By Jeana K. Reinbold

Tide Turns against Hybrid Plans in the Circuit Where They Began

Almost two decades ago, Hon. James F. Queenan, in *In re McGregor*, became one of the first courts in the nation to address "hybrid" plans.[1] Since then, numerous other courts have weighed in on the topic. At one point, the majority of courts in the First Circuit were supportive of the hybrid plan adopted by *McGregor*.[2] Somewhat remarkably, in just the past year or so, courts in the First Circuit formerly supportive of these plans have done a 180-degree turn on the confirmability.[3]

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What Is a "Hybrid Plan"?

A hybrid plan is a plan that blends several of the unique benefits of chapter 13. First, it seeks to modify a claim by bifurcating it into its secured and unsecured components. Second, it seeks to pay the bifurcated "secured claim" beyond the term of the plan. It is most frequently invoked with regard to non-homestead mortgages (*i.e.*, a claim other than a claim secured only by a security interest in real property that is the debtor's principal residence).

The first proposition, bifurcating a claim, is not controversial. Section 1322(b)(2) expressly authorizes the modification of secured claims, with the exception of principal residences, in the same manner as any other secured claimholder.[4] The problem, however, is with the second component. Section 1322(b) provides:

> Subject to subsections (a) and (c) of this section, the plan may—
>
> ...
>
> (2) 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[.]
>
> ...
>
> (5) notwithstanding paragraph (2) of this subsection, provide for the curing of any default within a reasonable time and maintenance of payments while the case is pending on any unsecured claim or secured claim on which the last payment is due after the date on which the final payment under the plan is due[.][5]

While § 1322(b)(2) says that a debtor may modify certain secured debt, once a claim is "modified," it is subject to several limitations. Section 1325(a)(5) provides a menu of options on how a debtor can modify the debt. Where the claimholder has not accepted the plan or the debtor is not surrendering the property securing the claim to such holder, the debtor is required to pay the present value of the allowed secured claim in full over the life of the plan.[6] As has been observed, this puts the option of modifying a secured mortgage claim out of the financial reach of most debtors dealing with mortgage loans that are typically too large to be paid during the three- to five-year life of the plan.[7]

To get around these limitations, enter the hybrid option. Courts have found independent support for their conclusion that a plan can both modify the debt, yet also "cure and maintain" beyond the time limit for the plan, in § 1322(b)(5). These courts note that while it is true that the U.S. Supreme Court said that bifurcation was tantamount to a modification of the rights of a secured claimholder prohibited under § 1322(b)(2), bifurcation, together with "maintaining" the payments on the claim under § 1322(b)(5), avoids the command of § 1322(b)(2). According to Judge Queenan:

> Presumably, if only subsection (b)(2) were applicable, the payments would have to be completed within five years. But subsection (b)(5) provides independent support for such a plan. Subsection (b)(5) does not require the plan proponent to avoid modification of the "rights" of the secured claimholder. Its command is complied with so long as payments are maintained on the "secured claim." The amount of the secured claim is determined by valuation pursuant to section 506(a). This wording avoids the fine

1 *See In re McGregor*, 172 B.R. 718 (Bankr. D. Mass. 1994); *In re Fortin*, 482 B.R. 35, at 42 n.8, (Bankr. D. Mass. 2012).

2 *See, e.g., McGregor*, *supra* at 718; *In re Murphy*, 175 B.R. 132 (Bankr. D. Mass. 1994); *Brown v. Shorewood Financial Inc. (In re Brown)*, 175 B.R. 129 (Bankr. D. Mass. 1994); *In re Kheng*, 202 B.R. 538 (Bankr. D.R.I. 1998); *Federal National Mortgage Association v. Ferreira (In re Ferreira)*, 223 B.R. 258 (D.R.I. 1998); *In re Veliz*, 2009 WL 3418638, No. 08-13292 (Bankr. D.R.I. Oct. 16, 2009); *In re Plourde*, 402 B.R. 488, 491-92 (Bankr. D.N.H. 2009).

3 *See In re Pires*, 2011 WL 5330772, No. 09-18708-FJB (Bankr. D. Mass. Nov. 7, 2011); *In re Bullard*, 475 B.R. 304 (Bankr. D. Mass. 2012), *appeal pending*, No. 12-54 (B.A.P. 1st Cir.); *In re Fortin*, *supra* at 43; *cf. Bell v. Bankowski (In re Bell)*, 2011 WL 2712755, No. 10-10870-DJC (D. Mass. July 12, 2011) (affirming bankruptcy court's finding that proposal to execute new note and mortgage constituted impermissible modification).

4 *See, e.g., In re Legowski*, 167 B.R. 711, 715 (Bankr. D. Mass. 1994).

5 11 U.S.C. § 1322(b)(2) and (5).

6 11 U.S.C. § 1325(a)(5).

7 *Legowski*, *supra* at 715-16 (citing 1 K. Lundin, *Chapter 13 Bankruptcy* § 4.49 (1994), and *Rake v. Wade*, 508 U.S. 464 (1993)).

distinction made in *Nobelman*, based on the wording of subsection (b)(2), between modification of the "rights" of a secured claimholder and modification of the "secured claim." Subsection (b)(5), moreover, provides that its provisions control "notwithstanding paragraph (2) of this subsection."[8]

The Tide Turns

The recent opinions by courts in the First Circuit cite a tension in statutory construction created by the *McGregor* reading of the statutes that cannot be resolved. The courts in the *In re Pires*, *Bullard* and *Fortin* cases have recently addressed this problem of statutory construction.[9]

In each of these cases, the respective chapter 13 debtors proposed to pay arrearages on secured mortgage claims through the plan and "maintain" payments by paying the bifurcated secured claims during and after the life of the plan.[10] The mortgagees in these cases complained that a hybrid plan was not a valid option in chapter 13 and that payments longer than the statutorily imposed five-year limit were not permitted.

