *Id.* "The reasoning behind this position is based largely on the concern that a contrary reading could lead to debtor manipulation; if a date other than the transaction date is utilized, debtors could seek to nullify the application of the anti-modification clause by modifying the use of their property immediately prior to filing." *In re Kelly*, 486 B.R. 882, 884-85 (Bankr. E.D. Mich. 2013).

One earlier court, however, turned to the legislative history of § 1322(b)(2) as support for its adoption of the date of the security interest approach. *In re Smart*, 214 B.R. 63, 67-68 (Bankr. D. Conn. 1997). The *Smart* court concluded that the phrase "real property that is the debtor's principal residence" modifies the antecedent term "security interest." *Id.* at 67. When read this way, the *Smart* court decided that § 1322(b)(2) was subject to at least two credible interpretations—it could be read as referring to the home's status as the debtor's principal residence at either the present time or at the time the security interest was created. *Id.* Concluding that the statute was ambiguous, the court looked to the legislative history of § 1322(b)(2) and decided that it was intended to "encourage and sustain a flow of affordable capital into the home lending market." *Id.* at 68. Fearing that debtors might manipulate their place of residence after the loan date and in anticipation of bankruptcy, the *Smart* court concluded that mortgage loan transaction date best served the Congressional purpose of the flow of capital to the mortgage lending market. *Id.*

3. Approach # 3: Hybrid Approach

The third approach taken by courts is a so-called "hybrid approach," which looks to "both the circumstances as they exist on the petition date as well as the underlying agreement." *In re Baker*, 398 B.R. at 203. This approach seeks to address the dual policy concerns "of creditors and debtors attempting to manipulate the application of the antimodification clause." *Id.*

## C. This Court concludes that the real property that is the security interest must *include* the debtor's principal residence *as of the petition date* in order for the antimodification provision to apply.

**[1, 2]** As the *Brooks* court observed, much has been written over the past two decades regarding the meaning of § 1322(b)(2) such that "this Court can do little to add anything of value to the analysis." *In re Brooks*, 550 B.R. at 23. As such, this Court will take a position without further fanfare. *Id.* This Court adopts the view that the anti-modification provision applies if the security interest in the real property includes the debtor's principal residence (*i.e.*, the Bright-Line Includes Approach).[3] This Court also adopts the

**3.** The Debtors argue that the Court of Appeals for the Sixth Circuit rejected this approach in *Reinhardt v. Vanderbilt Mortg. & Fin., Inc. (In re Reinhardt),* 563 F.3d 558 (6th Cir. 2009). The issue in *Reinhardt* was whether the anti-modification provision applied to a loan secured by a mortgage on real property and a security interest in a mobile home that was the debtors' principal residence. *Id.* at 560-61. The creditor in *Reinhardt* argued that "the logical reading of § 1322(b)(2) in light of the [definition of a 'debtor's principal residence' in] new § 101(13A) is that to get the benefit of § 1322(b)(2) a creditor must have a security

view that the petition date is the appropriate date to determine the debtor's principal residence status (*i.e.*, the Petition Date Approach).

**[3]** While this Court adopts the Bright-Line Includes Approach, this Court does so for different reasons than those expressed by other courts adopting this approach. Like the First Circuit in *Lomas*, this Court agrees that the meaning of § 1322(b)(2) is ambiguous where the real property at issue serves as more than the debtor's principal residence.

> Although disagreement about a provision's meaning does not necessarily lead to the conclusion that it is ambiguous, the court concludes that § 1322(b)(2) is in fact ambiguous. While *Wages* argues that the statute does not state that it protects real property that is *exclusively* the debtor's principal residence, neither does it state that it protects real property that is *partially* the debtor's principal residence. The statute uses only the word "is" without any adverb, and that leads to an ambiguity.

*In re Abrego*, 506 B.R. at 514 (citation omitted) (emphasis in original); *see also In re Wages*, 508 B.R. at 168 (Kurtz, J., dissenting) ("That two appellate courts could, after careful analysis, come to such divergent conclusions on the plain meaning of the statute tends to support the notion that the statute actually is ambiguous.").

**[4]** Where the statutory language is ambiguous, courts turn to the legislative history to interpret the meaning of a statute. *Lomas*, 82 F.3d at 4. The legislative history suggests that the "favorable treatment of residential mortgagees [under § 1322(b)(2) ] was intended to encourage the flow of capital into the home lending market." *Nobelman v. American Sav. Bank*, 508 U.S. 324, 332, 113 S.Ct. 2106, 2111-12, 124 L.Ed.2d 228 (1993) (Stevens, J., concurring). Indeed, each of the three approaches courts have taken in interpreting § 1322(b)(2) seeks to pay homage to this Congressional purpose. *See In re Bulson*, 327 B.R. at 842 ("[A] precise definition, even if arbitrary, is exactly what is needed to avoid disruption in the home mortgage capital market."); *In re Wages*, 508 B.R. at 167 ("The adoption of an objective rule eliminates line drawing and promotes certainty in the home mortgage lending market."); *In re Brunson*, 201 B.R. at 354 (concluding that a totality of factors approach "serves the Congressional intent of encouraging home mortgage lending, as illuminated by the Supreme Court in *Nobelman*.").

As the *Lomas* court observed, however, "the legislative history is silent on the scope of the incentive Congress wished to give home lenders." *Lomas*, 82 F.3d at 6. In defining the scope of the protections for the residential loan market, most courts strive to create an approach that is pre-

interest [t]hat *contains* the debtor's principal residence[.]'' *Id.* at 563 (internal quotation marks omitted) (emphasis in original). The Sixth Circuit responded by stating ''[t]hat [the creditor] has to adjust the wording of the statute to reach its desired result shows the error of its interpretation.'' *Id.*

In rejecting the creditor's argument, however, the Sixth Circuit's point was that the debtor's personal residence must actually *be* real property for the anti-modification provision to apply—not simply sit on real property. *Id.* at 563. Because, a mobile home is not real property under applicable Ohio law, the Sixth Circuit held that the antimodification provision did not apply. *Id.* at 564-65.

In this case, the parties do not dispute that the Debtors' principal residence *is* real property. *Reinhardt* did not address the question of whether real property this *is* a debtor's principal residence but also serves other purposes is outside of the scope of the anti-modification provision.

dictable [4] and not subject to manipulation. To develop an approach to § 1322(b)(2) that best meets these objectives in the mixed-use property context, it is important to factor in the temporal component of § 1322(b)(2) as well.

Unfortunately, there is no perfect combination of the mixed-use property approaches and temporal component approaches that neatly satisfies all concerns. The multi-factor considerations in the case-by-case/hybrid approach mitigate against manipulation by debtors or creditors since the court can consider such factors when determining whether the anti-modification provision does or does not apply in a particular case. But this approach provides little in the way of predictability to either debtors or creditors since it will depend on which factors the court considers and what weight the court gives those factors.

This Court declines to adopt those approaches that use the loan date as the date to determine the debtor's principal residence status. This Court finds no ambiguity in the temporal component of § 1322(b)(2). Like the majority of courts that have addressed this issue, this Court agrees that the plain language of § 1322(b)(2) "points to the present and not the past." *In re Berkland*, 582 B.R. at 577. *Scarborough* is the most prominent case to have adopted the Loan Date Approach, "but in that case the court offered little discussion of the issue and no reason for disregarding the plain language of the statute." *In re Berkland*, 582 B.R. at 578.

The combination of the Bright-Line Only Approach and the Petition Date Approach lacks predictability at the loan inception date and is subject to manipulation by debtors. *In re Bulson*, 327 B.R. at 846 (debtor could manipulate the anti-modification exception by adding a second living unit to the property on the eve of bankruptcy); *In re Scarborough*, 461 F.3d at 412 (debtor could manipulate the anti-modification exception by taking on temporary tenants prior to filing bankruptcy).

The combination of the Bright-Line Includes Approach and the Petition Date Approach in contrast, has greater predictability in the mixed-use property context and is less susceptible to manipulation by a debtor. So long as the real property securing the creditor's claim includes the debtor's personal residence on the petition date, the claim will be subject to the anti-modification provision. *In re Wages*, 508 B.R. at 167 (observing that "either a property is a debtor's principal residence or it is not."). [5] While there is no perfect solution (absent clarification by the legislature), this Court finds that the combination of the Bright-Line Includes Approach and the Petition Date Approach best comports with the language and objective underlying § 1322(b)(2)'s antimodification provision.

**4.** As one court observed:

> [A] precise definition [of the anti-modification provision], 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.

*In re Bulson,* 327 B.R. at 842.

**5.** This Court recognizes that in the non-mixed-use context, it is still possible for a debtor to manipulate the applicability of the anti-modification provision by moving to a new residence pre-petition but "[a]ny approach to this issue that one takes is subject to [potential] manipulation." *In re Brinkley,* 505 B.R. at 213.

**D. Section 1322(b)(2) precludes the modification of Creditor's claim.**

**[5, 6]** Turning to the facts of this case, Creditor "bears the burden of proof to show by a preponderance of the evidence that its claim falls within the anti-modification exception of § 1322(b)(2)." *In re Snowden*, 546 B.R. 39, 44 (Bankr. E.D. Ky. 2016) (internal quotation marks and citations omitted); *see also In re Berkland*, 582 B.R. at 576 (same as relates to the anti-modification provision of § 1123(b)(5) ). The parties waived the evidentiary hearing scheduled in this case and instead submitted this matter to this Court on the briefs, stipulation of facts and stipulated exhibits.

The parties' dispute centers on whether any of the following factors remove the Creditor's claim from the protections of § 1322(b)(2)'s anti-modification provision: (1) the Property serves as the Debtors' sole place of business for the child care facility that they operate; (2) the Debtors rent a separate structure on the Property to a third-party and receive rental income; and, (3) Creditor's claim is secured by multiple parcels of real property.

**[7]** The first two factors relate to the mixed-use property issue. Under the approach adopted by this Court, the fact that the Debtors operate a business from their home does not exclude Creditor's claim from the anti-modification provision of § 1322(b)(2) simply because the Property also serves additional purposes. *See In re Wages*, 508 B.R. at 168. Similarly, the fact that the Debtors rent a separate structure on the Property to a third-party and receive rental income, in and of itself, does not preclude application of the anti-modification provision to the Creditor's claim. *See In re Brooks*, 550 B.R. at 26.

The third factor, however, goes to whether Creditor's claim is secured by collateral *in addition* to the real property that is the Debtors' principal residence, in which case the antimodification provision would not apply. The Debtors asserts that Creditor's claim is secured by additional collateral—namely, a second parcel of land that is not the Debtors' residence. The Debtors note that the parties have in fact stipulated that Creditor's claim is secured by two separate parcels [Docket Number 41, p.7 (citing to Docket Number 24, Line 5) ].

**[8, 9]** As the Creditor properly notes, however, "[t]he fact that a debtor's home sits on a large tract or multiple lots does not automatically lead to a conclusion that the claim is secured by more than just the personal residence." *In re Snowden*, 546 B.R. at 44 (collecting cases). The determination of whether multiple parcels of real property constitute a debtor's principal residence "is a fact-intensive analysis." *Id.*

**[10]** Creditor argues that both parcels of real property securing its claim are the Debtors' principal residence based on evidence in the record characterizing the parcels as one residential property. In particular, Creditor asserts that the Debtors' schedules in this case and their prior chapter 7 case, together with the Appraisal and the "tax records" establish that the Debtors' principal residence includes both parcels.

First, Creditor notes that in the Debtors' prior chapter 7 case, the Debtors scheduled the Property as their residence and claimed the homestead exemption on Schedule C [Docket Number 42, p.2]. Similarly, Creditor observes that the Debtors claim a homestead exemption on Schedule C in this case [Docket Number 42, p.8; Docket Number 45, p.1].

In response, Debtors explain that the Property was scheduled together in their current case as an "administrative conven-

ience" because both parcels are collateral for the Creditor's claim [Docket Number 44, p.4]. The Debtors point out that it is clear from their schedules in this case that their residence is separate from the second parcel because the schedules expressly state that the Debtors' residence is "valued together with adjoining parcel on SR 775" [Docket Number 44, p.5]. With respect to the exemption issue, Debtors state that Creditor has not offered any proof that Debtors intended to claim their homestead exemption against anything other than the portion of the collateral that holds their principal residence [Docket Number 44, p.5]. Regardless, Debtors maintain that the exemption issue is "nullity" because there is no equity in the Property [*id.*].

This Court finds that the manner in which the Debtors scheduled the Property in their prior chapter 7 case and this case in and of itself is not conclusive as to whether both parcels securing Creditor's claim are the Debtors' principal residence for purposes of § 1322(b)(2). While the Debtors did in fact check the box identifying the Property as a "single-family home" in Schedule A/B in the Debtors' prior case, they went on to identify and value the parcels separately as follows:

Parcel No: 32-018-1301.000-$11,830.00

Parcel No: 32-018-1500.000-$98,720.00

[Creditor's Ex. B, p.10]. Further, Creditor's assertion that the Debtors claimed a homestead exemption for the Property in their prior case is incorrect. The Debtors claimed no exemption for the Property in their prior case. [Id., p.16-17]. The Debtors' schedules in their current case are similarly inconclusive regarding whether the additional parcel is part of the Debtors' principal residence. This Court notes that the Debtors did not check a box on Schedule A/B in their current case describing the nature of the Property [Docket Number 1, p.10]. This Court further observes that the Debtors value the Property at $122,000 on Schedule C in their current case and only claim a homestead exemption in the amount of $100,000 [Docket Number 1, p.16], which could support the Debtors' argument that they were only claiming an exemption in the portion of the Property that is their residence.

