

# NORTON BANKRUPTCY LAW ADVISER

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## SECOND CIRCUIT SUSTAINS NOTICE AND JURISDICTION CHALLENGES TWENTY-FIVE YEARS AFTER ENTRY OF ORDERS IN JOHNS-MANVILLE

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Notice is vital in every bankruptcy case. With each filed pleading, decisions must be made as to the appropriate recipients, the method of service and the date on which the pleading must be served or the corresponding notice must be published. At least since the U.S. Supreme Court's decision in *Mullane v. Central Hanover Bank & Trust Co.*,<sup>1</sup> bankruptcy attorneys have grappled with notice issues. The recent decision of the U.S. Court of Appeals for the Second Circuit in *Johns-Manville Corp. v. Chubb Indemnity Ins. Co. (In re Johns-Manville Corp.)*,<sup>2</sup> is a stark reminder of the importance of ensuring that notice is comprehensive. In *Chubb*, the Second Circuit found that the specific language within a notice was not sufficient as to a particular insurance company, thereby permitting a collateral attack on the basis of subject matter jurisdiction 25 years after entry of the confirmation order in *Johns-Manville*.

### Factual Background

Johns-Manville Corporation was the largest supplier of raw asbestos in the U.S. from the 1920s until

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the 1970s.<sup>3</sup> Once studies linked asbestos exposure to respiratory diseases, including certain forms of lung cancer, the company became the target of numerous products liability lawsuits in the 1960s and 1970s.<sup>4</sup> As a result, on August 26, 1982, Johns-Manville and certain affiliates (collectively Manville) filed Chapter 11 petitions in the U.S. Bankruptcy Court for the Southern District of New York.<sup>5</sup> Because some individuals' diseases would not manifest for decades, the parties and the bankruptcy court were faced with creating a remedy which would address both present and future claims.<sup>6</sup>

To that end, Manville engaged in settlement negotiations with respect to its insurance coverage disputes, resulting in the execution of a series of settlement agreements among Travelers<sup>7</sup> and the Settling Insurers<sup>8</sup> (the 1984 Insurance Settlement Agreement).<sup>9</sup> On August 2, 1984, in seeking preliminary approval of the 1984 Insurance Settlement Agreement, Manville stated to the bankruptcy court:

“The parties to the Agreement will request this Court to order that[,] because these [insurance] policies constitute property of the [Manville] estate under Section 541 of the [Bankruptcy] Code..., the property be liquidated by this settlement, and that all claims by any person to the *res* be channeled to that liquidated fund, and that all persons be enjoined from suing the Settling Insurers because the property of the estate has been liquidated and will be in possession of the Court.”<sup>10</sup>

Manville simultaneously sought approval of a campaign to mail notice to a group of interested parties and to publish notice in 91 newspapers throughout the U.S. and Canada.<sup>11</sup> On August 2, 1984, the bankruptcy court issued a Notice of Hearing to Consider Approval of Compromise and Settlement of Insurance Litigation (the August 2, 1984 Notice) that provided, in part:

“The proposed Insurance Settlement Agreement provides [that]... [a]n order of the Bankruptcy

Court shall be obtained providing that all persons shall be restrained and enjoined from commencing and/or continuing any suit, arbitration or other proceeding of any type or nature for any and all claims, demands, allegations, duties, liabilities and obligations (whether or not presently known) which have been, or could have been, or might be asserted by any person against any and all the Settling [Insurers] based upon, arising out of or relating to any or all of the insurance policies.”<sup>12</sup>

On June 3, 1985, a letter agreement was executed that amended the 1984 Insurance Settlement Agreement.<sup>13</sup> The amendment stated, among other things, that:

“The Court has *in rem* jurisdiction over the Policies and thus the power to enter appropriate orders to protect that jurisdiction. The channeling order is intended *only* to channel claims against the *res* [of the Manville estate] to the Settlement Fund and the injunction is intended *only* to restrain claims against the *res* (*i.e.*, the Policies) which are or may be asserted against the Settling Insurers.”<sup>14</sup>