The *Pires* court never reached the secondary issue as to whether the particular plan in that case comported with the definition of "maintenance of payments" contemplated in § 1322(b)(5), as it resolved the case by deciding that *McGregor* was wrongly decided and ruled in the mortgagees' favor. In so doing, the court departed from nearly 20 years of precedent in the circuit and reversed its own previous position on the matter.[11] The *Pires* court set forth four reasons for its analysis.

First, the court noted that § 1322(b)(5) permits only "maintenance of payments *while the case is pending*."[12] It found that this plainly was not intended as a formula, akin to that in § 1325(a)(5), for assuring that the holder of a secured claim is paid value equivalent to its claim.[13] The court observed that for § 1322(b)(5) to serve as a mechanism for payment of a modified secured claim is to construe it as authorizing payment over a term longer than the plan term, but that § 1322(b)(5) did not permit that.[14] It noted, however, that when § 1322(b)(5) is construed as merely permitting continuation during the plan of payments on an unmodified obligation, there is no difficulty.[15] It held that § 1322(b)(5) does not authorize payments beyond the plan term, but rather merely leaves unimpaired the agreement under which payments will continue.[16]

Second, the court found that § 1322(b)(5) is subject to the requirement that payments on the plan be completed in no more than five years.[17] It could identify no principle of statutory construction that would permit it to distinguish subsection (5) from all the other enumerated subparts of § 1322(b).[18]

Third, the court observed that allowing bifurcation under § 1322(b)(5) could provide for an end-run around the antimodification provision in § 1322(b)(2) and permit the modification of principal residences.[19] Section 1322(b)(5) begins with the phrase "notwithstanding paragraph (2) of this subsection"—in other words, that which subsection 5 permits is permitted without regard to the antimodification exception in paragraph 2. The court found that the proposed construction of § 1322(b)(5) would have Congress giving with one hand precisely what it took away with the other, which would be a strange result.[20] In *Bullard*, while focusing primarily on the incompatibility of the *McGregor* approach with Supreme Court's proscription in *Nobelman*, the court agreed with the *Pires* court that such a statutory reading as proposed would relieve the debtor of the restriction of the antimodification provision, which presented insurmountable difficulties in statutory construction.[21]

Finally, the *Pires* court noted that using § 1322(b)(5) as set forth in a typical hybrid plan would require the division of a mortgage claim into three parts: secured, unsecured and arrearage, creating difficulties apportioning payments between the secured and unsecured components of the arrearage claim.[22] As no obvious answer to this issue has been provided by courts or the drafters, the court took this as further evidence that the drafters did not intend for § 1322(b)(5) to authorize hybrid treatment.[23] The *Fortin* court similarly concluded that § 1322(b)(5) only provides a limited opportunity to cure arrearages and maintain regular payments going forward, as the modification of a claim would create complications trying to allocate payments.[24]

Conclusion

Perhaps the most surprising thing about these cases is the forceful language and conviction with which these courts are reaching the conclusion that hybrid plans are not confirmable, despite the many years of precedent to the contrary. The *Pires* court found that as a matter of statutory construction, a reading that the language in § 1322(b)(5) authorizes a form of modification of secured claims created "difficulties" that were "insuperable."[25] In *Bullard*, the court described the "critical infirmity" in *McGregor* as the "conceit" that § 1322(b)(5) authorizes something that § 1322(b)(2) does not.[26] The *Fortin* court ruled that "after careful consideration," it was "convinced" that the Bankruptcy Code does not permit the use of § 1322(b)(2) and (5) in the same plan with respect to the same claim.[27] It will be interesting to see if this trend continues in other jurisdictions. abi

8 *See McGregor*, *supra* at 721 (distinguishing *Nobelman v. Amer. Savings Bank*, 508 U.S. 324 (1993)); *Murphy*, *supra* at 137; *Brown*, *supra* at 132-33.
9 *Pires*, *supra* at *5; *Bullard*, *supra* at 311; *Fortin*, *supra* at 43.
10 *Pires*, *supra* at *1, *7; *Bullard*, *supra* at 312-14; *Fortin*, *supra* at 43. The debtor in *Pires* also proposed to change the interest rate to 4 percent per annum for the bifurcated claim over the remaining term of the mortgage, a change in terms that the mortgagees contended did not even comport with the meaning of "maintenance of payments" as contemplated in *McGregor*. *Pires*, *supra* at *2-3.
11 *Compare Pires*, *supra* at *1, *with In re Espada*, No. 09-16519-FJB, Doc. No. 59. (Bankr. D. Mass. Jan. 11, 2010). The author was the counsel for the mortgagee in the *Espada* case and also argued the mortgagees' position on several occasions, albeit unsuccessfully, in other cases before some of these courts.
12 *Pires*, *supra* at *5 (emphasis in original).
13 *Id.*
14 *Id.*
15 *Id.*
16 *Id.*
17 *Id.*
18 *Pires*, *supra* at *6 (citing *In re Koper*, 284 B.R. 747, 754 (Bankr. D. Conn. 2002)).
19 *Id.*
20 *Id.*
21 *Bullard*, *supra* at 311-12.
22 *Pires*, *supra* at *7.
23 *Id.*
24 *Fortin*, *supra* at 43.
25 *Pires*, *supra* at *5.
26 *Bullard*, *supra* at 312.
27 *Fortin*, *supra* at 43.