Next, Creditor maintains that the Appraisal "values the lots as essentially one, listing only the total value in its appraisal report" [Docket Number 42, p. 8]. Creditor further notes that the Appraisal itself is a residential appraisal [*id.*]. As with their schedules, the Debtors respond that they obtained a single appraisal "for consistency's sake" since both parcels secure Creditor's claim [Docket Number 44, p.5].

This Court finds Creditor's arguments regarding the Appraisal to be similarly inconclusive. The Appraisal merely establishes the value of the collateral securing Creditor's claim. The fact that it is a "residential" appraisal is unavailing. As Creditor argues and the tax records confirm, both parcels are residential property [Creditor's Ex. A]. As such, the fact that the Appraisal values the parcels as such does nothing to establish that the second parcel is also the Debtors' principal residence.

Finally, Creditor argues that "the tax records show the property is used as a single-family residence and residential vacant land" [Docket Number 45, p.1 (referencing Creditor's Ex. A) ]. Debtors counter that the tax records "tell a very different and far more convincing story" [Docket Number 44, p. 5]. They maintain that the tax records show that the Debtors' residence sits solely on parcel no. 32-018-1500.000 ("Parcel # 1") while the separate structure that is rented to a third-party is located on parcel no. 32-018-1301.000 ("Parcel # 2") [id.].

While Creditor could have painted a clearer picture supporting the Debtors'

residential use of the second parcel, this Court finds that the tax records together with other evidence in the record are sufficient to establish that the both parcels serve as the Debtors' principal residence. The tax records show that the house, which is on Parcel # 1, was built in 1966 [Creditor's Ex. A, p. 1]. Parcel # 2 includes a storage shed, which was also built in 1966. Parcel # 2 also includes the garage [6] with the attached rental unit and another storage shed, which were all built in 1976 [*id.*, p. 5].[7] The tax records, as well as the deed, reflect that the Debtors acquired both parcels in the same conveyance on October 9, 1996 [Creditor's Ex. A, Debtors' Ex. A]. The fact that all of the out-buildings are located on Parcel # 2, including the only garage on the Property [Appraisal, pp. 4, 11], suggests that the two parcels were acquired to be used as one residential property. *See In re Beckford*, 247 B.R. 27, 30 (Bankr. D. Conn. 2000) (finding that the "location of the driveway and off-street parking area supports the conclusion that, although the house may be located within the confines of one lot, both lots have been used together as one residence.").

The configuration of the two parcels likewise suggests that the two parcels are one integrated property. The second parcel is in a u-shape that completely surrounds the parcel containing the Debtors' house. The Debtors' house appears to be positioned right on the edge of both parcels such that the inability to use Parcel # 2 would impair the Debtors' use and enjoyment of their house on Parcel # 1. As such, the layout of the parcels suggests that Parcel # 2 serves more as an "expanded backyard" than as a separate and distinct property. *See In re Frank*, 2014 Bankr. LEXIS 4467 at *13, 2014 WL 5395857, at *5 (Bankr. E.D.N.C., Oct. 23, 2014). Drawing reasonable inferences from the record before this Court, it is difficult for this Court to find that the Debtors do not use Parcel # 2 as part of their principal residence.[8]

For the foregoing reasons, this Court finds that Creditor's claim is secured only

**6.** From the pictures in the tax records, it appears that part of the garage is on the same parcel as the Debtors' home, which if true would further substantiate the conclusion that both parcels are used by the Debtors' as their principal residence. Creditor, however, did not make this argument so this Court is not making a factual finding to that effect nor is this Court considering this apparent overlap as a part of this decision.

**7.** There are three tax cards for Parcel # 1 and one tax card for Parcel # 2. Consistent with the parties' arguments, the pictures in the tax cards reflect that the Debtors' house is located on Parcel # 1 and the out-buildings are located on Parcel # 2 [Creditor's Ex. A]. As noted in the Appraisal, the pictures also show the Debtors' daughter's mobile home is located on Parcel # 2.

The description in the tax cards, however, is less clear. Card 1 for Parcel # 1 describes the Debtors' house, additions to the Debtors' house, and improvements that appear to relate to the daycare playground area as being part of Parcel # 1 [*id.*, p. 1], which is consistent with the pictures and the parties' positions. Card 3 for Parcel # 1, however, describes the garage with attached unit and the two storage sheds as being part of Parcel # 1 as well [*id.*, p. 5]. It is not entirely clear which portions of the Property are described in the remaining two tax cards.

For purposes of this decision, this Court will focus its analysis on the location of the structures as shown in the pictures because it is consistent with the parties' positions. If given consideration, however, the narrative description in the tax cards would support this Court's determination that both parcels are part of the Debtors' principal residence.

**8.** Given the scarcity of facts regarding the Debtors' actual personal use of the second parcel, this Court will entertain a motion to re-consider if the inferences this Court has drawn from the record are incorrect.

by a security interest in real property that is the Debtors' principal residence and, as such, is protected by the anti-modification provision of § 1322(b)(2). Accordingly, Creditor's objection to the Debtors' proposed plan is sustained.

By separate order, this Court will give the Debtors twenty-one (21) days to file an amended plan consistent with this decision.

**SO ORDERED.**

**IN RE: Marlon Cecil BUSH, Debtor.**

**Case No: 18-bk-02532**

United States Bankruptcy Court,
M.D. Tennessee, Nashville Division.

Signed October 2, 2018

**Background:** Chapter 7 trustee objected to enhanced Tennessee homestead exemption claimed by debtor based on his alleged "custody" of his wife's granddaughter.

**Holding:** The Bankruptcy Court, Charles M. Walker, J., held that debtor had "custody" of child and was accordingly entitled to enhanced Tennessee homestead exemption available to debtors having custody of minor child.

Objection overruled.

**1. Bankruptcy ⚿2762.1**
**Federal Courts ⚿3106**

If bankruptcy court finds ambiguity in state exemption statute, it must turn to legislative history to resolve the conflict or certify question to the state's highest court.

**2. Statutes ⚿1102**

Ambiguity exists where two or more enacted provisions or statutes are inconsistent.

**3. Statutes ⚿1102, 1153**

In deciding whether statutory ambiguity exists, court should consider the context of the statutory language at issue, along with the context of the entire statute.

**4. Statutes ⚿1102**

Just because parties support different interpretations of statutory language does not mean that the language is ambiguous.

**5. Homestead ⚿17**

To determine whether Chapter 7 debtor had "custody" of his wife's granddaughter, so as to be entitled to enhanced Tennessee homestead exemption available to debtors having custody of minor child, bankruptcy court had to look to how the undefined term "custody" was used in other Tennessee statutes that were in pari materia, as relating to the common subject matter of custody of minor children. Tenn. Code Ann. § 26-2-301(f).

**6. Statutes ⚿1153**

Words and phrases used in legislative act should be read in context with the entire act and assigned such meanings as to harmonize with the act as a whole.

**7. Statutes ⚿1152**

Statutory provision that may seem ambiguous in isolation may be clarified by the remainder of the statutory scheme, if only one of the permissible meanings produces a substantive effect that is compatible with the rest of the law.

**8. Homestead ⚿5**

Tennessee homestead exemption laws are to be liberally construed in favor of the claimant.

**9. Bankruptcy ⚿2762.1**

Exemption laws of the State of Tennessee had to be applied, in debtor's Chap-

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF NEW YORK

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In re:

Case No. 8-18-77193-reg

Deirdre Ventura,

Chapter 11

Debtor.

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**MEMORANDUM DECISION OVERRULING OBJECTIONS TO THE DEBTOR'S ELECTION AS A SUBCHAPTER V DEBTOR**

***Introduction***

The matter before the Court presents a series of legal issues that are for the most part issues of first impression. The Court is being asked to rule on questions of law resulting from amendments to the Bankruptcy Code pursuant to the Small Business Reorganization Act of 2019 which became effective on February 19, 2020. These amendments, commonly referred to as the SBRA, were instituted to broaden the opportunity for small businesses to successfully utilize the benefits of chapter 11 of the Bankruptcy Code. Congress recognized that many of the benefits afforded to large corporate debtors under chapter 11 were for all practical purposes out of the reach of smaller businesses. Chapter 11 is often an expensive and highly complicated proposition. Many small businesses have neither the money nor the time to navigate the process, even with the considerations given to small businesses prior to the enactment of the SBRA. Had Congress been given a crystal ball with the power to see what the world is facing today, including the severe disruption to our Nation's economy and its impact on small businesses, Congress likely could not have drafted a more effective set of mechanisms to help these businesses reorganize and hopefully survive. These amendments will be analyzed and challenged over the coming months and years, as are all new significant changes to the law. While this case may be one of the first to require a court to rule on the applicability and interpret complex issues,

courts in this country have been called upon since the founding of our Republic to respond to similar challenges.

In the case of Deirdre Ventura (the "Debtor"), these issues arise in the context of objections to the Debtor's recent amendments to her petition to designate herself as a small business debtor and to proceed as a subchapter V debtor. The objections require the Court to answer the following questions:

1) Can the Debtor amend her petition to take advantage of the benefits of the SBRA where the Debtor's case has been pending for over fifteen months and a creditor's proposed plan of reorganization has been scheduled for a hearing on confirmation?
2) Assuming the SBRA applies to the Debtor's case, does the Debtor qualify as a "small business debtor" within the newly amended definition of 11 U.S.C. § 101(51D)(A) where the majority of her debt consists of a mortgage encumbering the property where she both resides and operates a bed and breakfast?
3) Assuming the Debtor fits within the definition of a small business debtor, is the Debtor barred from utilizing provisions applicable to subchapter V debtors to modify the mortgage encumbering the property where she both resides and operates a bed and breakfast?

For the reasons set forth below, the Court answers the first two questions in the affirmative and finds that under its interpretation of 11 U.S.C. § 1190(3), the Debtor is not barred from utilizing this SBRA provision solely on the basis that the mortgage she seeks to modify is a purchase money mortgage secured by her residence. Based on the Court's answers to these questions, the objections to the Debtor's amended petition are overruled.

While these conclusions do not mean that the Debtor will succeed as a subchapter V debtor, the Debtor will be given a chance to proceed under this subchapter. The Debtor must still fulfill her obligations under subchapter V, including proposing a feasible plan and coordinating with the newly appointed subchapter V trustee.

***Procedural History and Facts***

In 1981, the Debtor began working in the real estate brokerage business specializing in the sales and development of hotels and lodges. Ultimately, she became the sole owner of Innvest Hotel Brokers, LLC which she used to conduct a lodging property brokerage business. (Debtor's Objection to Mot. of Gregory Funding for Order Denying & Voiding Debtor's Election as a Sub-Chapter V Debtor, 1:2, Mar. 24, 2020, ECF No. 97.).

The Debtor, along with another individual, purchased the Harbor Rose Property (the "Property") in December 2007. The acquisition of the Property was financed in part by a $1 million dollar loan ("Note") secured by a mortgage ("Mortgage") on the Property from Wells Fargo Bank, N.A. ("Wells Fargo"). (Emergency Mot. to Prohibit Use of Cash Collateral. & for Relief from Auto. Stay, Exh. A, Nov. 12, 2018, ECF No. 17.). The Note and the Mortgage were eventually assigned in 2015 to Gregory Funding, as servicer for U.S. Bank National Association, as Indentured Trustee on Behalf of and with Respect to Ajax Mortgage Loan Trust 2015-B Mortgage-Backed Notes Series 2015-B ("Gregory"). *Id*. Exh. B. According to the proof of claim filed in this case, Gregory is owed $1,678,664.80. (Claim No. 3-1, Dec. 21, 2018.).

The Property is not a typical Long Island residence. The original structure was built in the mid-1800's and is located in Cold Spring Harbor, a small waterfront village on Long Island's North Shore. (Ventura Aff. ¶ 7.). The Property is registered on The National Registry of Historic Places. *Id*. It is also recognized as a significant historic structure by the Town of

Huntington Historic Preservation Society. *Id*. Rooms at the property from the time the Debtor acquired it were made available for rent by the Debtor as advertised on Craigslist, Facebook and Wimdu (a European version of Airbnb). (Ventura Aff. ¶ 5.). The Debtor has included as exhibits to her submission copies of emails from potential guests from 2009 through 2011. (Debtor's Objection to Mot. of Gregory Funding for Order Denying & Voiding Debtor's Election as a Sub-Chapter V Debtor, Exh. A, Mar. 24, 2020, ECF No. 97.). The documentary evidence supports a finding that paying guests were staying at the Property within the first year that the Debtor purchased the Property. At the time the Debtor purchased the Property, the Huntington Town Code only permitted individuals to rent two guest rooms out of their property. (Ventura Aff. ¶ 11.).

