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Stretching a Rule 'Till' It Breaks: The Unexamined Inapplicability of Till in Chapter 12 Cases Involving a Debtor's Primary Residence

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Since chapter 12 is modeled after chapter 13, plus the relative paucity of chapter 12 case law, there is a considerable degree of cross-pollination whereby chapter 13 case law is used to resolve chapter 12 issues.[1] Ordinarily, this is fine. Despite their similarities, however, chapter 12 is unique in certain respects. For example, chapter 12 plan payments may be made annually (instead of monthly), chapter 12 debtors may extend payments on secured claims many years beyond the end of the plan period, and a chapter 12 debtor may modify the rights of a creditor whose claim is secured only by a lien on the debtor's primary residence.[2]

Before relying on chapter 13 case law in a chapter 12 case, one must give due and critical regard to these differences, lest the case prove inapposite. Unfortunately, an as-yet-largely-unchallenged trend appears to be emerging whereby courts are applying the rule laid down by the U.S. Supreme Court in *Till v. SCS Credit Corp.*, a chapter 13 case governing the interest rates that are afforded to creditors with security interests in property other than a debtor's primary residence, in chapter 12 cases without due regard for the differences between the chapters.[3]

Facts and Holding in *Till*

Till v. SCS Credit Corp. began with the purchase of a used truck in Kokomo, Ind.[4] Prior to bankruptcy, the debtors financed most of the purchase of an approximately $6,395 truck with an interest rate of 21 percent.[5] The debtors proposed a chapter 13 plan under which they would pay interest on SCS's secured claim at a rate of 9.5 percent per month.[6] They arrived at this rate by taking the national prime rate (*i.e.*, the rate at which banks make low-risk loans to commercial entities) and adding a so-called "risk premium" of 1.5 percent to adjust for the risk of nonpayment posed by the debtors' financial condition.[7]

SCS objected to the debtors' plan, arguing that it was entitled to the 21 percent contract interest rate, and that the debtors had failed to meet their burden to rebut this presumption.[8] Eventually, the Supreme Court held that the debtors' proposal — the so-called "formula approach" whereby a risk premium was added to the national prime rate — was the correct method for the calculation of the creditor's interest rate in "cases like this involving secured interests in personal property."[9] The statutory authority recognized by the *Till* Court as supporting its decision was § 1322(b)(2) of the Bankruptcy Code, which "expressly authorizes a Bankruptcy Court to modify the rights of any secured creditor whose claim is secured by an interest in anything other than 'real property that is the debtor's primary residence.'"[10] This is important because by making explicit the statutory basis underlying its endorsement of the formula approach, the Court, also by logical implication, set limits on the future use of the formula approach.

Testing the Limits of the *Till* Approach

Why* Till *'s Sometime Expansion into Chapter 11 Does Not Mean That It Belongs in Chapter 12

Given its facts — a subprime auto lender insisting on an interest rate north of 20 percent — one unfamiliar with post-*Till* case law could be forgiven for reading *Till* as a case whose rule should be limited to similar cases involving similar facts; as, in other words, a cautionary tale echoing the old adage that "pigs get fat, but hogs get slaughtered." But in fact, far from applying *Till* only to cases where loans secured by personal property are crammed down under § 1322(b)(2), it was not long before the *Till* rule began to gain life in the chapter 11 context as well.

Whether *Till* governs the determination of cramdown interest rates in chapter 11 cases is the subject of much debate.[11] Supporting the use of *Till* in chapter 11 cases is a *dictum* in the *Till* opinion in which the plurality held that they thought that "it [was] likely that Congress intended [for] bankruptcy judges and trustees to follow essentially the same approach when choosing an appropriate interest rate under any of these provisions" (*i.e.*, § 1325(a)(5)(B) and, some have argued, comparable provisions in chapters 11 and 12).[12]

Also supporting the theory that *Till* might apply in the chapter 11 context is the similarity between the statute authorizing the cramming down of the creditor in that case (§ 1322(b)(2)) and the comparable provision in chapter 11 (§ 1123(b)(5)). Section 1322(b)(2) provides that "[s]ubject to [§ 1322(a) and (c)], the 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*, or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims."[13] Section 1123(b)(5) provides that "[s]ubject 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 the debtor's principal residence*, or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims."[14] In short, the provisions are identical.

