Chapter 13 Cramdowns

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Overview of Lien Stripping in Chapter 7

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[1] The opinions expressed in this article are solely that of the author and should not be construed as the opinion of SunTrust Bank or any parents or affiliates thereof.

I. Bifurcating Claims and Stripping Down Liens

a. Sections 506(a) and 506(d)

In 1992, the Supreme Court addressed the issue of stripping down or bifurcating the lien of a Chapter 7 debtor when the collateral's value was less than the amount owed on the note secured by real property.[2] In *Dewsnup*, the chapter 7 debtor sought to have the lien securing her $120,000 debt reduced to $39,000 which was the fair market value of the property.[3] She argued that the interrelationship between section 506(a) (claim valuing) and section 506(d) (lien voiding) dictated that result.[4]

The Supreme Court, however, found ambiguity in the text of the provision and held that section 506(d) does not allow a strip down of the lien because claim is fully allowed under section 502 and happens to be also secured by a lien.[5] Accordingly, section 506(a) examines "allowed secured claim" with regard to claim valuation for distribution (allowing bifurcation) while section 506(d) examines "allowed secured claim" with regard to avoidance of any lien on a disallowed claim.[6] The Court stated that despite the sensible interpretation that "allowed secured claim" means the same thing in section 506(a) as in 506(d), lien avoidance under a strict plain language statutory interpretation would depart from Congressional intent that liens were meant to pass through bankruptcy unaffected.[7] The Court relied on a century long history of liens surviving bankruptcy, except under certain reorganization conditions.[8] Further, the Court relied on Congress's failure to change language to support voiding liens in liquidation when it had

[2] *Dewsnup v. Timm*, 502 U.S. 410 (1992).
[3] *Id*. at 413.
[4] *Id*.
[5] *Id*. at 417.
[6] *See, id*.
[7] *Id*.
[8] *Id*. at 418-19.

opportunities to do just that.[9] Reconciling the ambiguity identified by the Court, a determination that a portion of the claim is unsecured under section 506(a) does not result in avoidance of the lien.

b. Sections 506(a) and 1322(b)(2)

The Supreme Court was not easily done with stripping down liens using section 506(a). In 1993, the Court considered a debtor's request to strip down the lien to current market value, this time under the provisions of Chapter 13, which unlike Chapter 7, allows modification to secured claims in certain instances.[10] In *Nobelman*, a Chapter 13 debtor proposed a plan to value the secured claim under section 506(a) but stated the valuation was not a modification and therefore not subject to the anti-modification provisions of 1322(b)(2).[11] The debtor argued that the protections of section 1322(b)(2) apply only to the extent the claim is "secured", which is determined first by section 506(a).[12]

While correct to look to section 506(a) to determine the status of the claim, the Court held that section 1322(b)(2) focuses on the rights of the lien holders, not just the status of the claims.[13] These "rights" are not defined in the bankruptcy code and therefore are determined by state law.[14] The rights of a lien holder are not limited to the value of the claim secured by the lien, but also include rights to repayment and the right to retain the lien until paid, and the right

[9] *Id*. at 419.
[10] *Nobelman v. Am. Sav. Bank*, 508 U.S. 324 (1993).
[11] *Id*. at 327-28.
[12] *Id*.
[13] *Id*. at 328. The Court stated "[b]ut even if we accept petitioner's valuation, the bank is still the 'holder' of a 'secured claim,' because petitioners' home retains $23,500 of value as collateral." *Id*. at 329. This analysis of section 506(a) becomes a foundation for cases that follow finding that a wholly unsecured lien may be stripped by section 1322(b)(2).
[14] *Id*. at 329.

to sell at foreclosure.[15] These rights cannot be modified under section 1322(b)(2), even when the value of the collateral securing the debt is less than the total amount of the debt.

II. Stripping Off Liens with No Current Value

a. Sections 506(a) and 1322(b)(2)

Left untouched by the Court was the determination whether a Chapter 13 debtor could modify the rights of a junior lien creditor when there was no value to support the collateral (stripping off wholly unsecured liens). The majority of courts have answered this question in the affirmative, holding that a Chapter 13 debtor may strip off wholly unsecured junior mortgage liens.[16] The majority of courts reasoned that *Nobleman* stood for the proposition that there must be some value to the lien under section 506(a) for entitlement to protection under section 1322(b)(2), since this provision protects only secured claims, even if only partially secured.[17] Accordingly, under Chapter 13, the anti-modification exception protects a mortgage creditor's rights only when it has a secured claim, which means a value more than zero under section 506(a).[18]

b. Sections 506(a) and 506(d)

i. Disallowed Strip Off in Chapter 7 (4th Circuit, 6th Circuit, 7th Circuit)