As with many local businesses, the Great Recession of 2008 had a drastic impact on the Debtor's hotel brokerage business. (Debtor's Objection to Mot. of Gregory Funding for Order Denying & Voiding Debtor's Election as a Sub-Chapter V Debtor, 3:3, Mar. 24, 2020, ECF No. 97.). Eventually, the Debtor defaulted on the Mortgage. *Id*. On January 18, 2013, Debtor filed a voluntary petition for relief from her creditors under chapter 7. (Case No. 8-13-70280-reg, ECF No. 1.) ("First Case"). The First Case was filed as a no-asset chapter 7 case, and the majority of the Debtor's debts were listed as consumer debts. *Id*. ECF 11. On May 1, 2013, the Debtor received a discharge and the case was closed shortly therafter. *Id*. ECF No. 16. On May 3, 2013, the Debtor formed Harbor Rose LLC ("Harbor Rose") as a New York State limited liability company. (Ventura Aff. ¶ 3 n.1.).

On February 6, 2014 the Debtor filed a voluntary petition for relief under chapter 13 ("Second Case"). (Case No. 8-14-70473-reg, ECF No. 1.). The Second Case was dismissed for the failure to file necessary documents. *Id*. ECF No. 33. Despite the fact that the Debtor

described her debts as primarily consumer debts, the Debtor included in Schedule I a breakdown of income and expenses from the operations of Harbor Rose. *Id*. ECF No. 10. From the information set forth in the Second Case, it is clear that the Debtor's sole source of income was derived from Harbor Rose, which was operating at the Property. Based on the information provided by the Debtor in the Second Case, there does not appear to be an attempt by the Debtor to mislead her creditors or to create a false impression regarding her use of the Property, notwithstanding her description of her debts as primarily consumer debts.

On February 18, 2015, the Debtor executed a loan modification with respect to the Note and Mortgage (the "Loan Modification"). (Emergency Mot. to Prohibit Use of Cash Collateral. & for Relief from Auto. Stay, 8:4, Nov. 12, 2018, ECF No. 17.). As part of the modification the co-owner of the Property transferred his interest to the Debtor. *Id*. Although the Loan Modification gave the Debtor more favorable terms, the Debtor defaulted on her obligations under the Loan Modification. *Id*. 9:4. In February of 2016, Gregory commenced a foreclosure action against the Debtor in the Supreme Court for the State of New York, Suffolk County. *Id*. 10:5.

Despite the Debtor's financial setbacks, the Debtor took steps to increase her ability to rent rooms to guests at the Property. The Debtor obtained a permit to operate as a bed and breakfast on May 4, 2016. (Ventura Aff. ¶ 11.). The Debtor urged one of the Town Councilpersons to sponsor an amendment to allow bed and breakfasts to provide up to four guest rooms and permit a maximum stay of 29 days. (Ventura Aff. ¶ 12.). The Debtor was successful in her endeavors and on November 16, 2017, the Debtor obtained a Certificate of Permitted Use for four guest rooms. (Ventura Aff. ¶ 13.). By June, 2018, the Debtor upgraded the Property to provide four guestrooms. *Id*. The Debtor also obtained the proper permits to add

an additional bathroom for guests, replaced the HVAC for a portion of the Property, upgraded the electric service, and built an enclosed porch with heat for year-round use. *Id*.

It appears there is no other such bed and breakfast in the Town of Huntington, and according to the Debtor's affidavit, there is no other similar bed and breakfast on Long Island as of March 24, 2020. (Ventura Aff. ¶ 10.). The Town of Huntington requires as a condition to receiving the bed and breakfast permit that the owner operator reside at the bed and breakfast premises. *Id*. In addition to its lodgings, Harbor Rose offers health and wellness package, including yoga classes, acupuncture treatments, massage treatments. (Emergency Mot. to Prohibit Use of Cash Collateral. & for Relief from Auto. Stay, 19:6, Nov. 12, 2018, ECF No. 17.).

On August 8, 2018, a judgment of foreclosure and sale was granted in favor of Gregory, with a sale date scheduled for October 25, 2018 (the "Foreclosure Sale"). *Id*. at 14-15:5-6. Pursuant to Gregory's Broker's Price Opinion dated October 02, 2018, the Property was valued at $1,200.000.00. *Id*. Exh. H. On October 24, 2018 (the Petition Date"), the Debtor filed a voluntary petition under chapter 11 (the "Current Case"). As of the Petition Date, Gregory was owed a total amount of $1,678,664.80. *Id*. at 17:6. The current value of the Property is unknown.

In the Current Case, the Debtor again described her debts as primarily consumer debts. (Case No. 8-18-77193-reg, ECF No. 1.). The Debtor also stated that she was an individual chapter 11 debtor and did not designate herself as a small business debtor. *Id*. The Debtor's description of the Property in the Current Case accurately set forth that it was being used as a place of business. For example, when the Debtor was asked "What is the property?" she checked the box "Other" and wrote "B&B Inn" on Schedule A/B instead of checking the box for

"Single-family" home. *Id*. In Schedule C, the Debtor claimed an exemption for the Property pursuant to 11 U.S.C. § 522(b)(2) wherein she described it as "Bed & Breakfast." *Id*. Again, on Schedule D, the Debtor described the Property as a "Bed and Breakfast." *Id*. The Debtor also lists her income and expenses from the operations of Harbor Rose in her Statement of Current Monthly Income. *Id*. ECF No. 26.

On November 12, 2018, Gregory moved this Court for an Order: (1) directing the Debtor to establish a Debtor in possession account, directing immediate turnover of cash collateral to the Debtor in possession account, and prohibiting the Debtor's use of cash collateral until the motion and request for adequate protection payments to Gregory could be heard, pursuant to 11 U.S.C. § 363(C)(2)(B); (2) granting Gregory relief from the automatic stay pursuant to 11 U.S.C. § 362(d)(1); or alternatively (3) adequate protection payments pursuant to 11 U.S.C. § 363(e). (Emergency Mot. to Prohibit Use of Cash Collateral. & for Relief from Auto. Stay, at 3, Nov. 12, 2018, ECF No. 17.). In December 2018, the Debtor agreed to pay monthly adequate protection payments to Gregory in the amount of $3,5000, to maintain proper insurance on the Property, and to timely remit taxes due subsequent to January 1, 2019. (Agreed Order Resolving Mot. for Adequate Protection Payments, at 1-2, Dec. 13, 2018, ECF No. 32.).

With the consent of the parties, the Court entered an order directing the Debtor and Gregory to participate in the Loss Mitigation Program with respect to the Property. (Order Directing the Debtor and Creditor Gregory Funding, as servicer for US Bank as Indentured Trustee to Ajax Mortgage Loan to participate in the Loss Mitigation Program, Dec. 20, 2018, ECF No. 35.). In June of 2019, the parties agreed to terminate loss mitigation, to increase the adequate protection payment to Gregory to $4,800 monthly, and to require that by September 30, 2019, the Debtor file a proposed disclosure statement and chapter 11 plan of reorganization

acceptable to Gregory in its sole and absolute discretion. (Further Agreed Order Concerning Adequate Protection Payments, *Inter Alia*, June. 11, 2019, ECF No. 53.). In the event the Debtor's proposed disclosure statement and plan were deemed unsatisfactory to Gregory, Gregory would be permitted to file a competing plan which would provide for the sale of the Property to satisfy the Mortgage. *Id*. The Debtor failed to file a proposed disclosure statement and plan by the September 30, 2019 deadline, which effectively terminated the Debtor's exclusivity as an individual chapter 11 debtor.

At the November 19, 2019 status conference, the Court directed the Debtor and Gregory to each file a proposed plan of reorganization and disclosure statement by December 13, 2019. As expected, Gregory's proposed plan provided for an auction sale of the Property subject to higher and better offers. (Chapter 11 Plan of Liquidation, Dec. 13, 2019, ECF No. 60.). Gregory's proposed plan also provided for a carve out from the sale proceeds to pay all the other classes in full. *Id*. The Debtor's proposed plan sought to modify the Mortgage by reducing the secured portion of Gregory's claim to $1,050,00, which the Debtor represented was the value of the Property at that time, and repaying the secured portion of the claim over 30 years at 4.25 percent interest per annum. (Debtor's First Amended Plan of Reorganization, Dec. 20, 2019, ECF No. 67.). According to the Debtor's proposed plan, Gregory would receive no payment on account of the unsecured portion of its claim because the Debtor had previously received a discharge in the First Case. *Id*.

The viability of the Debtor's plan hinged on her ability to utilize 11 U.S.C. § 1123(b)(5) to bifurcate the Mortgage into a secured and unsecured claim, and to pay only the secured portion in full. However, because the Debtor resided at the Property, and 11 U.S.C. § 1123(b)(5) specifically excluded modification of claims secured by liens on a debtor's residence, the Court

determined that the Debtor's proposed plan was unconfirmable on its face. So long as any portion of the Property constituted the Debtor's residence, 11 U.S.C. § 1123(b)(5) could not be used to modify the Mortgage. This conclusion was consistent with *In re Macaluso*, 254 B.R. 799 (Bankr. W.D.N.Y. 2000), *In re Addams*, 564 B.R. 458 (Bankr. E.D.N.Y. 2017) and *In re Wages*, 508 B.R. 161 (B.A.P, 9th Cir. 2014). For these reasons, on January 13, 2020, the Court did not approve the Debtor's disclosure statement. (Order Approving Disclosure Statement Relating to Chapter 11 Plan of Gregory Funding as Plan Sponsor, *Inter Alia*, Jan. 13, 2020, ECF No. 79.). At the same hearing, the Court approved Gregory's Disclosure Statement and authorized Gregory to solicit votes. *Id*. The Court also set February 26, 2020 as the date for a hearing on the confirmation of Gregory's proposed plan (the "Confirmation Hearing"). *Id*.

In preparation for the Confirmation Hearing, Gregory solicited the necessary votes and filed the certification of ballots on February 20, 2020. (Certificate as to Balloting Accepting and Rejecting the Chapter 11 Plan, Feb. 20, 2020, ECF No. 81.). One day prior to the date the certification of ballots was filed, and seven days prior to the Confirmation Hearing, the SBRA became effective. Pub. L. No. 116-54 § 5, 133 Stat. 1079, 1087. Congress made clear that the changes to the Code set forth in the SBRA were intended to allow small businesses and individuals to take advantage of a chapter 11 process that would be less costly and time consuming than the current process. H.R. REP. No. 116-171, at 2 (2019).

At the Confirmation Hearing, the Court advised the parties of the SBRA and offered the Debtor the opportunity to proceed with the hearing as scheduled or the Court would adjourn the hearing for a short time to allow the Debtor to determine whether she wished to amend her petition. The Debtor opted to have the Confirmation Hearing adjourned. On March 3, 2020, the

Debtor filed a letter with the Court advising that she intended to amend her petition. (Letter to Court regarding Debtor's Intention to Amend Her Petition, Mar. 3, 2020, ECF No. 85.).

On March 6, 2020, the Debtor amended her petition to designate herself as a small business debtor under the newly amended definition, and to elect to proceed as a subchapter V debtor. (Aff. Pursuant to E.D.N.Y. LBR 1009-1(a), Mar. 6, 2020, ECF No. 87.). On March 6, 2020, the United States Trustee (the "U.S. Trustee") appointed Salvatore LaMonica, Esq., as the subchapter V trustee (the "Trustee") pursuant to 11 U.S.C. § 1183(a). (Notice of Appointment of Subchapter V Trustee, Mar. 6, 2020, ECF No. 88.). On March 10, 2020, the Court entered a scheduling order setting a status conference for April 1, 2020 and setting the Debtor's deadline to file a plan for June 8, 2020. (Order Scheduling Status Conference Under 11 U.S.C. § 1188, Mar. 9, 2020, ECF No. 91.).

On March 9, 2020, Gregory filed a motion objecting to the Debtor's designation as a subchapter V debtor (the "Motion"), raising a wide range of objections to the Debtor's designation, including objections based on prejudice to Gregory's vested rights in this case, as the Court was at the point of holding a hearing to confirm Gregory's proposed plan. (Mot. to Object to Debtor's Designation as a Sub-Chapter V, 16:6, Mar. 10, 2020, ECF No. 92.).[1] In addition, Gregory asserts that the Debtor is not eligible for subchapter V relief because she does not fit within the definition of "small business debtor" as set forth in newly amended 11 U.S.C. § 101(51D)(A). *Id*. 18-19:7-8. Even if she fits within the definition, Gregory asserts that the Debtor should be judicially estopped from amending her designation based on her prior representations to Gregory as well as her prior statements in the prior bankruptcy filings and the Current Case. (Reply in Connection with Objection to Debtor's Designation as a Sub-Chapter V Debtor, 8:4,

[1] Gregory has filed an Objection to Debtor's Designation as a Sub-Chapter V. ECF No. 89 and a motion seeking the same relief, ECF No. 92. The Court will refer to both filings as the Motion, ECF No. 92.