It makes intuitive sense, then, that where *Till* was decided for the purpose of determining the extent of a debtor's rights under § 1322(b)(2), it might be similarly utile in the determination of a debtor's rights and abilities under that statute's mirror image in chapter 11. However, the comparable statute in chapter 12 is different. Section 1222 governs the contents (both mandatory and optional) of a confirmable plan. Section 1222(b)(2), chapter 12's analogue to §§ 1123(b)(5) and 1322(b)(2), provides as follows: "Subject to [§ 1222 (a) and (c)], the plan may ... modify the rights of holders of secured claims, or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims."

Under § 1222(b)(2), unlike § 1322(b)(2) or 1123(b)(5), a debtor may forcibly modify the rights of a fully secured creditor holding a mortgage on his/her primary residence.[15] The restriction against doing so contained in §§ 1322(b)(2) and 1123(b)(5) reflect Congress's recognition that creditors "whose claims are secured only by a lien on the debtor's home" are entitled to a "special protection."[16] Legislative history indicates that the purpose of this special protection is to protect the flow of capital into residential mortgage lending and "encourage private individual ownership of homes as a traditional and important value in American life."[17]

It was in this context, and with these limitations and public policy priorities in mind, that *Till* was decided.[18] The plurality of justices who decided *Till* knew that by forcing a subprime auto lender to accept a formulaically crammed-down "prime-plus" interest rate, they were not setting a precedent that might run afoul of the limitation codified in § 1322(b)(2) or Congress's intent to promote home ownership by ensuring the continued flow of capital into residential mortgage lending. Neither does importing *Till* into chapter 11 run afoul of the identical limitation codified in § 1123(b)(5) or force residential mortgage lenders to accept potentially diminutive formulaically crammed-down interest rates. Not so with chapter 12.

Encouraging private home ownership is no less compelling a public policy interest in the chapter 12 context, but Congress was forced to scale back slightly the protection afforded to residential mortgage lenders as a practical matter: With small farms, the debtor's residence and agricultural property are often situated on the same parcel and often secure the same loan. Without some measure of adjustment of those loans, feasible reorganization would often be impossible. However, that adjustment must be gradual and approved by a bankruptcy court in view of all relevant facts, with due consideration given to Congress's goal of promoting private home ownership. Accordingly, residential mortgage lenders are entitled to certain protections in the chapter 12 context, protections that would be threatened if courts were to graft, without due and proper analysis, the rule of *Till* onto chapter 12.

Before a chapter 12 plan that crams down the interest rate of a secured lender can be confirmed, the *debtor* has the burden of proving that the plan complies with the requirements set forth in § 1225 and that the proposed modifications are necessary for an effective reorganization.[19] Further, chapter 12 debtors have the burden of showing that their proposed interest rate is reasonable and/or consistent with customary lending practices.[20] To hold that these burdens are satisfied merely because the debtor chose a rate permissible under the *Till* formula — a formula that was never designed for use on creditors with liens on a debtor's primary residence — effectively shifts the burden from the debtor to the creditor, thereby running afoul of the intent of Congress and, in all likelihood, the intent of the *Till* plurality itself.[21] For instance, in *In re Standley*, the bankruptcy court applied the *Till* rule in a chapter 12 case where the debtors sought to cram down the interest rate on a loan secured by, among other things, the debtors' personal residence, and held that the creditor failed to meet its burden of showing that an upward adjustment of its interest rate outside the suggested *Till* range was justified.[22]