On December 22, 1986, the bankruptcy court confirmed the Manville plan (the Confirmation Order) and, as part of that confirmation, approved the insurance settlements (the Insurance Settlement Order, and together with the Confirmation Order, the 1986 Orders).<sup>15</sup> The Manville plan provided for the establishment of the Manville Personal Injury Settlement Trust (the Manville Trust), the channeling of the Policy Claims to the Manville Trust, and Manville's transfer of certain property to the Manville Trust, including approximately \$850 million from the settlements with insurers (\$80 million of which came from Travelers).<sup>16</sup> As defined in the Insurance Settlement Order, “Policy Claims” included: “any and all claims... (whether or not presently known) which have been, or could have been, or might be, asserted by any Person against any or all members of [Manville] or against any or all

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members of the Settling Insurer Group based upon, arising out of or relating to any or all of the Policies.”<sup>17</sup> The 1986 Orders contained broad injunctions in favor of, among others, the Settling Insurers with respect to the Policy Claims (the “Injunctions”).<sup>18</sup> On appeal, the Second Circuit affirmed the 1986 Orders.<sup>19</sup>

Many years later, certain persons injured by exposure to asbestos commenced asbestos-related lawsuits against Travelers in various courts on statutory and common law grounds (the Third-Party Actions).<sup>20</sup> The Third-Party Action plaintiffs alleged that Travelers was liable to them for its own conduct in connection with its insurance relationship with Manville.<sup>21</sup> In response to those lawsuits, on June 19, 2002, Travelers filed a Motion for Temporary Restraining Order and Preliminary Injunction in the bankruptcy court, seeking to bar the Third-Party Actions on the ground that they violated the Injunctions.<sup>22</sup> The bankruptcy court agreed and granted the motion.<sup>23</sup>

Following a lengthy court-ordered mediation over which former New York Governor Mario Cuomo presided, some of the parties reached settlements that provided for the establishment of a fund totaling approximately \$440 million.<sup>24</sup> On March 26, 2004, in the bankruptcy court, Travelers filed motions to approve the settlements and a Motion for an Order Interpreting and Enforcing the Confirmation Including the Insurance Settlement Order and the Channeling Injunction, seeking enforcement of the Injunctions and a clarification that the Injunctions prohibited prosecution of the Third-Party Actions against Travelers.<sup>25</sup> Chubb Indemnity Insurance Company, one of the objectors, contended that the bankruptcy court lacked authority to enjoin its contribution and indemnity claims against Travelers.<sup>26</sup>

After an evidentiary hearing, the bankruptcy court entered findings and conclusions that detailed the basis for an order approving the settlements (the Clarifying Order).<sup>27</sup> In the Clarifying Order, the bankruptcy court stated that the Injunctions underlying the Manville plan, the Confirmation Order and the Insurance Settlement Order had always enjoined all present and future Third-Party Actions against Travelers.<sup>28</sup> As to Chubb, the bankruptcy court stated that the 1986 Orders barred Chubb’s contribution and indemnity claims against Travelers.<sup>29</sup>

Following substantial affirmance by the U.S. District Court for the Southern District of New York,<sup>30</sup> the Second Circuit reversed the bankruptcy court’s clarification of the 1986 Orders.<sup>31</sup> In doing so, the Second Circuit held that the bankruptcy court did not have subject matter jurisdiction in 1986 to enter the

Injunctions with respect to the Third-Party Actions. Specifically, the Second Circuit held “that the bankruptcy court erred by using the 2004 Orders as a ‘jurisdictional bootstrap’ to enjoin non-derivative claims against Travelers, a non-debtor, that did not seek to collect from Manville’s bankruptcy estate.”<sup>32</sup>

On appeal, the Supreme Court reversed the Second Circuit’s decision, finding that “it was error for the Court of Appeals to reevaluate the Bankruptcy Court’s exercise of jurisdiction in 1986.”<sup>33</sup> Relying on principles of res judicata and finality, the Supreme Court stated:

[O]nce the 1986 Orders became final on direct review (whether or not proper exercises of bankruptcy court jurisdiction and power), they became res judicata to the “parties and those in privity with them, not only as to every matter which was offered and received to sustain or defeat the claim or demand, but as to any other admissible matter which might have been offered for that purpose.”<sup>34</sup>