Mar. 26, 2020, ECF No. 99.). Gregory also argues that the Debtor cannot modify the Mortgage pursuant to pursuant 11 U.S.C. § 1190(3) because the Debtor used the Mortgage proceeds to purchase a residence, not to invest in Harbor Rose. (Mot. to Object to Debtor's Designation as a Sub-Chapter V, 32:13, Mar. 10, 2020, ECF No. 92.).

On March 19, 2020 the U.S. Trustee filed an Objection ("U.S. Trustee Objection") to the Debtor's election to be treated as a subchapter V case, raising timing and technical issues. (United States Trustee's Objection to Debtor's Election to Be Treated as a Subchapter V Case, Mar. 19, 2020, ECF No. 96.). On March 24, 2020, the Debtor filed her opposition to the Motion (Debtor's Objection to Mot. of Gregory Funding for Order Denying & Voiding Debtor's Election as a Sub-Chapter V Debtor, Mar. 24, 2020, ECF No. 97.), and Response to the U.S. Trustee Objection. (Resp. to United States Trustee's Objection to Debtor's Election to Be Treated as a Subchapter V Case, Mar. 24, 2020, ECF No. 98.). In her submissions, the Debtor pointed to her professional experience in the hotel business, the unique characteristics of the Property, her consistent use of the Property as a bed and breakfast, and the improvements the Debtor made to the Property as sufficient grounds for finding that the Debtor is a small business debtor within the definition of § 101(51D)(A), and that she qualified to proceed as a subchapter V debtor.

On March 30, 2020, the Debtor filed a letter indicating that since the Debtor filed her amended petition to make a retroactive election under subchapter V, the Debtor has been unable to have any meaningful negotiations with Gregory. (Letter Pursuant to 11 U.S.C. § 1188(c) Outlining Efforts by the Debtor to Attain Consensual Plan of Reorganization, Mar. 30, 2020, ECF No. 101.). The Debtor further notes that the Trustee has attempted to persuade Gregory to negotiate with the Debtor, to no avail. *Id*. On April 1, 2020, the Court held a telephonic hearing

on the Motion and the U.S. Trustee's Objection, which was attended by the Debtor's counsel, Gregory's counsel, the U.S. Trustee and the subchapter V Trustee. Thereafter, the matter was marked submitted.

***Discussion***

On August 23, 2019, the President signed the SBRA into law, which became effective on February 19, 2020. Pub. L. No. 116-54 § 5, 133 Stat. 1079, 1087. The SBRA is codified in 11 U.S.C. §§ 1181-1195, and certain Bankruptcy Code sections that existed prior to the SBRA have been modified as well. *Id*. By enacting this law, Congress intended to streamline the reorganization process for small business debtors because small businesses have often struggled to reorganize under chapter 11. H.R. REP. No. 116-171, at 1-2 (2019).

Of pertinence, the Report from the House Committee on the Judiciary contains, *inter alia*, the following statement:

> Small businesses--typically family-owned businesses, startups, and other entrepreneurial ventures— "form the backbone of the American economy." By their very nature, however, the longevity of these businesses is limited. According to the Small Business Administration Office of Advocacy, approximately 20 percent of small businesses survive the first year, but by the five-year mark only 50 percent are still in business and by the ten-year mark only one-third survive. Notwithstanding the 2005 Amendments, small business chapter 11 cases continue to encounter difficulty in successfully reorganizing…the legislation allows these debtors "to file bankruptcy in a timely, cost-effective manner, and hopefully allows them to remain in business" which "not only benefits the owners, but employees, suppliers, customers, and others who rely on that business."

*Id*. at 2. (Citing the Unofficial Transcript of Oversight of Bankruptcy Law and Legislative Proposals: Hearing Before the Subcomm. on Antitrust, Commercial, & Admin. Law of the H. Comm. on the Judiciary, 116th Cong. 27 (2019) (on file with H. Comm. on the Judiciary staff)).

Newly amended 11 U.S.C. § 101(51D)(A) of the Bankruptcy Code defines a "small business debtor", in part, as "…a person engaged in commercial or business activities . . . that has aggregate noncontingent liquidated secured and unsecured debts as of the date of the filing of

the petition . . . in an amount not more than $2,725,625. . . not less than 50 percent of which arose from the commercial or business activities of the debtor. ” 11 U.S.C. § 101(51D)(A).[2] The definition of “small business” excludes debtors whose primary business is owning “single asset real estate.” *Id*.

Prior to enactment of the SBRA, the only statutory provision the Debtor could have considered to modify the Mortgage was 11 U.S.C. § 1123(b)(5). This section permits chapter 11 debtors to propose a plan that modifies 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. § 1123(b)(5).[3]

The SBRA has given small business debtors who designate themselves as subchapter V debtors another tool to be used when proposing a plan. Section 1190(3) provides as follows:

> A plan filed under this subchapter—
>
> (3) notwithstanding section 1123(b)(5) of this title, may modify the rights of the holder of a claim secured only by a security interest in real property that is the principal residence of the debtor if the new value received in connection with the granting of the security interest was—
>
> (A) not used primarily to acquire the real property; and
>
> (B) used primarily in connection with the small business of the debtor.

11 U.S.C. § 1190(3).

Furthermore, a trustee will be appointed in every subchapter V case. The subchapter V trustee will act as a fiduciary for creditors, in lieu of an appointed creditors’ committee. The subchapter V trustee is also charged with facilitating the subchapter V debtor’s small business

[2] Late on the evening of March 25, 2020, the U.S. Senate unanimously passed the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) (S.3548) to combat the U.S. spread of coronavirus, which threatens to plunge U.S. into a global recession. For one year, the Act increases the eligibility threshold to file under subchapter V of chapter 11 of the Bankruptcy Code to businesses with less than $7.5 million of debt.

[3] As set forth in the facts, the Court ruled that because the Debtor resided at the Property, she could not modify the Mortgage under this provision.

reorganization and monitoring the subchapter V debtor's consummation of its plan of reorganization. 11 U.S.C § 1183 (a), (b).

Prior to enactment of the SBRA, small business debtors were required to file a plan of reorganization within 120 days after the order for relief, and "any party in interest" could file a plan at certain times and under certain circumstances. 11 U.S.C. §§ 1121(b), (c). The newly enacted law gives subchapter V debtors the exclusive right to file a plan of reorganization, which must be filed within 90 days after entry of the order for relief. 11 U.S.C. § 1189(a), (b). This plan deadline may be extended by the Court "…if the need for the extension is attributable to circumstances for which the debtor should not justly be held accountable." 11 U.S.C. § 1189(b).

### *1. Does the SBRA apply to the Debtor's case?*

#### *a. Procedural and timing issues*

The SBRA is silent as to whether it applies to pending cases, or only to cases commenced after the effective date. In the Current Case, the Debtor did not designate herself as a small business debtor on her petition, which was filed over fifteen months prior to the effective date of the SBRA. The Debtor has since amended the petition to reflect 1) that she is a small business debtor and 2) that she seeks to proceed as a subchapter V debtor. The sole reason for filing the amended petition is to take advantage of the changes to the Bankruptcy Code and Rules pursuant to the SBRA. While the U.S. Trustee does not specifically urge the Court to find that the SBRA should only apply to cases filed after February 19, 2020, the U.S. Trustee does argue that procedural issues prevent the Debtor from electing to proceed as a subchapter V small business debtor. In the Motion, Gregory raises a wide range of objections to the Debtor's designation, including due process objections based on prejudice to Gregory's vested rights in this case, estoppel arguments, and objections based on whether the Mortgage is subject to modification under § 1190(3).

According to Fed. R. Bankr. P. 1020(a), once a small business debtor designates itself in the petition, "…the status of the case as a small business case shall be in accordance with the debtor's statement under this subdivision, unless and until the court enters an order finding that the debtor's statement is incorrect." Fed. R. Bank. P. 1020(a). The Court's finding of incorrect designation is triggered by an objection to the designation. *See In re Angel Fire Water Co.*, LLC, No. 13–10868 ta11, 2015 WL 251570, at *6 (Bankr. D. N.M. Jan. 20, 2015) (finding that because the debtor never elected to be a small business debtor and no party objected to its status, it would be inappropriate for the court to alter the debtor's statement *sua sponte*).

Pursuant to Fed. R. Bankr. P. 1009(a), "[a] voluntary petition, list, schedule or statement may be amended by a debtor as a matter of course at any time before the case is closed." However, such amendment by the debtor is not necessarily controlling. The designation by the debtor in the original petition still retains evidentiary effect as it is signed under penalty of perjury. *In re Roots Rents, Inc.,* 420 B.R. 28, 39-40 (Bankr. D. Idaho. 2009).

As the U.S. Trustee points out, the SBRA imposes several requirements in subchapter V cases. First, a "SBRA trustee" is appointed by the U.S. Trustee, who is charged with development of a consensual plan. 11 U.S.C. § 1183(b)(7). Within 60 days of entry of the order for relief, the Court must hold a status conference with the SBRA trustee. 11 U.S.C. § 1188(a). Subsection (b) provides that the court may extend the 60-day deadline if "…the need for an extension is attributable to circumstances for which the debtor should not justly be held accountable." 11 U.S.C. § 1188(a). Pursuant to 11 U.S.C. § 1189(b), the subchapter V debtor shall file a plan within 90 days of entry of the order for relief, "…except that the court may extend the period if the need for the extension is attributable to circumstances for which the debtor should not be justly held accountable." 11 U.S.C. § 1189(b). In addition, the subchapter V

debtor must submit a status report 14 days prior to the status conference detailing efforts to reach a consensual plan. 11 U.S.C. § 1188(c).

According to the U.S. Trustee, there is no bar to applying the SBRA retroactively to cases commenced prior to February 19, 2020. However, because the order for relief in the Debtor's case was entered on October 24, 2018, the Debtor's 90-day deadline to file a plan has expired, and it does not appear that the SBRA trustee can effectively function as the facilitator of a consensual plan. Furthermore, many status hearings have already taken place in this case without the participation of a subchapter V trustee. First, the Court notes that both the 90 day deadline to file a plan and the 60 day deadline to hold a status conference may be extended if the need for an extension is attributable to circumstances for which the debtor should not be justly held accountable. Given that the Debtor's case was filed over fifteen months ago, the Court finds that to argue the Debtor should have complied with the procedural requirements of a law that did not exist is the height of absurdity. The Debtor is not required to comply with deadlines that clearly expired before the Debtor could have elected to proceed as a subchapter V debtor.

In one of the very few written decisions regarding the SBRA, the Bankruptcy Court found that any practicality and scheduling issues arising from an SBRA designation in a case commenced prior to the effective date of the SBRA, while they might result in redundant hearings or the "procedurally awkward" process of resetting deadlines, did not pose an absolute bar to retroactive application of the SBRA. *See In re Progressive Solutions, Inc.*, No. 8:18-bk-14277-SC, 2020 WL 975464, at *4 (Bankr. C.D. Cal. February 21, 2020) (The United States Trustee raised objections on several grounds related to practicality and scheduling issues which the court overruled. The court ultimately permitted the resetting or rescheduling of these

procedural matters "…in order to provide due process to all parties involved, unless vested rights of parties would be abridged or otherwise prejudiced.").

Armed with this case law and since there is no prohibition provided by Congress, the Court finds that it is within the Court's discretion to reset the timelines to allow the Debtor to avail herself of the newly enacted law that was not at her disposal when she filed the Current Case. Therefore, the Court overrules any objections raised by the U.S. Trustee or Gregory based on procedural or timing issues imposed by the SBRA.

***b. Gregory's substantive rights***

Gregory also argues that retroactive application of the SBRA to the Debtor's case is impermissible because it would be predjudicial to Gregory with respect to its "vested rights." Gregory interprets vested rights to mean prior orders issued by this Court permitting Gregory to file its own plan and approving Gregory's disclosure statement, along with the Court's finding that the Debtor's proposed disclosure statement was patently unconfirmable. However, an analysis of Gregory's argument and applicable case law leads the Court to a different conclusion.

Both Gregory and the U.S. Trustee acknowledge that there is no statutory prohibition to applying the SBRA to cases that were pending prior to the effective date of this legislation. The few cases that discuss this issue agree that while there is a presumption against retroactivity, this presumption applies to "'new provisions affecting contractual or property rights, matters in which predictability and stability are of prime importance.'" *In re Moore Props. of Person Cty., LLC*, No. 20-80081, 2020 WL 995544, at *3 (Bankr. M.D.N.C. February 28, 2020) (citing *Landgraf v. USI Film Products*, 511 U.S. 244, 271 (1994) (other citations omitted)). As Judge Kahn noted, and this Court agrees, subchapter V incorporates many of the provisions already applicable to small business debtors. *In re Moore Props. of Person Cty., LLC*, 2020 WL 995544, at *4, n.10. At least one other court considering this issue has drawn the same conclusion. *In re*

*Body Transit, Inc. d/b/a Rascals Fitness*, No. 20-10014 (ELF), 2020 WL 1486784, at *6 (Bankr. E.D. Pa. Mar. 24, 2020) (holding that "…in general, the new subchapter V provisions do not impair the vested property interests of creditors and, therefore, the concerns supporting application of the canon of statutory construction disfavoring the retroactive application of new law are absent."). In addition, the amendment of the definition of "small business debtor" in 11 U.S.C. § 101(51D)(A) of the Bankruptcy Code did not appear to affect the contractual or vested property rights of parties that existed prior to the effective date of the SBRA. *In re Moore Props. of Person Cty., LLC*, 2020 WL 995544, at *4, n.10.