Since chapter 12 cases are comparatively uncommon, there are only a small number of cases addressing the applicability of *Till*, and none of them squarely addresses the issue of whether it is proper to apply *Till*'s rule to the modification of a loan that has been secured by a debtor's primary residence. A number of courts have simply assumed without deciding, often without opposition from the parties involved, that *Till* applies in chapter 12.[23] For example, in *First National Bank of Durango v. Woods (In re Woods)*, the Tenth Circuit BAP held that *Till* applied, focusing its analysis on the *dictum* in *Till* that the Court "thought it likely" that Congress would wish that the rule applied under similar provisions. The *Woods* court focused on the similarities between §§ 1325(a)(5) and 1225(a)(5) without any analysis whatsoever of the differences between §§ 1322(b)(2) and 1222(b)(2) (even though the farm property at issue in that case contained the debtors' home).[24]

Perhaps the most in-depth analysis of the applicability of *Till* in the chapter 12 context comes in an unpublished decision, *In re Prescott*.[25] In that case, Southern Bank, which had a lien on the debtor's real and personal property (possibly including the debtor's primary residence, although this is not addressed in the decision), objected to the debtor's attempt to reduce its interest rate to 5 percent.[26] In response, the bankruptcy court held that the rate was acceptable under *Till* because it provided for a 1.75 percent increase over the then-existing national prime rate of 3.25 percent.[27] In support of its conclusion that *Till* governed the issue of how a bank's interest rate should be determined, the court cited a 1998 law review article (six years before *Till* was decided) and two other cases (one unpublished) where it was assumed without case laws or decided after very cursory analysis that *Till* applies.[28]

The U.S. Bankruptcy Court for the District of Nebraska went a step further and approved a local rule for use in all cases under chapters 9, 11, 12 and 13, creating a statutory presumption that the *Till* formula approach is to be used "whenever the Court is required to determine the value, as of the effective date of a plan, of property to be distributed under a plan for any confirmation purposes."[29]

Conclusion

Till was a case that set the interest rate that a subprime auto lender in a chapter 13 case could receive for its loan secured by a $4,000 truck.[30] The decision expressly states that it found its authority in § 1322(b), a statute that "authorizes a Bankruptcy Court to modify the rights of any creditor whose claim is secured by an interest in anything other than real property that is the debtor's principal residence."[31] Although its rule might be aptly applied in other cases, including potentially chapter 11 cases, involving loans secured by personal property or even real property other than a debtor's primary residence, it is a mistake to hold that *Till* governs in chapter 12 cases wherein the debtor's primary residence is involved. This takes *Till* completely out of the factual context in which it arose and into territory never contemplated by its authoring plurality.

Moreover, application of *Till* in chapter 12 cases needlessly threatens Congress's intent to protect the flow of capital into residential mortgage lending by, in effect, switching the burden for plan confirmation from the debtor to any creditor who wishes to object to an interest rate outside the *Till* range. There is no particular reason why a bankruptcy court considering a chapter 12 plan should not, in theory, be able to use the sort of analysis that goes into a *Till*-style formula approach (*i.e.*, considering the extent to which the proposed interest rate deviates from the national prime rate). However, the burden should remain squarely on the debtor to substantiate his/her proposed interest rate, and that burden should not be satisfied by showing compliance with a formula set down in a chapter 13 case that was never intended to govern the cramming down of residential mortgage rates.

1. *See, e.g., Arkison v. Plata (In re Plata)*, 958 F.2d 918, 921 n.9 (9th Cir. 1992); *Foulston v. BDT Farms (In re BDT Farms)*, 21 F.3d 1019, 1021 n.3 (10th Cir. 1994).

2. 11 U.S.C. § 1222(b).

3. *Till v. SCS Credit Corp.*, 541 U.S. 465 (2004).

4. *Id.* at 469.

5. *Id.* at 470.

6. *Id.* at 471.

7. *Id.*

8. *Id.* at 471-72.

9. *Id.* at 475, 478-79.

10. *Id.* at 475 (citing 11 U.S.C. § 1322(b)(2)).

11. For treatment of this issue, *see* Thomas R. Fawkes and Steven M. Hartmann, Revisiting *Till*: Has a Consensus Emerged in Chapter 11s?, XXVII *ABI Journal* 6, 28-29, 66, July/August 2008.