The Supreme Court remanded the case to the Second Circuit indicating that it was not deciding “whether any particular respondent is bound by the 1986 Orders.”<sup>35</sup> In doing so, the Supreme Court acknowledged that Chubb “has maintained that it was not given constitutionally sufficient notice of the 1986 Orders, so that due process absolves it from following them, whatever their scope.”<sup>36</sup>

### The Second Circuit’s Decision as to Chubb on Remand

The Second Circuit considered whether the bankruptcy court and the district court erred in determining that: (a) Chubb was afforded due process so as to be bound by the 1986 Orders, and (b) the bankruptcy court possessed subject matter jurisdiction to bar Chubb’s contribution and indemnity claims against Travelers. In its decision, the Second Circuit upheld Chubb’s due process argument; found that Chubb was then permitted to challenge the bankruptcy court’s jurisdiction to issue the 1986 Orders; adhered to its earlier holding that the bankruptcy court exceeded its jurisdiction in 1986; and accordingly held that Chubb is not bound by the 1986 Orders.<sup>37</sup>

Starting with the due process argument, the Second Circuit determined that Chubb did not receive constitutionally sufficient notice of the 1986 Orders. The Second Circuit stated that “there can be little doubt that the publication notice employed by the bankruptcy court in 1984 was insufficient to bind Chubb to the 2004 interpretation of the 1986 Orders.”<sup>38</sup> The Second

Circuit did not believe that the language used in the August 2, 1984 Notice would have caused a recipient “to predict that the bankruptcy court would exceed its *in rem* jurisdiction in entering the 1986 Orders” “in order to comprehend that the contemplated channeling injunction would bar Chubb’s *in personam*, non-derivative claims against Travelers.”<sup>39</sup> The Second Circuit was persuaded by the June 3, 1985 amendment to the Insurance Settlement Agreement in finding that Chubb was not an interested party in the Johns-Manville case and did not receive notice of the 1986 Orders.<sup>40</sup> Specifically, Chubb “could not have anticipated from the way the proceedings unfolded that its contribution and indemnity claims—which were abstract, ‘unimaginable,’ and inchoate at the time—would be enjoined.”<sup>41</sup>

In addition, the Second Circuit found that Chubb was not represented in the 1986 proceedings. The Future Claimants Representative represented “‘persons who have been exposed to’ Manville’s asbestos products and who may subsequently ‘manifest disease post-petition.’”<sup>42</sup> The court observed that “Chubb does not fall within that category, and its interests relating to inchoate, non-derivative, post-petition claims against Travelers were not spoken for in those proceedings.”<sup>43</sup> Moreover, the Second Circuit determined that the participants in the 1986 proceedings had divergent interests from those of Chubb, and thus Chubb was not adequately represented in those proceedings.<sup>44</sup>

Finally, the Second Circuit rejected the due process analysis of both the bankruptcy and the district courts. The Second Circuit found that: (1) the bankruptcy court improperly assumed that Chubb was bound by the 1986 Orders;<sup>45</sup> and (2) the district court’s reliance on *MacArthur* was misplaced because, unlike the third party in *MacArthur*, “Chubb was not a party to the 1986 proceedings[,]... there is no indication in the record of a privity relationship between Chubb and any of the actual parties.”<sup>46</sup> Further, the court stated that “Chubb asserts that it received *no notice at all* of the 1986 Orders or the pre-confirmation fairness hearings relating to the 1984 Insurance Settlement Agreement.”<sup>47</sup>

Having found that Chubb was deprived of due process, the Second Circuit went further to hold that Chubb was permitted to collaterally attack the 1986 Orders on subject matter jurisdictional grounds. To get there, the Second Circuit interpreted the Supreme Court’s decision in *Bailey* narrowly: “[t]he *Bailey* Court did not contradict the conclusion of our jurisdictional inquiry.”<sup>48</sup> The Second Circuit then upheld, as to Chubb, its prior ruling that the bankruptcy court:

lacked subject matter jurisdiction to enjoin such claims against non-debtor Travelers in Manville’s Chapter 11 proceedings. “[A] bankruptcy court only has jurisdiction to enjoin third-party non-debtor claims that directly affect the *res* of the bankruptcy estate.”<sup>49</sup>