In discussing the applicability of the SBRA to a pending bankruptcy case, Judge Kahn in *In re Moore Props. of Person Cty., LLC* relied on guidance from the Supreme Court, which considered the issue of retroactivity in the context of a newly enacted bankruptcy statute. *Id*. at 3. (citing *United States v. Sec. Indus. Bank*, 459 U.S. 70 (1982)). The Court in *Sec. Indus. Bank* was called on to determine whether § 522(f) of the 1978 Bankruptcy Act, which provided debtors with a vehicle to remove certain liens that attached to property of the debtor's estate prepetition, violated the Fifth Amendment. *United States v. Sec. Indus. Bank*, 459 U.S. 70 (1982). Instead of dealing with this Constitutional clash head-on, the Supreme Court held that this provision was not intended to apply to property interests created before the enactment of the 1978 Bankruptcy Act. *Id*. The Court acknowledged that the Congressional authority to enact legislation "…has been regularly construed to authorize the retrospective impairment of contractual obligations." *Id*. at 74. (citing *Hanover National Bank v. Moyses*, 186 U.S. 181, 188 (1902)). However, the Supreme Court distinguished between using that authority to modify existing contractual obligations and using it to "defeat traditional property interests." *Id*. at 75. The Court in *Landgraf v. USI Film Products* further taught that "[t]he presumption against statutory retroactivity is

founded upon elementary considerations of fairness dictating that individuals should have an opportunity to know what the law is and to conform their conduct accordingly," and the principle that "settled expectations should not be lightly disrupted." *Landgraf v. USI Film Products*, 511 U.S. 244, 245, 265 (1994). After analyzing the Supreme Court's rulings, Judge Kahn concluded that in the case before him, there were no taking or retroactivity concerns which were the focus of the Supreme Court in *Landgraf* and *Security Indus. Bank. In re Moore Props. of Person Cty., LLC*, 2020 WL 995544, at *4.

Judge Kahn did single out 11. U.S.C. § 1190(3) as a potential area of concern if it were to be retroactively applied to affect a property right existing prior to the enactment of the SBRA, but he did not make a ruling as to whether this provision violated the Fifth Amendment prohibition against taking property without compensation. *Id*. at *4, n.14.

While Gregory speaks in terms of damage to its vested rights resulting from the progress made in the Debtor's bankruptcy case, Gregory is focused on the wrong question. The correct question to ask is whether designation of the Debtor as a subchapter V debtor will impair Gregory's rights as they existed prior to the effective date of the SBRA. Clearly, the amendment to the definition of "small business debtor" does not amount to a taking of property. The SBRA merely amends the definition of small business debtor to ensure that certain debtors can avail themselves of a less costly and time-consuming path to reorganization that befits the family – owned businesses and other "Main Street" businesses that are currently in such dire need of relief. *See In re Moore Props. of Person Cty., LLC*, 2020 WL 995544, at *5 n.10 (Bankr. M.D.N.C. February 28, 2020) ("…the SBRA [amends] the definition of 'small business debtor' under chapter 1, but that revision does not affect contractual or vested property rights any more than the general availability of subchapter V.").

The more difficult question is whether 11 U.S.C. § 1190(3) should apply to property rights which vested prior to the effective date of the SBRA, such as Gregory's rights as mortgagee. In order to answer this question, the nature of Gregory's rights must be defined. At the time Gregory became the mortgagee with respect to the Property, Gregory was granted a bundle of rights under New York State law. *Butner v. U.S.*, 440 U.S. 48, 55 (1979). The Note and Mortgage afforded *in personam* rights against the Debtor including a right to proceed against the Debtor to collect the amount due and owing under the Note. In addition, Gregory was granted *in rem* rights to proceed against the Property and seek a sale of the Property. The proceeds of the sale would then be applied against the amount due and owing. The right to sell the Property would generate only an amount of money that reflects the value of the Property as established at a free and fair auction sale. To the extent the sale left a deficiency, Gregory would have been entitled to proceed against the Debtor for the deficiency. However, because the Debtor previously received a discharge of her personal obligations, Gregory is left with only its rights against the Property under New York State law. In this unique case, Gregory can no longer seek entry of a judgment against the Debtor personally because of the discharge entered in the First Case. It should also be noted that Gregory may still avail itself of all rights granted to a secured creditor under the Code that have not been amended by the SBRA.

The exception to the anti-modification provision permits a debtor to modify the rights of certain mortgagees by allowing the debtor to bifurcate a claim into a secured and unsecured claim based on the value of the underlying collateral. 11 U.S.C. § 1190(3). Since Gregory can look solely to the value of the Property to satisfy the Debtors obligation as a result of the discharge the Debtor received in the First Case, application of 11 U.S.C. § 1190(3) will not deprive Gregory of any rights Gregory retained under state law. Even if the Note had not been

discharged in the First Case, the Court is not convinced that 11 U.S.C. § 1190(3) would raise sufficient Constitutional doubts to warrant only prospective application. The Bankruptcy Code works to abrogate contractual rights, but does not affect the vested property rights of mortgagees. As the Supreme Court stated in *Security Natl. Bank*, "our cases recognize, as did the common law, that the contractual right of a secured creditor to obtain repayment of his debt may be quite different in legal contemplation from the property right of the same creditor in the collateral. Compare *Hanover National Bank v. Moyses*, *supra*, with *Lousisville Joint Stock Land Bank v. Radford*, *supra*, and *Kaiser-Aetna v. United States*, 444 U.S. 164, 100 S. Ct. 383, 62 L. Ed.2d 332 (1979)." 459 U.S. 70, 75. Consequently, applying § 1190(3) to the modify the Mortgage would not violate Gregory's Fifth Amendment rights.

This still leaves the Court to consider whether applying the SBRA to the Debtor's case is predjudicial based on the history of this case, including the fact that the Court had previously rejected the Debtor's proposed plan and was poised to rule on whether to confirm Gregory's proposed plan. To this Court, this question does not raise Constitutional issues, nor does it require the Court to treat the rulings in the Debtor's case as "vested" rights. Until a plan is confirmed no property rights can be said to have vested in either the Debtor or Gregory. What Gregory is alluding to is whether by permitting the Debtor to elect treatment as a subchapter V debtor would cause prejudice to Gregory. As Judge Clarkson stated in *Progressive Solutions*, he would consider whether "…other events occurring during the pendency of the present case . . . would be disturbed by the designation of the case as a Subchapter V case." *In re Progressive Solutions, Inc.*, 2020 WL 975464, at *4. Similarly, in *In re Body Transit, Inc. d/b/a Rascals Fitness*, Judge Frank took into consideration whether permitting the debtor to elect treatment as a subchapter V debtor would unduly prejudice the objecting party. *In re Body Transit, Inc. d/b/a*

*Rascals Fitness*, 2020 WL 1486784, at *7. Given that subchapter V was not available to the Debtor on the Petition Date and the Debtor has made very clear from the outset the nature of Property as a business, the Court will not penalize the Debtor because after careful analysis by Congress the law has been amended to address the needs of debtors that engage in the type of business she operates. These types of debtors who are willing to risk everything to start and maintain their own businesses should not be penalized, rather, they should be applauded. Gregory will retain many of the rights it had at the inception of the case, any delay caused by this ruling is not sufficiently prejudicial to Gregory, given the current economic conditions. For these reasons, the Court finds that the SBRA applies to the Debtor's case in its totality.

***2. Does the Debtor fit within the definition of a "small business debtor"?***

As previously stated, the SBRA amended the definition of "small business debtor", in part, to provide that it is "a person engaged in commercial or business activities . . . that has aggregate noncontingent liquidated secured and unsecured debts as of the date of the filing of the petition . . . in an amount not more than $2,725,625. . . not less than 50 percent of which arose from the commercial or business activities of the debtor. " 11 U.S.C. § 101(51D)(A). The definition of "small business debtor" excludes debtors whose primary business is owning "single asset real estate." *Id*.

The Debtor listed on Schedule D filed on the Petition Date the Mortgage in the amount of $1,5000.000.00. This debt combined with the other secured and unsecured debts totals $1,562.182.00 which is within the threshold statutory threshold of § 101(51D). What remains to be determined is whether more than 50% of the Debtor's debts rose from her commercial or business activities, which was not part of the calculation when determining whether a debtor was a small business debtor prior to the effective date of the SBRA.

Since there is no statutory definition of what constitutes "commercial or business activities," Gregory looks to the definition of "consumer debt" to assist in determining what types of debt fit within this new description. A consumer debt is a debt "…incurred by an individual primarily for a personal, family, or household purpose." 11 U.S.C. § 101(8). "Debt" means "liability on a claim," 11 U.S.C. § 101(11) (1982), and "claim," in turn, is broadly defined as any "right to payment, whether or not such right is ... secured, or unsecured." 11 U.S.C. § 101(4)(A).

Gregory correctly points out that this Court has previously held that a residential mortgage fell within the definition of "consumer debt." *In re Lemma*, 393 B.R. 299 (Bankr. E.D.N.Y. 2008). For the parties' understanding, there was no allegation in the *Lemma* case that the debtors used their residence for anything other than their personal residence. Other courts have drawn the same conclusion. *In re Kelly*, 841 F.2d 908, 912 (9th Cir. 1988) (recognizing that "[t]he statutory scheme so clearly contemplates that consumer debt include debt secured by real property that there is no room left for any other conclusion."); and *In re Hall*, 258 B.R. 45, 50 (Bankr. M.D. Fla. 2001) (a purchase money mortgage on a residence is a consumer debt). The same could be true of HELOCs, depending upon the use of the mortgage proceeds. *See In re Naut*, No. 07–20280 (REF), 2008 WL 191297, at *6 (E.D. Pa. Jan. 22, 2008) (holding that the debt was consumer debt because virtually all the proceeds from the refinancing and second mortgage debts were used to purchase and improve the property, not for any business purpose.); *Cox v. Fokkena* (*In re Cox*), 315 B.R. 850, 8-9 (B.A.P. 8th Cir. 2004) (despite the debtor's contention that they bought their home for investment purposes, the record revealed that the debt fit squarely within the definition of a consumer debt because the proceeds were used to complete the construction of and furnish the family's home.).

However, the fact that a debtor incurs mortgage debt to buy a residence does not automatically mean that the debt is consumer debt. "The test for determining whether a debt should be classified as a business debt, rather than as a consumer debt, is whether it was incurred with an eye toward profit…[c]ourts must look at the substance of the transaction and the borrower's purpose in obtaining the loan, rather than merely looking at the form of the transaction." *In re Martin*, No. 12–38024, 2013 WL 5423954, at *6 (S.D. Tex. Sept. 26, 2013). *See also In re Booth*, 858 F.2d 1051, 1055 (5th Cir. 1988) (a debt incurred with an eye toward profit is a business debt, rather than consumer debt.).

Gregory asserts that the form of the transaction was solely a residential loan for the purposes of purchasing a primary residence, not operating a business. Gregory points to the Mortgage whereby the Debtor declared, "I will occupy the Property and use the Property as my principal residence within 60 days after I sign this Security Instrument." (Emergency Mot. to Prohibit Use of Cash Collateral. & for Relief from Auto. Stay, Exh. A, 8:6, Nov. 12, 2018, ECF No. 17.). Gregory also directs the Court's attention to the fact that Harbor Rose was not formed until six years after the Mortgage was originally granted, and any subsequent change in the Debtor's use of the Property does not change the nature of the debt. Gregory asserts that none of the Debtor's debts, let alone 50% of the debts, are derived from the operation of Harbor Rose and none of the Mortgage proceeds were used to renovate the Property for the benefit of the business. Finally, Gregory emphasizes the Debtor's previous characterization of the Mortgage debt as consumer debt in her prior bankruptcy filings and the Current Case as grounds for finding that the Debtor is not a small business debtor within the definition of 11. U.S.C. § 101(51D)(A).

In response, the Debtor points to her long history in the hotel business, her stated need to create a business that would keep her close to her adopted daughter, and the very unique

characteristics of the Property to support a finding that the Mortgage debt was indeed incurred for commercial purposes. The Debtor purchased a six-bedroom historic mansion with the intention of converting this large house into a guest house. From the outset, the Debtor asserts she rented the guest rooms by advertising on various websites. The Debtor also invested in the Property by installing a new septic system to accommodate her business. Six year after purchasing the Property, she decided to register the Property as the first legal bed and breakfast in the Town of Huntington.