Naturally, if a differentiation is made between partially secured claims and wholly unsecured claims with regard to lien avoidance in Chapter 13, it is no surprise that debtors and creditors once again began hotly debating the interplay (or lack thereof) between the various

[15] *Id*. at 328-329 (stating these are the rights "bargained for by the mortgagor and the mortgagee" in *Dewsnup*, 502 U.S. 410, 417).
[16] *See, e.g.*, *Pond v. Farm Specialist Realty (In re Pond)*, 252 F.3d 122 (2d Cir. 2001); *McDonald v. Master Fin., Inc. (In re McDonald)*, 205 F.3d 606 (3d Cir. 2000); *In re Bartee*, 212 F.3d 277 (5th Cir. 2000); *In re Lane*, 280 F.3d 663 (6th Cir. 2002); *Zimmer v. PSB Lending Corp.*, 313 F.3d 1220 (9th Cir. 2002); and In re *Tanner*, 217 F.3d 1357 (11th Cir. 2000).
[17] *See e.g. Pond*, 252 F.3d at 125.
[18] *See, id*.

subsections of 506. In 2001, two Maryland Chapter 7 debtors sought to strip off a junior mortgage lien as wholly unsecured, contending *Dewsnup* only applies to an attempt to strip down a lien to a lower value.[19] The court found the reasoning in *Dewsnup* applicable to a strip off as well as a strip down – namely the history of a lien passing through bankruptcy and the lien as a bargained for right between the parties.[20] The Sixth Circuit soon followed with reasoning along similar threads and referencing *Dewsnup*, but also acknowledged how the issue remains unsettled:

> As in the case of a "strip down," to permit a "strip off" would mark a departure from the pre-Code rule that real property liens emerge from bankruptcy unaffected. Also, as in the case of a "strip down," a "strip off" would rob the mortgagee of the bargain it struck with the mortgagor, i.e., that the consensual lien would remain with the property until foreclosure. . . . [N]otwithstanding the dissatisfaction of some, we are not at liberty to ignore the Supreme Court's reasoning, which Congress has made no apparent attempt to modify or correct through legislative action.[21]

Ten years later, the Seventh Circuit also applied *Dewsnup* to wholly unsecured liens in Chapter 7.[22] Judge Posner begins his analysis of section 506 with the overarching principle that liens pass through bankruptcy unaffected "provided that it's a valid lien and secures a valid claim ('an allowed secured claim')."[23] Using prior Seventh Circuit precedent, the court explains that a lien holder in Chapter 7 has a spectrum of options:

> The holder of such claim can if he wants ignore the bankruptcy proceeding and enforce his claim by foreclosing the lien. But alternatively he can file the claim in the bankruptcy proceeding, which will be an unsecured claim to the extent that it exceeds the value of the collateral. The upside of this way of proceeding is that if the claim exceeds that value, yet the debtor has assets sufficient to enable the excess at least or a portion of it to be paid in satisfaction of an unsecured claim, the creditor will be better off than by foreclosing his lien. The downside is that

[19] *Ryan v. Homecomings Financial Network*, 253 F.3d 778, 781 (4th Cir. 2001).
[20] *Id*. at 782 (citing *Dewsnup*, 502 U.S. at 417-418).
[21] *In re Talbert*, 344 F.3d 555, 561 (6th Cir. 2003).
[22] *Palomar v. First American Bank*, 722 F.3d 992 (7th Cir. 2013).
[23] *Id*. at 993.

> the claim may be disallowed, in which event the lien will be avoided; for all a lien is is security, so if there is nothing to secure, the lien is down the drain.[24]

Then taking into consideration the prior Circuit cases on this issue, "the only lien voided by section 506(d) in whole or part is one securing a claim rejected in whole or part by the bankruptcy court. . ."[25] To get the lien strip relief the debtors seek, they must file Chapter 13, and the strip off comes with a trade-off – lien avoidance in exchange for access to a larger pool of assets from a three to five year repayment plan.[26]

ii. Chapter 7 Lien Strip (*In re McNeal*, 11th Circuit)

In 2012, the Eleventh Circuit took the appeal of both the bankruptcy and district court denial of a Chapter 7 debtor's motion to determine the secured status of a second lien on her home.[27] The Chapter 7 debtor and the lender agreed that the value of the home was less than the amount owed under the note secured by the first position lien, and thereby the junior lien was wholly underwater.[28] Accordingly, the debtor argued that the junior lien debt was wholly unsecured and therefore void under 506(d).[29]