Accordingly, the Second Circuit concluded that Chubb was not bound by the 1986 Orders.<sup>50</sup>

## Observations

Twenty-five years following the bankruptcy court’s entry of the 1986 Orders, the Second Circuit has now concluded that the August 2, 1984 Notice was insufficient as to Chubb. Interestingly, neither before nor after remand from the Supreme Court was a hearing held at which parties could present evidence as to what Chubb knew or should have known in 1986. Fundamentally, the Second Circuit’s decision on remand appears to be in conflict with the Supreme Court’s determinations that the Third-Party Actions are Policy Claims “enjoined as against Travelers by the language of the 1986 Orders,”<sup>51</sup> and that the “detailed findings of the Bankruptcy Court place the [Third Party] Actions within the terms of the 1986 Orders without pushing the limits.”<sup>52</sup> Indeed, the *Chubb* decision contradicts the Second Circuit’s own decision in 1988 that recognized that “all... interested parties were provided with notice and a hearing before the settlements were approved by the Bankruptcy Court.”<sup>53</sup>

Arguably, publication notice that the Policy Claims were being enjoined under the 1986 Orders should have been adequate as to Chubb. The Supreme Court and the Second Circuit in its first opinion stated that the Policy Claims included the Third-Party Actions: “We begin at our point of agreement with the Second Circuit, that the Direct Actions [i.e., Third-Party Actions] are ‘Policy Claims’ enjoined as against Travelers by the language of the 1986 Orders[.]”<sup>54</sup> However, the Second Circuit in *Chubb* holds that Chubb did not receive sufficient notice of the bankruptcy court’s “interpretation” in 2004 of its own 1986 Orders. The question remains as to what language in the notice would have been adequate in 1986.

As a result of its conclusion as to due process with respect to Chubb, the Second Circuit took the opportunity to revisit its earlier decision on subject matter jurisdiction, which is equally troubling. Once it found that Chubb did not receive constitutionally sufficient notice and thus *in personam* jurisdiction was lacking as to Chubb with respect to the 1986 proceedings, the Second Circuit did not need to address subject matter jurisdiction. Further, the Supreme Court expressly

stated before remand that “[w]e think, though, that it was error for the Court of Appeals to reevaluate the Bankruptcy Court’s exercise of jurisdiction in 1986.”<sup>55</sup> Nevertheless, the Second Circuit reconsidered subject matter jurisdiction and adhered to its earlier decision that the Injunctions in the 1986 Orders exceeded the bankruptcy court’s subject matter jurisdiction.

In *Mullane*, the Supreme Court succinctly articulated the standard for providing notice: “An elementary and fundamental requirement of due process in any proceeding which is to be accorded finality is notice reasonably calculated, under all the circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity to present their objections.”<sup>56</sup> The Court also instructed that publication notice may be sufficient and appropriate.<sup>57</sup> As the *Chubb* decision exhibits, though, bankruptcy practitioners must carefully consider the specific language used in a notice, whether actual or published. The Second Circuit’s conclusion that the language in the notice given 25 years ago was not sufficient as to Chubb and that, therefore, Chubb could collaterally attack the bankruptcy court’s jurisdiction, may jeopardize a \$440 million settlement that would benefit thousands of individuals suffering from asbestos-related diseases.<sup>58</sup>