While the Property is clearly the Debtor's primary residence, the primary purpose of purchasing the Property appears to have been to own and operate a bed and breakfast. The Debtor's goal was to combine her business with the needs of her life as a single parent. The fact that the Debtor resides at the Property does not control whether the Mortgage is in the nature of a debt which arose from the commercial or business activities of the Debtor. In fact, the Debtor's affidavit in support of her opposition to the Motion indicates that the Town of Huntington will not grant a permit to run a bed and breakfast if the owner/ operator does not live inside the facility itself.

Case law supports this finding. *See In re Martin*, No. 12–38024, 2013 WL 5423954, at *6 (S.D. Tex. Sept. 26, 2013) ("[c]ourts must look at the substance of the transaction and the borrower's purpose in obtaining the loan, rather than merely looking at the form of the transaction…"). Based on the case law and the relevant facts, the Court finds that the Debtor fits within the definition of a small business debtor under the SBRA.

### *3. Does judicial estoppel apply to preclude the Debtor from claiming that the Mortgage debt arose from commercial or business activities?*

As an alternative argument, Gregory asserts that the Debtor is judicially estopped from asserting that the Mortgage debt arose from her commercial or business activities. Gregory

points out that the Debtor's current position that her debts are not primarily consumer debts is clearly inconsistent with her earlier position that those same debts are primarily consumer debts in her prior bankruptcy filings and in the original schedules filed in the current case.

A debtor may be judicially estopped from changing its legal position when a court has adopted and relied on it and the party claiming judicial estoppel suffers an unfair detriment as a result, unless mistake or inadvertence is an applicable defense. *See New Hampshire v. Maine*, 532 U.S. 742, 742-743 (2001) ("'[W]here a party assumes a certain position in a legal proceeding, and succeeds in maintaining that position, he may not thereafter, simply because his interests have changed, assume a contrary position, especially if it be to the prejudice of the party who has acquiesced in the position formerly taken by him.'") (citing *Davis v. Wakelee*, 156 U.S. 680, 689 (1895)). *See also Ahrens v. Perot Sys. Corp.*, 205 F.3d 831, 833 (5th Cir. 2000) ("Judicial estoppel applies to protect the integrity of the courts--preventing a litigant from contradicting its previous, inconsistent position when a court has adopted and relied on it.") (other citations omitted)). Inadvertence can be shown where the party in question either lacks sufficient knowledge of the undisclosed claims or would have no motive for their concealment. *Superior Crewboats, Inc. v. Primary P & I Underwriters* (*In re Superior Crewboats, Inc.*), 374 F.3d 330, 335 (5th Cir. 2004) (citing *In re Coastal Plains, Inc.*, 179 F.3d 197, 210 (5th Cir. 1999)).

The Supreme Court in *New Hampshire v. Maine* recognized that "'[t]he circumstances under which judicial estoppel may appropriately be invoked are probably not reducible to any general formulation of principle.'" *New Hampshire v. Maine*, 532 U.S. at 750. However, a general test for determining when judicial estopped may be invoked has been developed, as follows: (i) a party's later position is clearly inconsistent with its earlier position, (ii) the party's

former position has been accepted in some way by the court in the earlier proceeding, such that "judicial acceptance of an inconsistent position in a later proceeding would create 'the perception that either the first or the second court was misled,'" and (iii) the "party seeking to assert an inconsistent position would derive an unfair advantage or impose an unfair detriment on the opposing party if not estopped." *New Hampshire v. Maine*, 532 U.S. at 750-51.

Judicial estoppel has been applied in the bankruptcy context where a debtor changes its designation on the petition. *See In re Save Our Springs (S.O.S.) Alliance, Inc.*, 393 B.R. 452 (Bankr. W.D. Tex. 2008) (judicial estoppel prevented the debtor from amending its petition to designate itself as a non-small business debtor because it was inconsistent with its original designation and the debtor had already enjoyed the benefits of expedited proceedings as a small business debtor.).

Relying on *In re Jones*, 556 B.R. 327 (Bankr. E.D. Mich. 2016) and *In re Orlando*, No. 17-41616 (CJP), 2018 WL 3637231 (Bankr. D. Mass. July 30, 2018), Gregory asserts that bankruptcy courts have adopted judicial estoppel to bar debtors from changing the description of their debts from consumer debts to non-consumer debts. In *In re Jones*, after the U.S. Trustee moved to dismiss the chapter 7 debtor's case under section 707(b) of the Bankruptcy Code, the debtor changed her response and indicated that her debts were "not primarily consumer debts, but were not primarily business debts either." *In re Jones*, 556 B.R. 327 at 330. The court in *In re Jones* noted that the timing of the debtor's change was indicative of "gamesmanship" on the part of the debtor in order to render section 707(b) inapplicable and escape possible dismissal of the case. *Id*. at 335. Similarly, in *In re Orlando*, the bankruptcy court found that the debtor's change in his position regarding the nature of his debts from consumer debts to business debts after the

U.S. Trustee filed a motion to dismiss the debtor's case under 11 U.S.C. § 707(b) was a "late strategy change" instead of a mistake or inadvertence. *In re Orlando*, 2018 WL 3637231, at *4.

In applying the above factors to the Debtor's case, the Court finds that judicial estoppel does not bar the Debtor's change in description of the nature of her debts. First, it is not clear that her change of description of her Mortgage debt as a business debt is inconsistent with the Debtor's prior description of her debts. The Debtor referred to the Property as a bed and breakfast in the Current Case. By way of example, when the Debtor was asked "What is the property?" she checked the box "Other" and wrote "B&B Inn" on Schedule A/B instead of checking the box for "Single-family" home. (Case No. 8-18-77193-reg, ECF No.1.). In Schedule C, the Debtor claimed an exemption for the Property pursuant to 11 U.S.C. § 522(b)(2) wherein she described it as "Bed & Breakfast." *Id*. Again, on Schedule D, the Debtor described the Property as a "Bed and Breakfast." *Id*. The Debtor also lists her income and expenses from the operations of Harbor Rose in her Statement of Current Monthly Income. *Id*. ECF No. 26. These representations by the Debtor reflect the hybrid nature of the Property, which is rare. The Property is integral to the business operations, and the Court finds that the Debtor was attempting to be clear and forthright in her representations regarding the Property and the Mortgage.

Second, the Court took no specific action in the Current Case or in the prior bankruptcy filings based on a description of the Mortgage debt as consumer debt. This Court was not misled about the nature of the Mortgage which encumbered the Property. Third, the Debtor cannot be said to have taken unfair advantage over Gregory by changing the description of her debts to fit within a statute that did not exist at the time of the Petition Date. It is more akin to an innocent choice by the Debtor than gamesmanship. The Debtor's change in status was not made in

response to a 11 U.S.C. § 707(b) motion to dismiss by the U.S. Trustee, nor was it done with "the obvious motive" to make a certain law inapplicable. In fact, the law was not applicable at the time of the Petition Date because it did not exist. The SBRA was designed to protect small business debtors by affording them the right to reorganize in a timely, cost-effective manner. The Court also takes into consideration whether the Debtor's change in description of her debt, if permitted, would be unfairly detrimental to Gregory. Gregory points to the unfair burden and delay imposed, as Gregory was poised to confirm its proposed plan of liquidation that would have resulted in a sale of the Property and payment to Gregory from the sale proceeds. While the Court recognizes that there will be some prejudice to Gregory if the Debtor is permitted to recharacterize her debt, the Debtor must still satisfy the requirements of subchapter V in order to confirm a plan. There is no guarantee that the Debtor will be successful in this attempt, but given the current economic climate, it is doubtful that a sale of the Property could take place any time in the near future. Given the unique circumstances of this case, the prejudice to Gregory is minimized.

Finally, Gregory relies on case law where courts have judicially estopped debtors from changing their representations in petitions and schedules, made under penalties of perjury, when those changes were made because of changed circumstances in their bankruptcy cases. *See In re Osborne*, 490 B.R. 75 (Bankr. S.D.N.Y. 2013) (Court applied judicial estoppel where the debtors moved to vacate the discharge and dismiss their chapter 7 case following the discovery of a previously undisclosed asset.). Here, the Debtor is not reacting to the discovery of some wrongdoing she may have committed, nor did the Debtor make false claims in her petition. The Debtor is merely amending her petition and avail herself of the right created by a statute that did not exist as of the time of Petition Date. The cases cited by Gregory have a common denominator

that is inapposite to the present case; they did not concern a newly enacted law that is designed to protect debtors like the Debtor in the Current Case, who are small business owners.

For all the reasons stated herein, this Court finds that the instant case comes within the purview of 11 U.S.C. § 101(51D)(A) because the primary use of the Property was, and remains, for the operation of a bed and breakfast, rather than as a principal residence. The fact that the Harbor Rose entwines the Debtor's personal and business life does not control whether the Mortgage is a business debt or a consumer debt. In essence, the Debtor is not changing her position; the significant changes to the Bankruptcy law enable the Debtor to take advantage of a new definition of "small business debtor" in order to attempt to save her business.

**4. *Is the Debtor entitled to utilize 11 U.S.C. § 1190(3)?***

Both the Debtor and Gregory agree that in order to propose a plan and successfully exit bankruptcy, the Debtor must be permitted to modify the Mortgage. Prior to the effective date of the SBRA, the only statutory provision the Debtor could rely on to modify the Mortgage was 11 U.S.C. § 1123(b)(5). This section permits chapter 11 debtors to propose a plan that modifies 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. § 1123(b)(5). The Debtor's proposed plan sought to utilize this provision to modify the Mortgage, but this Court found that because the Debtor uses the Property for both business and residential purposes, the Property is the Debtor's principal residence. *See In re Harriman*, 2014 WL 131203 at *3 (Bankr. N.D. Cal.) (citing *In re Wages*, 508 B.R. 161, 168 (B.A.P. 9th Cir. 2014)). Therefore, the Debtor was prohibited from modifying the Mortgage under the law as it existed at the time.

The SBRA has given small business debtors who designate themselves as subchapter V debtors another tool to be used when proposing a plan. § 1190(3) provides as follows:

A plan filed under this subchapter—

(3) notwithstanding section 1123(b)(5) of this title, may modify the rights of the holder of a claim secured only by a security interest in real property that is the principal residence of the debtor if the new value received in connection with the granting of the security interest was—

(A) not used primarily to acquire the real property; and

(B) used primarily in connection with the small business of the debtor.

11 U.S.C. § 1190(3).

Although there are three decisions of record regarding application of the SBRA, only *In re Moore Props. of Person Cty., LLC* mentioned this particular provision. The *In re Moore Props. of Person Cty., LLC* court found that it did not apply in the case before it because the debtor was not an individual. *In re Moore Props. of Person Cty.*, *LLC*, 2020 WL 995544, at *4 n.14. In *dicta*, the court did state that if this section did apply, the court would consider whether the application of 11 U.S.C. § 1190(3) constituted an impermissible taking. *Id*. Therefore, the Court cannot look to prior case law to interpret this section.

This Court shall commence its analysis by employing the applicable rules of statutory construction. The Court is charged with interpreting all federal and state statutes according to their plain meaning. *Tyler v. Douglas*, 280 F.3d 116, 123 (2d Cir. 2001), *cert. denied*, 536 U.S. 906 (2002). In determining its degree of ambiguity or clarity, courts cannot examine statutory language in isolation. *Robinson v. Shell Oil Co*., 519 U.S. 337, 341 (1997). The Court must determine the specific context in which the language appears, and the statutory scheme's broader framework in order to preserve the coherence and consistency of the statutory scheme. *U.S. v. Ron Pair Enters., Inc*., 489 U.S. 235, 240-41 (1989) (citing *Northern Pipeline Construc. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 52-53 (1982)). "[I]n matters of statutory interpretation, the plain meaning of statutory language is often illuminated by considering not only the particular statutory language at issue, but also the structure of the section in which the key language is found, and the design of the statute as a whole and its object." *Pellegrino v. United States*

*Transp. Sec. Admin*., 896 F.3d 207, 216 n.10 (3d Cir. 2018) *reh'g en banc granted*, 904 F.3d 329 (3d Cir. 2018).

Armed with these principles, the Court will undertake its interpretation of this section. First, unlike 11 U.S.C. § 1123(b)(5), which precluded modifications of claims secured by mortgages on the debtor's principal residence, 11 U.S.C. § 1190(3) specifically permits the modification of claims secured by mortgages on the debtor's principal residence. Therefore, the plain language of the first paragraph of 11 U.S.C. § 1190(3) does not act as an impediment to the Debtor's attempt to modify the Mortgage. Indeed, the Property falls squarely within this paragraph.

Second, subparagraphs (A) and (B) do not bar the Debtor outright from using this provision to modify the Mortgage. Subparagraphs (A) and (B) further limit the application of this provision to mortgage proceeds that were:

> (A) not used primarily to acquire the real property; and
>
> (B) used primarily in connection with the small business of the debtor.

