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Bankruptcy: Pre-Petition Acceleration of Mortgage Debt on Principal Residence - Arrearages May Be Cured under Chapter 13 Plan and Original Payment Schedule Reinstated.

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RECENT DEVELOPMENT

BANKRUPTCY: PRE-PETITION ACCELERATION OF MORTGAGE DEBT ON PRINCIPAL RESIDENCE—ARREARAGES MAY BE CURED UNDER CHAPTER 13 PLAN AND ORIGINAL PAYMENT SCHEDULE REINSTATED. *Grubbs v. Houston First American Savings Association,* 730 F.2d 236 (5th Cir. 1984) (en banc).

The United States Court of Appeals for the Fifth Circuit held in *Grubbs* that a Chapter 13 debtor may propose a payment plan to cure an accelerated pre-petition mortgage default on his principal residence, even after initiation of state foreclosure proceedings. The decision is significant because it allows a Chapter 13 debtor to: (1) cure arrearages accumulated by a default on his home mortgage during the life of his bankruptcy plan, and (2) reinstate the original installment payment terms despite the acceleration of that debt which would otherwise require immediate and full payment.

Houston First American Savings Association [Houston First], in April 1979, made a three year mortgage loan to Grubbs in return for a promissory note and a deed of trust secured by Grubbs' principal residence. The loan constituted a second mortgage. Following several months of nonpayment, Houston First exercised its option under the note, accelerated the debt, and demanded payment in full. In June 1981, foreclosure proceedings were initiated in state court. The following month, Grubbs filed a Chapter 13 bankruptcy, thereby staying foreclosure. In February 1982, Grubbs amended his bankruptcy payment plan by proposing that the delinquent amounts be paid during the thirty-six month plan and that the original terms of the mortgage be reinstated. Houston First objected to the proposal, and the bankruptcy court sustained that objection. The district court and a summary court of the Fifth Circuit affirmed. The Fifth Circuit, en banc, however, reversed, holding that Grubbs may cure his default of the monthly payments during the life of the plan and remanded for further consideration of the proposal and objections thereto.

Under section 1322(b)(3) of the Bankruptcy Code (11 U.S.C. § 1 (1982)),

the debtor is generally permitted to cure or waive any default. Section 1322(b)(5) allows cure of long-term debts within a reasonable time on any unsecured or secured claim "on which the last payment is due after the date on which the final payment under the plan is due." Section 1322(b)(5) is limited by section 1322(b)(2), which states that claims secured only by an interest in the debtor's principal residence cannot be modified by a Chapter 13 plan.

In an extensive analysis of the legislative histories of these statutes, Judge Take, writing for the majority, determined that the purpose of Chapter 13 is to enable a debtor to repay his debts over an extended period of time without full liquidation of his assets. Additionally, the majority held that the power to cure provided by the statutes necessarily comprehends the power to de-accelerate the note in order to make payment upon it. The court concluded that even though the mortgage debt was otherwise due in full upon acceleration, cure of the arrearages was allowed under section 1322(b)(3), and such cure complied with section 1322(b)(2) in that the creditor's rights were not modified.

The *Grubbs* majority relied strongly on a recent decision from the Second Circuit, *In re Taddeo.* Under identical facts and circumstances, the *Taddeo* court held that to preserve the goals and purposes of the Bankruptcy Code, a Chapter 13 debtor could cure his mortgage default on his principal residence under section 1322(b)(3) by de-accelerating the debt and reinstating the original payment terms under section 1322(b)(5). *See In re Taddeo,* 685 F.2d 24, 27-28 (2d Cir. 1982). As did the mortgagee in *Taddeo,* Houston First contended that the cure under section 1322(b)(5) was applicable only to non-accelerated debts, since state law made the entire accelerated debt immediately due and payable in full. *See General Motors Acceptance Corp. v. Uresti,* 553 S.W.2d 660, 663 (Tex. Civ. App.—Tyler 1977, writ ref'd n.r.e.); *In re Williams,* 11 Bankr. 504, 506 (Bankr. S.D. Tex. 1981). The Fifth Circuit followed *Taddeo*'s reasoning and held that federal law determines the payment schedule on a pre-petition accelerated mortgage. *See Grubbs v. Houston First Am. Sav. Ass'n,* 730 F.2d 236, 242 (5th Cir. 1984). For other decisions supporting this aspect of *Grubbs,* see *In re Clark,* 738 F.2d 869, 874 (7th Cir. 1984) (to apply § 1322(b)(5) look to date of last payment under note, rather than due date after acceleration); *In re Allen,* 42 Bankr. 360, 362 (Bankr. N.D. Ohio 1984) (§ 1322(b)(5) refers to date on face of mortgage); *In re Stokes,* 39 Bankr. 336, 341 (Bankr. E.D. Va. 1984) ("last payment" in § 1322 (b)(5) means when it would have been due but for acceleration).