**Research References:** Norton Bankr. L. & Prac. 3d §§ 34:1 to 35:5

**West’s Key Number Digest,** Bankruptcy ☞2131

### Notes

1. *Mullane v. Central Hanover Bank & Trust Co.*, 339 U.S. 306, 70 S. Ct. 652, 94 L. Ed. 865 (1950).
2. *Johns-Manville Corp. v. Chubb Indem. Ins. Co.* (In re Johns-Manville Corp.), 600 F.3d 135 (2d Cir. 2010).
3. *Johns-Manville Corp.*, 600 F.3d at 138.
4. *Johns-Manville Corp.*, 600 F.3d at 138.
5. *Johns-Manville Corp.*, 600 F.3d at 138.
6. *Travelers Indem. Co. v. Bailey*, \_\_\_ U.S. \_\_\_, 129 S. Ct. 2195, 2199, 174 L. Ed. 2d 99 (2009). On August 14, 1984, the bankruptcy court appointed a Future Claims Representative (the “August 14, 1984 Order”) to represent “those persons who have been exposed to asbestos or asbestos products mined, manufactured or supplied by Manville pre-petition and have manifested or will manifest disease post-petition and who are not otherwise represented in these proceedings.” *Johns-Manville Corp.*, 600 F.3d at 140.
7. Throughout the appeals, “Travelers” has referred to “Travelers Casualty and Surety Company, Travelers Property Casualty Corporation, and Travelers Indemnity Company, as well as their respective affiliates, predecessors, successors, assigns, officers and directors.” *Johns-Manville Corp.*, 600 F.3d at 138 n.1.
8. The “Settling Insurers” were “The Travelers Indemnity Company on behalf of itself and each of its Affiliates, The Home Insurance Company on behalf of itself and each of its Affiliates and each Lloyd’s Syndicate and British Company.” *Johns-Manville Corp.*, 600 F.3d at 139 n.2.
9. *Johns-Manville Corp.*, 600 F.3d at 139.
10. *Johns-Manville Corp.*, 600 F.3d at 139 (alterations in original).
11. *Johns-Manville Corp.*, 600 F.3d at 139-40.
12. *Johns-Manville Corp.*, 600 F.3d at 140.
13. *Johns-Manville Corp.*, 600 F.3d at 141.
14. *Johns-Manville Corp.*, 600 F.3d at 141 (emphasis added by Second Circuit).
15. *Johns-Manville Corp.*, 600 F.3d at 141.
16. *Bailey*, 129 S. Ct. at 2199; *Johns-Manville Corp.*, 600 F.3d at 141-42.
17. *Johns-Manville Corp.*, 600 F.3d at 141-42. The Second Circuit stated that the “Confirmation Order incorporated by reference the Insurance Settlement Order.” *Johns-Manville Corp.*, 600 F.3d at 142.
18. *Johns-Manville Corp.*, 600 F.3d at 141-42.
19. *MacArthur Co. v. Johns-Manville Corp.*, 837 F.2d 89 (2d Cir. 1988), cert. denied, 488 U.S. 868, 109 S. Ct. 176, 102 L. Ed. 145 (1988).
20. *Johns-Manville Corp.*, 600 F.3d at 141-42.
21. *Johns-Manville Corp.*, 600 F.3d at 141-42.
22. *Johns-Manville Corp.*, 600 F.3d at 141-42.
23. *Johns-Manville Corp.*, 600 F.3d at 141-42.
24. *Johns-Manville Corp.*, 600 F.3d at 142-43.
25. *Johns-Manville Corp.*, 600 F.3d at 143.
26. *Johns-Manville Corp.*, 600 F.3d at 143.
27. *Johns-Manville Corp.*, 600 F.3d at 143.
28. *Johns-Manville Corp.*, 600 F.3d at 143.
29. *Johns-Manville Corp.*, 600 F.3d at 143-44.
30. In re *Johns-Manville Corp.*, 340 B.R. 49 (S.D.N.Y. 2006), vacated, 517 F.3d 52, rev’d and remanded sub nom., *Travelers Indem. Co. v. Bailey*, \_\_\_ U.S. \_\_\_, 129 S. Ct. 2195, 2199, 174 L. Ed. 2d 99 (2009).
31. *Johns-Manville Corp. v. Chubb Indem. Ins. Co.* (In re *Johns-Manville Corp.*), 517 F.3d 52 (2d Cir. 2008), rev’d and remanded sub nom., *Travelers Indem. Co. v. Bailey*, \_\_\_ U.S. \_\_\_, 129 S. Ct. 2195, 174 L. Ed. 2d 99 (2009).
32. *Johns-Manville Corp.*, 600 F.3d at 146 (quoting *Johns-Manville Corp. v. Chubb Indem. Ins. Co.* (In re *Johns-Manville Corp.*), 517 F.3d at 68).