Starting with subparagraph (A), the statute reads that the mortgage proceeds cannot have been used "primarily to acquire the real property." As a matter of common usage, the word "primarily" means "for the most part." *Primarily*, Merriam-Webster's Law Dictionary, (last visited Apr. 9, 2020). In the context of the 1954 Internal Revenue Code, the Supreme Court held that "primarily" means "of first importance" or "principally" rather than meaning "substantial." *Malat v. Riddell*, 393 U.S. 569, 572 (1966). The phrase "real property" refers back to the real property that is the debtor's residence. In this case, the question for the Court to answer is whether the Mortgage proceeds were used primarily to purchase the Debtor's residence. Unlike 11 U.S.C. § 1123(b)(5) which took an all-or-nothing approach to loans securing the debtor's

residence, 11 U.S.C. § 1190(3) asks the Court to determine whether the primary purpose of the mortgage was to acquire the debtor's residence.

Subparagraph (B) requires the Court to determine whether the mortgage proceeds were used primarily in connection with the debtor's business. Both of these subparagraphs direct the Court to conduct a qualitative analysis to determine whether the principal purpose of the debt was not to provide the debtor with a place to live, and whether the mortgage proceeds were primarily for the benefit of the debtor's business activities. This interpretation is consistent with the purpose and intent of the SBRA, which is to assist small business owners in whatever form they take, and to give them speedy access to relief via the bankruptcy process. As stated above, the Congressional intent of the SBRA was to keep small business owners in business, and to benefit the employees, suppliers, customers and others who rely on that business. A reading of this provision which takes into account the primary purpose of the mortgage debt instead of a bright-line test that would reject any business owner in the Debtor's unique position is consistent with the intent of the legislation.

Clearly, some business owners, such as business owners who took out a second mortgage and used the proceeds to buy farm equipment or a taxi medallion, easily fall into this classification. However, an inflexible reading of this statute would bar legitimate business owners such as the Debtor from obtaining relief under the SBRA. The Court does not find that this interpretation would be consistent with the goals of the SBRA.

The Court proposes that the following factors be considered to determine whether the mortgage in question is subject to modification under this section:

1. Were the mortgage proceeds used primarily to further the debtor's business interests;

2. Is the property an integral part of the debtor's business;
3. The degree to which the specific property is necessary to run the business;
4. Do customers need to enter the property to utilize the business; and
5. Does the business utilize employees and other businesses in the area to run its operations.

In the Debtor's case, she did not purchase a residence and use one room as an office space. The Debtor bought real property and commenced using the rooms to rent and spent considerable time and resources on obtaining the proper permits to run the Property as a bed and breakfast. The primary purpose of the Property is to offer rooms for nightly fees. Harbor Rose serves a variety of guests, including guests visiting the nearby Cold Spring Harbor labs. Harbor Rose also provides holistic services to the guests staying at the Property with package services offered for additional fees. Although the Mortgage proceeds were not used to refurbish the Property or to obtain the proper zoning changes and permits, the Mortgage proceeds were used to purchase the building that houses the business run by the Debtor.

Based on its interpretation of 11 U.S.C. § 1190(3), the Court finds that there is sufficient evidence to hold a full evidentiary hearing to determine whether the Debtor may use this statute to modify the Mortgage. Therefore, if the Debtor proposes a plan which provides for bifurcation of the Mortgage, the Court shall schedule a hearing to determine whether she may take advantage of this provision using the factors listed above, along with any additional evidence produced by the parties.

***Conclusion***

For all the reasons stated herein, the Court finds that the Debtor is a "small business debtor" within the purview of 11 U.S.C. § 101(51D)(A) and is eligible to proceed as a

subchapter V debtor in this case. Therefore, the Court overrules the U.S. Trustee Objection and overrules the objections raised by Gregory in the Motion. An order consistent with this Memorandum Decision will be entered forthwith.

**Dated: Central Islip, New York**
**April 10, 2020**

**Robert E. Grossman**
**United States Bankruptcy Judge**

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638 B.R. 499
United States District Court, E.D. New York.

GREGORY FUNDING, Appellant,
v.
Deirdre VENTURA, Appellee.

20-CV-1949 (WFK)
|
Signed 04/21/2022

**Synopsis**

**Background:** Individual Chapter 11 debtor, the operator of a bed and breakfast, amended her petition to designate herself as a "small business debtor" and to proceed as such under Subchapter V of Chapter 11. Mortgagee and United States Trustee (UST) filed objections. The United States Bankruptcy Court for the Eastern District of New York, Robert E. Grossman, J., 615 B.R. 1, overruled objections. Mortgagee appealed.

**[Holding:]** The District Court, William F. Kuntz, J., held that in light of the substantial prejudice faced by mortgagee due to debtor's belated amendment, the Bankruptcy Court abused its discretion by overruling mortgagee's objection to debtor's request to amend her petition.

Reversed.

**Procedural Posture(s):** On Appeal; Other.

West Headnotes (12)

**[1]** **Bankruptcy** In general; nature and purpose

Small Business Reorganization Act (SBRA), which created a new Subchapter V within Chapter 11 of the Bankruptcy Code, was designed to provide a more cost-effective and streamlined option for small businesses to reorganize. Pub. L. No. 116-54 § 5, 133 Stat. 1079.

3 Cases that cite this headnote

**[2]** **Bankruptcy** Secured creditors, protection of

Under Subchapter V of Chapter 11, small business debtors may modify claims secured by liens on their principal place of residence if certain requirements are met. 11 U.S.C.A. § 1190(3).

**[3]** **Bankruptcy** Who May File, and Time for Filing

Subchapter V of Chapter 11 provides debtors with the sole right to confirm a plan of reorganization. 11 U.S.C.A. § 1189(a).

1 Case that cites this headnote

**[4]** **Bankruptcy** Petition

Federal Rules of Bankruptcy Procedure provide for a general right to amend a voluntary petition. Fed. R. Bankr. P. 1009(a).

**[5]** **Bankruptcy** Record; assignments of error; briefs

A district court sitting in a bankruptcy appeal has the power to consider any issue presented by the record on appeal. 28 U.S.C.A. § 158(a).

1 Case that cites this headnote

**[6]** **Bankruptcy** Conclusions of law; de novo review

**Bankruptcy** Clear error

Bankruptcy court's findings of fact are reviewed for clear error, whereas findings that involve questions of law, or mixed questions of fact and law, are reviewed de novo.

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1 Case that cites this headnote

[7] **Bankruptcy** Discretion

A bankruptcy court's equitable discretion is reviewed for abuse of discretion.

[8] **Bankruptcy** Discretion

"Abuse of discretion" on the part of a bankruptcy court may consist of an error of law or a clearly erroneous finding of fact, or a decision that, though not necessarily the product of a legal error or a clearly erroneous factual finding, cannot be located within the range of permissible decisions.

[9] **Bankruptcy** Petition

Bankruptcy Court abused its discretion by overruling mortgagee's objection to motion by individual Chapter 11 debtor to amend her petition, designate herself as a Subchapter V debtor under the Small Business Reorganization Act (SBRA), which had not been in effect on the petition date, and modify her mortgage; belated amendment nearly 16 months after case was commenced caused substantial prejudice to mortgagee, which had spent considerable resources to get to point at which it was poised to confirm its competing, unopposed plan, amendment ended mortgagee's right to pass any plan, thereby completely changing its rights as a creditor and resetting "litigation posture" of proceedings, and prejudice to debtor did not outweigh prejudice to mortgagee, since, if modification were denied, debtor's interests would still be protected by Chapter 11, which required mortgagee's plan to be fair and equitable, proposed in good faith, reasonable, and in comportment with existing law. 11 U.S.C.A. §§ 1129(a), 1189(a), 1190(3), 1191(c); Fed. R. Bankr. P. 1009(a).

1 Case that cites this headnote

[10] **Bankruptcy** Petition

While the language of the bankruptcy rule governing amendments of voluntary petitions is permissive, a debtor's opportunity to amend cannot be exercised in all circumstances without regard to prejudicial reliance. Fed. R. Bankr. P. 1009(a).

1 Case that cites this headnote

[11] **Bankruptcy** Petition

In determining whether amendment of a bankruptcy petition would prejudice creditors, the appropriate inquiry is not whether a creditor will recover less or be adversely affected by the amendment; instead, court must determine whether the creditor would be adversely affected by having detrimentally relied on the debtor's initial position. Fed. R. Bankr. P. 1009(a).

1 Case that cites this headnote

[12] **Bankruptcy** Petition

Under the bankruptcy rule governing amendments of voluntary petitions, the right to amend does not mean that the debtor has an unfettered right to alter previously-settled rights of affected entities. Fed. R. Bankr. P. 1009(a).

**Attorneys and Law Firms**

***501** Salvatore LaMonica, LaMonica, Herbst & Maniscalco LLP, Wantagh, NY, for Appellee Salvatore LaMonica.

Christine Black, Office of the U.S. Trustee, Central Islip, NY, for Appellee Office of the United States Trustee.

Sarah M. Keenan, Sferrazza and Keenan, PLLC, Melville, NY, for Appellee Deirdre Ventura.

Michael Kwiatkowski, Bonnie Pollack, Matthew Glen Roseman, Cullen and Dykman LLP, Garden City, NY, for Appellant Gregory Funding.

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**DECISION & ORDER**

WILLIAM F. KUNTZ, II, United States District Judge:

Appellant Gregory Funding ("Gregory") appeals the April 10, 2020 Memorandum Decision and Order ("Decision") of the United States Bankruptcy Court for the Eastern District of New York (Grossman, J.) permitting Appellee Dierdre Ventura's ("Debtor") to amend her petition for reorganization, designate herself as a Subchapter V debtor under the Small Business Reorganization Act ("SBRA"), and modify her mortgage. For the reasons set forth below, the Decision is REVERSED and this appeal is DISMISSED.

**BACKGROUND**

The facts below are drawn from the Bankruptcy Court's Decision and from the parties' briefing on the instant appeal. On December 14, 2007, the Debtor purchased the Harbor Rose, a historic property located in Cold Springs Harbor, New York, to create a bed and breakfast. Decision at 3, ECF No. 1-3, Ex. A. To finance the transaction, the Debtor took out a $1,000,000.00 loan, secured by a mortgage on the Harbor Rose, and used the proceeds to purchase the property. *See id.*; Appellant's Br. at 7, ECF No. 5; Appellee's Br. at 5, ECF No. 6. The loan and mortgage were assigned to Gregory in 2015. Decision at 3.

Not long after the purchase, the Debtor began renting out rooms in the Harbor Rose. *Id.* at 4. She also lived in the property. *Id.* at 6, 8; Appellee's Br. at 6. On January 18, 2013, the Debtor defaulted on her mortgage, and she filed a voluntary petition for Chapter 7 bankruptcy. Decision at 4; Appellee's Br. at 7. On May 1, 2013, she received a discharge, and her case closed shortly thereafter. Decision at 4; Appellee's Br. at 7. On February 6, 2014, the Debtor voluntary petition for relief under Chapter 13. Decision at 4. This petition was eventually dismissed on August 6, 2014, because the Debtor failed to file the proper documents. *Id.*

On February 18, 2015, the Debtor executed a loan modification, which granted her more favorable loan and mortgage terms. *Id.* at 5; Appellee's Br. at 9. On May 1, 2015, the Debtor nonetheless defaulted on her obligations under the loan, and on February 11, 2016, Gregory commenced a foreclosure action against the Debtor in the Supreme Court of the State of New York in Suffolk County. Decision at 5. On August 8, 2018, Gregory obtained a judgment of foreclosure and sale of the Harbor Rose. *Id.* at 6.

***502 PROCEDURAL HISTORY**

On October 24, 2018, the Debtor filed a voluntary petition for Chapter 11 bankruptcy in the United States Bankruptcy Court for the Eastern District of New York. *Id.* At the time, the Harbor Rose was valued at $1,200,000.00, and the Debtor owed Gregory a total of $1,687,664.80. *Id.*

The Debtor's exclusive period in which to file a Chapter 11 plan lapsed on February 21, 2019. *Id.* at 8; Appellant's Br. at 8. On June 11, 2019, the parties agreed to extend this deadline to September 30, 2019. Decision at 7-8. Under the terms of this agreement, if Gregory rejected the Debtor's proposed disclosure statement and plan, Gregory could then file a competing plan which would provide for the sale of the Harbor Rose. *Id.* at 8.

The Debtor failed to file a proposed disclosure statement and plan by the September 30, 2019 deadline. *Id.* At a status conference on November 19, 2019, the Bankruptcy Court ordered the parties to each file a proposed plan of reorganization by December 13, 2019. *Id.* That day, Gregory filed its plan, which called for the sale of the Harbor Rose to satisfy the Debtor's outstanding obligations. *Id.*; Appellee's Br. at 10-11. The Debtor's proposed plan, on the other hand, sought to modify the mortgage by reducing the secured portion of Gregory's claim to $1,050,000.00, which the Debtor would repay over 30 years at a rate of 4.25% interest per annum. *Id.* However, Gregory would receive no payment on the unsecured portion of its claim because the Debtor had previously received a discharge in her 2013 bankruptcy. *Id.*

On January 13, 2020, the Bankruptcy Court determined the relief sought by the Debtor—modification of her mortgage—was precluded by 11 U.S.C. § 1123(b)(5) because the Debtor lived in the Harbor Rose. *Id.* at 9; Appellant's Br. at 8; Appellee's Br. at 10. The Bankruptcy Court thus held the Debtor's plan was unconfirmable on its face, approved Gregory's disclosure statement, and set a hearing for February

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26, 2020 to confirm Gregory's plan of reorganization. Decision at 9; Appellant's Br. at 8. In advance of the confirmation hearing, Gregory solicited the necessary votes and filed a certification of ballots on February 20, 2020. Decision at 9; Appellant's Br. at 8.

