DATE: 01-08-91

CITATION: VAOPGCPREC 01-91
Vet. Aff. Op. Gen. Couns. Prec. 01-91

TEXT:

Cramdowns under Chapter 13 of the Bankruptcy Code

QUESTIONS PRESENTED:

a. In the consideration of the payment of a loan guaranty claim would a cramdown reducing the principal debt owed by a debtor approved in a chapter 13 bankruptcy petition affect the claim filed by a holder?

b. Is it appropriate to approve additional attorneys fees incurred by a holder in objecting to a cramdown and to permit the lender to include such fees in the eligible indebtedness for purposes of accounting with the holder upon the filing of a claim?

COMMENTS:

1. Recent decisions both at the bankruptcy court level and the appellate court level have permitted debtors with outstanding home loan mortgages to reduce a mortgagee's secured claim to the value of the security, when such value is less than the total indebtedness, in the course of a chapter 13 bankruptcy proceeding. The amount of the indebtedness above the value of the security has been considered an unsecured claim subject to discharge as any unsecured claim.

2. An issue which follows from these decisions relates to whether, in the event such a situation arises on a VA guaranteed loan, a holder would be able to claim the amount discharged as part of a loan guaranty claim either prior to loan termination, if the loan is current or ultimately paid off, or after termination if the mortgagor defaults.

3. In a recent opinion issued by this office, O.G.C. Precedent 91-90, we held that pursuant to existing law a loan guaranty claim may be paid only after liquidation has occurred. We indicated that the liquidation could be in the form of a foreclosure sale or a transfer in lieu of foreclosure. Thus, based on the conclusions recited in that opinion, a lender is effectively precluded from filing a claim with VA prior to termination of the loan. Consequently, as long as the loan is current and has not been terminated by reason of a default in the payments, the lender may not file a claim under the VA loan guaranty.

4. Under the provisions of the current VA statute, the amount to be paid on a claim is based on the total indebtedness as compared to the value of the property. Total indebtedness is defined as "the amount equal to the total of (i) the unpaid principal of the loan, (ii) the interest on the loan as of the date applicable under paragraph (10) of

this subsection, and (iii) such reasonably necessary and proper charges ... associated with liquidation of the loan...." 38 U.S.C. § 1832(c)(1)(D).

5. The statute thus provides that the VA's loan guaranty liability shall be based on the difference between the debtor's total indebtedness at the time of the foreclosure and the value of the property as determined by VA. With the completion of the bankruptcy action, the debtor's total indebtedness will have been reduced to that as determined by the court after deducting the amount of the unsecured claim.

6. Generally, the liability of the guarantor depends primarily on the construction and application of the loan guaranty contract. 38 Am.Jur.2d, Guaranty § 73. The liability of a guarantor will not exceed the liability of the principal debtor as to the principal indebtedness. 38 Am.Jur.2d, Guaranty § 74. A guarantor may elect, however, to retain absolute guaranty liability regardless of what happens to the principal obligation by including terms to that effect in the loan guaranty contract. Id. § 79. Our review of the VA loan guaranty contract, which consists of the VA statute and regulations, does not reflect any term that shows an intent to deviate from the general legal principle herein recited. The intent to follow the general principle is clearly demonstrated in the statute which specifies the formula to follow when computing the VA's claim liability under the VA guaranty. 38 U.S.C. § 1832. The statute further provides that " t he liability of the United States under any guaranty ... shall decrease or increase pro rata with any decrease or increase of the amount of the unpaid portion of the obligation." 38 U.S.C. § 1803(b). VA's intent to limit the applicability of its guaranty to the outstanding liability of the mortgagor is again demonstrated by the existing VA regulation which provides that the release of personal liability of an obligor without the prior consent of the Secretary releases the VA of its loan guaranty liability. 38 C.F.R. § 36.4324(f).

7. In a chapter 13 cramdown, the unpaid portion of the debtor's obligation is adjusted to the value of the security. Any deficiency is considered an unsecured debt and, upon completion of the plan, the obligation to repay the balance of the unsecured debt is discharged. Therefore, by the time that a loan where a portion of the principal indebtedness has been reduced by a discharge in bankruptcy is terminated, for purposes of claim payment, the outstanding total indebtedness will have been adjusted to the reduced amount. The VA's liability on its guaranty would, therefore, be based on the indebtedness remaining after the cramdown.

8. Under the provisions of 38 C.F.R. § 4313, the Secretary may approve additional attorney fees to be included in the total indebtedness for purposes of loan guaranty claim payment if such fees are reasonable and pertain to matters affecting VA guaranteed loans. Generally, VA regulations require that lenders obtain and retain liens of proper dignity. 38 C.F.R. § 36.4325. Additionally, in order for lenders to preserve VA's liability under its guaranty, they may not release any obligors without the VA's consent. 38 C.F.R. § 36.4324(f). In the instant situation in order to comply with the VA regulations and requirements, a lender would be obligated to pursue an appeal of an unfavorable cramdown decision. Therefore, additional attorneys fees would appear warranted as long as they are approved in advance by VA.

9. It should be noted that this opinion provides that VA's loan guaranty liability has been reduced because of the statutory provisions relative to the determination of the outstanding debt at the time of foreclosure in a loan guaranty claim computation. If, in your opinion, relief to lenders is warranted, that goal may be accomplished through proper promulgation of regulations that would modify the method of computing the total indebtedness so that it would include any amounts deducted in a cramdown.

HELD:

1. Claims under the VA loan guaranty may only be filed after liquidation has occurred or after a conveyance in lieu of liquidation has been approved by VA and completed. At that time, based on the remaining outstanding indebtedness, a claim may be paid. If the bankruptcy action has been completed and the outstanding balance has been reduced in such proceeding, the VA liability would be based on the reduced balance.

2. Litigation associated with matters where a mortgagor is seeking a reduction in the outstanding mortgage loan balance is not unique to VA guaranteed loans; however, such litigation is required by VA in order to preserve the VA's liability under its guaranty. Attorney fees associated with such litigation thus may be included as part of a veteran's indebtedness in the lender's accounting with VA, provided VA approved such fees in advance.

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