But see In re McCann, 27 Bankr. 678, 679 (Bankr. S.D. Ohio 1982) (accelerated debt eliminates § 1322(b)(5) cure option); *In re Soderlund,* 18 Bankr. 12, 16 (Bankr. S.D. Ohio 1981) (since accelerated note due immediately, § 1322(b)(5) cure unavailable); *In re LaPaglia,* 8 Bankr. 937, 944

(Bankr. E.D.N.Y. 1981) (defaulted note becomes demand note on acceleration).

Courts have generally allowed debtors to cure their accelerated mortgages through a Chapter 13 proposal during different stages of foreclosure proceedings. Both the *Grubbs* and *Taddeo* decisions allow the debtor to cure his default prior to the entry of a state foreclosure judgment. The Seventh Circuit Court of Appeals extended these holdings in allowing cure even though a Wisconsin state court had entered a foreclosure judgment prior to the debtor's filing for bankruptcy. *See In re Clark,* 738 F.2d 869, 870, 874 (7th Cir. 1984). For other cases permitting cure subsequent to a foreclosure judgment but prior to sale, see *In re Gwinn,* 34 Bankr. 936, 945 (Bankr. S.D. Ohio 1983) (cure provisions allow reinstitution of accelerated mortgage even though brought to judgment); *In re Tuchman,* 29 Bankr. 39, 40 (Bankr. S.D.N.Y. 1983) (mortgage debt may be de-accelerated even though foreclosed under state law); *In re Acevedo,* 26 Bankr. 994, 997 (Bankr. E.D.N.Y. 1982) (debtor may cure and reinstate original payment schedule prior to actual sale); *In re Hardin,* 16 Bankr. 810, 810, 812-13 (Bankr. N.D. Tex. 1982) (debtor has right to reinstate installment plan prior to foreclosure sale).

But see In re Stokes, 39 Bankr. 336, 343 (Bankr. E.D. Va. 1984) (undue hardship on third party's rights if cure allowed after foreclosure); *In re Britton,* 35 Bankr. 373, 376 (Bankr. N.D. Ind. 1982) (debtor's plan cannot reinstate arrearages following foreclosure); *In re Maiorino,* 15 Bankr. 254, 257-58 (Bankr. D. Conn. 1981) (default converted into strict foreclosure may not be cured); *In re Land,* 14 Bankr. 132, 134 (Bankr. N.D. Ohio 1981) (following foreclosure, payment in full necessary during life of plan); *In re Pearson,* 10 Bankr. 189, 195 (Bankr. E.D.N.Y. 1981) (permitting debtor to reinstate following foreclosure judgment would seriously affect home mortgages; not allowed).

For cases in which the default may be cured after a foreclosure sale, see *In re LaCrue,* 33 Bankr. 569, 570, 572 (Bankr. D. Colo. 1983) (following sale, payment of arrearages during plan and deed of trust installments outside of plan approved); *In re Ivory,* 32 Bankr. 788, 791 (Bankr. D. Or. 1983) (right of redemption allows debtor to retain interest in sold property thus giving right to effect cure); *In re Chambers,* 27 Bankr. 687, 688-89 (Bankr. S.D. Fla. 1983) (debtor still has property rights since no divestment of title); *In re Taylor,* 21 Bankr. 179, 181 (Bankr. W.D. Mo. 1982) (Bankruptcy Code establishes own right of redemption "in lieu of state law"); *In re Thompson,* 17 Bankr. 748, 751 (Bankr. W.D. Mich. 1982) (arrearages may be cured and terms reinstated if redemption period has not run).

But see In re Rutterbush, 34 Bankr. 101, 103 (Bankr. E.D. Mich. 1982) (redemption period not stayed when petition filed; default not curable); *In*

re Jenkins, 14 Bankr. 748, 749-50 (Bankr. N.D. Ill. 1981) (following sale, mortgage merges into judgment); *In re Butchman,* 4 Bankr. 379, 380 (Bankr. S.D.N.Y. 1980) (under state law, after valid foreclosure and sale no right of redemption remains); *In re Robertson,* 4 Bankr. 213, 216 (Bankr. D. Colo. 1980) (at filing, debtors had only right of redemption, not right to cure default).

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