**[1]** **[2]** **[3]** On February 19, 2020, the SBRA came into effect. Decision at 9. Designed to provide a more cost-effective and streamlined option for small businesses to reorganize, the SBRA created a new Subchapter V within Chapter 11 of the Bankruptcy Code. *See* Small Business Reorganization Act of 2019, Pub. L. No. 116-54 § 5, 133 Stat. 1079, 1087. Subchapter V offers several powerful tools to qualifying small business owners. It also created an exception to § 1123(b)(5) that allows for small business debtors to modify claims secured by liens on their principal place of residence if certain requirements are met. *See* 11 U.S.C. § 1190(3). Subchapter V also provides debtors with the sole right to confirm a plan of reorganization. *See* 11 U.S.C. § 1189(a) ("Only the debtor may file a plan under this subchapter.").

To elect for Subchapter V relief, Chapter 11 debtors must "state in the petition whether the debtor is a small business debtor and, if so, whether the debtor elects to have subchapter V of chapter 11 apply." Interim Fed. R. Bankr. P. 1020(a);[1] *see* ***503** Interim Fed. R. Bankr. P. 1020 committee's note ("The title and subdivision (a) of the rule are amended to ... require a small business debtor to state in its voluntary petition ... whether it elects to proceed under subchapter V.").

**[4]** Because the SBRA was not in effect at the time she filed her petition for reorganization, the Debtor did not make this designation. *See* Decision at 10, 15. Thus, to proceed under Subchapter V, she needed to amend her petition to proceed as a small business debtor. Although neither the Bankruptcy Code nor the Bankruptcy Rules discuss making a small business designation after a petition has been filed, there is a general right to amend a voluntary petition under Bankruptcy Rule 1009. *See* Fed. R. Bankr. P. 1009(a) (providing that a debtor may amend a voluntary petition "as a matter of course at any time before the case is closed").

At the February 26, 2020 confirmation hearing, the Bankruptcy Court informed the Debtor of the SBRA and adjourned the hearing without confirming Gregory's plan to give the Debtor time to decide whether to proceed under the SBRA. Decision at 9-10. On March 6, 2020, the Debtor sought to amend her petition to designate herself as a Subchapter V debtor. *Id.* at 10.

On March 9, 2020, Gregory filed an objection to the Debtor's designation. *Id.* Gregory argued the Debtor's amendment prejudiced Gregory's rights, including its "vested right" to file and pursue its plan of reorganization. *Id.* Gregory also averred the Debtor was not eligible for Subchapter V relief because she failed to meet the definition of a "small business debtor" under 11 U.S.C. § 101(51D)(A) and, even if she did meet the definition, she nonetheless could not modify the terms of her mortgage under 11 U.S.C. § 1190(3) because she used the mortgage to purchase the Harbor Rose. *Id.* at 10-11.

The United States Trustee ("Trustee") also objected to the Debtor's proposed amendment. *Id.* at 11. The Trustee raised several procedural and timing issues with the Debtor's amendment—namely that the Trustee could no longer perform its duty to facilitate a consensual plan of reorganization because the Debtor's petition had been pending for nearly sixteen (16) months, and the SBRA's statutory deadlines had passed. *Id.* at 16.

In a memorandum decision dated April 10, 2020, the Bankruptcy Court overruled both objections, thus allowing the Debtor to amend her petition and proceed as a Subchapter V debtor and modify her mortgage. *See* Decision. On April 24, 2020, Gregory filed a notice of appeal of the Decision, raising the same arguments it raised in its original objection to the Debtor's March 6, 2020 election.[2] Notice of Appeal, ECF No. 1-1, Ex. A. On May 6, 2020, Gregory filed its Statement of Issues on Appeal and Designation of Record. Appellant's Br. at 6. The Debtor filed her Designation of Additional Items on Appeal on May 27, 2020. *Id.*

## JURISDICTION AND STANDARD OF REVIEW

**[5]** **[6]** **[7]** **[8]** "District Courts have appellate jurisdiction over 'final judgments, orders, and decrees' entered in bankruptcy court." ***504** *Satti v. Nechadim Corp.*, No. 17-CV-683, 2018 WL 1010206, at *3, 2018 U.S. Dist. LEXIS 26799, at *6 (E.D.N.Y. Feb. 16, 2018) (Brodie, J.) (quoting 28 U.S.C. § 158(a)). "A district court sitting in

a bankruptcy appeal has the power to consider any issue presented by the record on appeal." *In re Hilsen*, 119 B.R. 435, 439 (S.D.N.Y. 1990) (Patterson, J.); *see In re Lyondell Chem. Co.*, 585 B.R. 41, 57 n.5 (S.D.N.Y. 2018) (Cote, J.). "Findings of fact are reviewed for clear error, whereas findings that involve questions of law, or mixed questions of fact and law, are reviewed de novo." *In re Genco Shipping & Trading Ltd.*, 550 B.R. 676, 679 (S.D.N.Y. 2015) (Scheindlin, J.) (citation omitted). "A bankruptcy court's equitable discretion ... is reviewed for abuse of discretion." *In re A&P*, 467 B.R. 44, 50 (S.D.N.Y. 2012) (Seibel, J.) (citing *In re Dairy Mart Convenience Stores, Inc.*, 351 F.3d 86, 91 (2d Cir. 2003)). "An abuse of discretion may consist of an error of law or a clearly erroneous finding of fact, or a decision that, though not necessarily the product of a legal error or a clearly erroneous factual finding, cannot be located within the range of permissible decisions." *In re Dana Corp.*, 574 F.3d 129, 145 (2d Cir. 2009) (citations and internal quotation marks omitted).

## DISCUSSION

**[9]** Because the Debtor initially filed a petition for reorganization under Chapter 11 of the Bankruptcy Code, her eligibility for SBRA relief turns on whether she may amend her original petition to designate herself as a Subchapter V debtor under Rule 1009(a) of the Federal Rules of Bankruptcy Procedure. The Bankruptcy Court overruled Gregory's objections to the Debtor's request to amend her petition, finding it was "within the [Bankruptcy] Court's discretion" to allow the Debtor to "avail herself of" the SBRA, which was "not at her disposal when she filed" the instant case. Decision at 16.

**[10]** Under Rule 1009(a), a "voluntary petition, list, schedule, or statement may be amended by the debtor as a matter of course at any time before the case is closed." Fed. R. Bankr. P. 1009(a). While the language of Rule 1009(a) is permissive, "a debtor's opportunity to amend cannot be exercised in all circumstances without regard to prejudicial reliance." *Cash v. Thaler*, 319 Fed. App'x 4, 5 (2d Cir. 2009) (summary order) (citation omitted); *see In re Raggie*, 389 B.R. 309, 313 (Bankr. E.D.N.Y. 2008) (bankruptcy courts have the "discretion to reject a debtor's amendment when 'the facts and circumstances presented indicate that the amendment was filed in bad faith, [or was] fraudulent or prejudicial' " to creditors) (citing cases); *see also In re Momentum Mfg. Corp.*, 25 F.3d 1132, 1137 (2d Cir. 1994) (affirming a bankruptcy court's decision emphasizing that Rule 1009(a) right to amend can only be exercised when there is no issue of bad faith or prejudicial reliance). Courts have applied this standard when a pre-SBRA debtor seeks to amend its petition to proceed under Subchapter V. *See, e.g.*, *In re Body Transit, Inc.*, 613 B.R. 400, 408 (Bankr. E.D. Pa. 2020) ("[C]ourts have held that the ability to amend provided by Rule 1009 is subject to a party in interest's right to object if the amendment is made in bad faith or would unduly prejudice the party.") (citing cases); *see also In re Peak Serum, Inc.*, 623 B.R. 609, 616 (Bankr. D. Colo. 2020) ("[A]n eligible pre-SBRA debtor may generally amend its petition to elect to proceed under Subchapter V, subject to ... a finding that the level of prejudice to the objecting party does not override the debtor's right to amend its petition under Rule 1009(a).") (citation omitted).

**[11]** **[12]** "In determining whether the amendment would prejudice creditors, the ***505** appropriate inquiry is not whether a creditor will recover less or be adversely affected by the amendment; instead, a court must determine whether the creditor would be adversely affected by having detrimentally relied on the debtor's initial position." *In re Newton*, BAP No. MW 01-031, 2002 WL 34694092 at *3, 2002 Bankr. LEXIS 2089 at *6 (B.A.P. 1st Cir. Jan. 10, 2002) (citations omitted). This is because "[t]he right to amend ... does not mean that the debtor has an unfettered right to alter previously-settled rights of affected entities." *Id.* at *3, 2002 Bankr. LEXIS 2089 at *7 (citation omitted).

Applying this framework, courts have found that creditors are prejudiced when they suffer "actual economic loss due to the delay in filing the amendment" or when the parties "would have taken different actions, or asserted other positions, if the exemptions had been claim[ed] earlier." *In re Walck*, 459 B.R. 208, 212 (Bankr. M.D. Pa. 2011) (citing cases); *see In re Talmo*, 185 B.R. 637, 645 (Bankr. S.D. Fla. 1995) ("If the parties would have taken different actions or asserted different positions ... and the interest of those parties are detrimentally affected by the timing of the amendment, then the prejudice is sufficient to deny amendment."); *see also In re Green*, 268 B.R. 628, 656 (Bankr. M.D. Fla. 2001) (denying amendment where the debtors waited eighteen months to amend, and the parties expended "extraordinary legal fees and investigative costs" in reliance of the debtor's earlier representations); *In re*

*Jelinek*, 97 B.R. 429, 433 (Bankr. N.D. Ill. 1989) (prohibiting a debtor from amending under Rule 1009(a) where the debtor "waited over two years to propose" an amendment, which caused an unacceptable "degree of creditor prejudice.").

Here, the Bankruptcy Court failed to consider properly the substantial prejudice Gregory faces due to the Debtor's belated amendment. Nearly sixteen months passed before the Debtor moved to amend her petition to designate herself as a Subchapter V debtor. By then, both the parties and the Bankruptcy Court spent considerable time and resources to get to a point in which Gregory was posed to confirm its plan. The Bankruptcy Court held numerous hearings and the parties, after significant negotiations, agreed Gregory could pursue its unopposed plan of reorganization if the Debtor failed to submit a plan by September 30, 2019. In reliance on this agreement and on the Debtor's representation that her petition would proceed under Chapter 11, Gregory filed its plan of reorganization, solicited the necessary votes, and was on the cusp of confirming it when the Debtor sought to amend her petition. Moreover, because the SBRA grants the Debtor the sole right to confirm a plan of reorganization, the Debtor's amendment had the further prejudicial effect of terminating Gregory's right to pass *any* plan, thereby "completely chang[ing] the rights of [Gregory] as a creditor" and resetting the "litigation posture" of the proceedings. *In re Zwirn*, No. 04-40306-BKC-AJC, 2007 WL 1239059 at *4, 2007 Bankr. LEXIS 1293 at *12 (Bankr. S.D. Fla. Mar. 9, 2007). The Debtor's amendment cannot be allowed to cause such prejudice.

In addition, the prejudice to the Debtor does not outweigh the prejudice to Gregory. If the Debtor is prevented from modifying her petition, she remains in the Chapter 11 process. While this may prevent her from accessing some of the tools afforded by Subchapter V, the Debtor's interests are still protected by Chapter 11, which requires Gregory's plan to be "fair and equitable," 11 U.S.C. § 1191(c), proposed in good faith, deemed to be "reasonable," and in comportment with existing law. *Id.* § 1129(a). On this record, the ***506** Bankruptcy Court abused its discretion by overruling Gregory's objection to the Debtor's request to amend her petition.

## CONCLUSION

For the foregoing reasons, the Court REVERSES the Decision of the Bankruptcy Court.

### All Citations

638 B.R. 499, Bankr. L. Rep. P 83,764

Footnotes

1 Interim Rule 1020 was adopted by Bankruptcy Courts in the Eastern District of New York by Administrative Order No. 686, effective February 19, 2020. After enactment of the CARES Act, which necessitated amendments to Interim Rule 1020, Bankruptcy Courts in the Eastern District adopted the current amended version of Interim Rule 1020 by Administrative Order No. 692, effective April 22, 2022, to apply in all cases and proceedings governed by the SBRA.

2 Gregory also appealed the Decision directly to the United States Court of Appeals for the Second Circuit. *See* Mot. for Cert. of Direct Appeal, ECF No. 1-1. On September 17, 2020, the Second Circuit denied Gregory's direct appeal. *See* Mandate, ECF No. 2.


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