12. 541 U.S. 465, 474. However, while the debate is not the subject of this article, the consensus on *Till*'s applicability in chapter 11 is far from unanimous. Those opposing the use of *Till* in the chapter 11 context point to another *dictum* contained in a footnote of the *Till* decision indicating that the plurality's formula approach is unsuited for cases where there exists an efficient market of potential financiers for the debtor. *See* 541 U.S. 465, 477 n.14. *See also* Louis E. Robichaux IV, Russell A. Perry and Jonathan L. Howell, "*Till* in Chapter 11 Cases and the Looming 'Efficient Market' Debate," XXXII *ABI Journal* 6, 22-23, 79-80, July 2013.

13. Emphasis added.

14. Emphasis added.

15. *See Justice v. Valley Nat'l Bank*, 849 F.2d 1078, 1082 (8th Cir. 1988) (holding that "[u]nlike section 1322 (b)(2) of Chapter 13, upon which it is based, section 1222(b)(2) does not prohibit debtors from modifying the rights of holders of claims secured only by a security interest in real property that is the debtor's principal place of residence") (internal quotations omitted). *See also In re Novak*, 102 B.R. 22, 23 (Bankr. E.D.N.Y. 1989) (noting that under chapter 12, unlike with other chapters, debtors may modify rights of holders of secured claims, including those holding mortgages on debtor's principal residence, including rate of interest to be paid, length of term and time of payments.) *See also In re Porter*, 1998 WL 272874, at *1 n.3 (Bankr. D. Vt. 1998).

16. *Nobleman v. Am. Sav. Bank*, 508 U.S. 324, 327 (1993).

17. *See 1st 2nd Mortg. Co. of N.J. Inc. v. Fernandos (In re Fernandos)*, 402 F.3d 147, 151 (3d. Cir. 2005), *citing Allied Credit Corp. v. Davis (In re Davis)*, 939 F.2d 208, 210 (6th Cir. 1993) (internal quotations omitted).

18. Interpreting courts have recognized this implicit limitation in *Till*'s reach. *See, e.g., In re Campbell*, 513 B.R. 846, 855 (Bankr. S.D.N.Y. 2014) (holding, in pertinent part, that *Till* applied in cases where property securing creditor's claim was "not the Debtor's principal residence"). *See also In re Cortner*, 400 B.R. 608, 612 n.6 (Bankr. S.D. Ohio 2009) (holding in chapter 13 context that "[t]here are other statutory exceptions to paying secured creditors at an interest rate based on *Till* ... [and that] One such exception is for claims secured by a security interest in the debtor's principal residence, for which the creditor is entitled to be paid at its contract rate of interest").

19. *In re Novak* at 23-24.

20. *In re Howe Farms LLC*, 2014 WL 6911395, at *4-5 (Bankr. N.D.N.Y. 2014).

21. *See, e.g., In re Standley*, 2013 WL 1191261, at *5 (Bankr. D. Mont. 2013).

22. *Id.*

23. *See, e.g., In re Pratt Vineyards LLC*, 2011 WL 10657053, at *5 (Bankr. E.D. Cal. 2011) (assuming without deciding that *Till* governs in chapter 12 context.)

24. 465 B.R. 196, 199, 205-08 (B.A.P. 10th Cir. 2012). The BAP's ruling was subsequently vacated on other grounds by the Tenth Circuit on other grounds. 743 F.3d 689 (10th Cir. 2014). *See also Toso v. Bank of Stockton (In re Toso)*, 2007 WL 7540985, *8 n.17 (B.A.P. 9th Cir. 2007) (holding, without challenge from parties, that *Till* applies in chapter 12 cases for same reasons cited in *Woods*).

25. 2011 WL 7268057 (Bankr. S.D. Ga. 2011).

26. *Id.* at *1.

27. *Id.* at *2.

28. *Id.* (citing *In re Hudson*, 2011 WL 1004630, at *6 (M.D. Tenn. 2011), and *In re Torelli*, 338 B.R. 390, 396 (Bankr. E.D. Ark. 2006)).

29. Neb. R. Bankr. P. 3023-1.

30. 541 U.S. 465, 470.

31. *Id.* at 475.

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