33. Bailey, 129 S. Ct. at 2205.
34. Bailey, 129 S. Ct. at 2205 (quoting *Nevada v. United States*, 463 U.S. 110, 130, 103 S. Ct. 2906, 77 L. Ed. 2d 509 (1983) (quoting *Cromwell v. Sac County*, 94 U.S. (4 Otto) 351, 24 L. Ed. 195 (1876))).
35. Bailey, 129 S. Ct. at 2207.
36. Bailey, 129 S. Ct. at 2207.
37. *Johns-Manville Corp.*, 600 F.3d at 158.
38. *Johns-Manville Corp.*, 600 F.3d at 157 (emphasis added).
39. *Johns-Manville Corp.*, 600 F.3d at 157.
40. *Johns-Manville Corp.*, 600 F.3d at 158.
41. *Johns-Manville Corp.*, 600 F.3d at 158.
42. *Johns-Manville Corp.*, 600 F.3d at 156 (quoting August 14, 1984 Order).
43. *Johns-Manville Corp.*, 600 F.3d at 156.
44. *Johns-Manville Corp.*, 600 F.3d at 156-57.
45. *Johns-Manville Corp.*, 600 F.3d at 149.
46. *Johns-Manville Corp.*, 600 F.3d at 150.
47. *Johns-Manville Corp.*, 600 F.3d at 151 (emphasis added).
48. *Johns-Manville Corp.*, 600 F.3d at 152.
49. *Johns-Manville Corp.*, 600 F.3d at 152.
50. *Johns-Manville Corp.*, 600 F.3d at 158.
51. Bailey, 129 S. Ct. at 2203.
52. Bailey, 129 S. Ct. at 2204.
53. *MacArthur*, 837 F.2d at 94.
54. Bailey, 129 S. Ct. at 2203.
55. Bailey, 129 S. Ct. at 2205.
56. *Mullane*, 339 U.S. at 314.
57. *Mullane*, 339 U.S. at 314-16.
58. At the time of writing this article, Travelers had filed a Petition for Rehearing and/or Rehearing En Banc with the Second Circuit. As such, the *Johns-Manville* saga, which has spanned nearly thirty years and generated significant case law as well as § 524(g) of the Bankruptcy Code, continues.

## THE NUTS, BOLTS, CARROTS, AND STICKS OF THE MORTGAGE AND FORECLOSURE CRISIS; AND A SUGGESTED SOLUTION\*

Lauren Hassouni

### INTRODUCTION

“By any measure, voluntary efforts to restructure unsustainable home loans fall far short of the continuing flood of foreclosures. Because of the negative spillover effects, out-of-control foreclosures ultimately affect *everyone*. Until we stop the epidemic, the economy can’t recover. It’s that simple.”<sup>1</sup>

The U.S. is struggling to exit the worst recession since the early 1980s,<sup>2</sup> caused in large part by a housing crisis<sup>3</sup> of such proportions that, according to one estimate, 16% of all mortgages, or 8.1 million homes, will be in foreclosure by the end of 2012.<sup>4</sup> Foreclosures of that magnitude, if allowed to proceed without intervention, will impose significant economic and social costs on the economy and on the American family.<sup>5</sup>

The foreclosure problem is complex and resistant to a simple solution. Various measures proposed and implemented by the Bush and Obama administrations to forestall the crisis can be classified as either “carrots”—rewards-based methods such as incentivized loan modifications—or “sticks”—punishment-driven methods such as legislation permitting bankruptcy judges to modify mortgages. An effective solution set will ultimately find the proper balance between carrots and sticks.

This article examines the different plans that have been implemented to address the crisis and concludes that the solution to the housing crisis must incorporate both voluntary measures backed by incentives *and* mandatory measures that will motivate voluntary action and provide an effective result on their own when the voluntary measures fail to achieve the necessary result. The programs currently in effect that provide monetary incentives to lenders for loan modifications have been largely unsuccessful and will continue to fail to halt the flood of foreclosures unless Congress enacts a meaningful backstop: the modification of home mortgages through an amendment to Bankruptcy Code § 1322(b)(2).