It was undisputed that the junior lien was allowed under section 502 and wholly unsecured under section 506(a).[30] With that, looking at the language of section 506(d), which provides "[t]o the extent that a lien secures a claim against a debtor that is not an allowed secured claim, such lien is void," the answer presents itself.[31] The court distinguished *Dewsnup* as concerning strip down of liens and not stripping off liens, and followed its previous decision in *Folendore* as controlling. *Folendore v. United States Small Bus. Admin.*, 862 F.2d 1537 (11th

[24] *Id*. at 993-94.
[25] *Id*. at 994.
[26] *Id*. at 995.
[27] *In re McNeal*, 735 F.3d 1263 (11th Cir. 2012).
[28] *Id*. at 1264.
[29] *Id*.
[30] *Id*. at 1265.
[31] 11 U.S.C. § 506(d); *McNeal*, 735 F.3d at 1265.

Cir. 1989)(holding an allowed claim that is wholly unsecured to be voidable under section 506(d)). The court rejected the extrapolation and extension of the *Dewsnup* holding to abrogate *Folendore*.[32] In their view, the issue had been decided in 1989 and *Dewsnup* did not change that.

Since the McNeal case, it has become regular practice to strip off wholly unsecured liens in Chapter 7 in Florida, Georgia, and Alabama, a course that takes much less time to complete (months versus years) and generally allows for no recovery on the debt (as opposed to a percentage payout on a Chapter 13 claim).

iii. Supreme Court Review (*Caulkett* and *Toledo-Cardona*)

The Supreme Court granted certiorari to a pair of like cases to answer the question, in light of *Dewsnup*, whether a Chapter 7 debtor may strip off a junior mortgage where the value of the collateral is less than the amount owed to a senior lienholder.[33] The Petitioner, Bank of America, argues that there lies an inherent difference between the claim (an entitlement to a distribution from the estate) and a lien (a state law recourse against collateral).[34] Bank of America rejects the Eleventh Circuit holding that a wholly unsecured claim, which may be valued for purposes of distribution under section 506(a) also means that the claim is not an "allowed secured claim" under section 506(d) and is therefore voidable.[35] Instead, Bank of America argues that the correct interpretation is that section 506(d) only voids liens that correspond to claims that specifically have not been allowed.[36]

The question is whether an "allowed secured claim" is tied to the value of that claim rather than the validity of the claim itself. The Eleventh Circuit position suggests that if there is

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[32] *Id*. at 1265-66.
[33] Brief for Petitioner, *Bank of Amer. v. Caulkett*; *Bank of Amer. v. Toledo-Cardona*, Nos. 13-1421, 14-163, p. (i). At the time of submission of these materials, the Respondents' Brief was not yet available.
[34] Brief for Petitioner, pp. 5-7. *See also*, 11 U.S.C. §§ 101(5), 101(37), and 506(a).
[35] Brief for Petitioner, pp. 12-13.
[36] *Id*. at 13 (citing *Dewsnup*, 502 U.S. at 415,417).

no value to the collateral then no part of the claim is "secured" making the lien voidable under section 506(d) since the claim is not an "allowed secured claim."[37] Bank of America's position suggests that the legal validity of a lien exists whether or not value would be realized by *in rem* enforcement of that lien at any given point in time. "Put differently, the value of collateral securing a debt affects only the treatment of the creditor's *claim* against the chapter 7 estate. It does not affect the validity of the creditor's *lien*."[38]

Chapter 7 Respondents agree that under section 506(a), the claims of underwater junior liens are wholly unsecured.[39] The debtors then construe section 506(d) as the next logical question – what happens to liens backing undisputed unsecured claims?[40] In other words, an unsecured claim is not an "allowed secured claim" and therefore any lien backing this unsecured claim is void.[41] The debtors distinguish the current cases from the Dewsnup holding by stating that Dewsnup simply held that a partially secured claim is an "allowed secured claim" and thus not voidable under section 506(d).[42]

The debtors are not alone in this view. In July 2014, Professor Lawrence Ponoroff presented a paper arguing just this.[43] He argues that bankruptcy is a complete adjusted treatment of a debtor's pre-petition life, realigned pursuant to the bankruptcy code.[44] A creditor may be secured with a valid lien under state law, but the meaning of how a creditor emerges from

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[37] *Folendore*, 862 F.2d at 1538-39.
[38] Brief of Petitioner, p. 13 (emphasis in original).
[39] *Bank of America, N.A. v. Caulkett*, No. 13-1421, Brief in Opposition to Petition for Writ of Certiorari, p. 11 (note that at the time of materials submission, Respondents' Brief was not yet available).
[40] *Id*.
[41] *Id*. *See*, 11 U.S.C. § 506(d). See also, *Dewsnup*, 502 U.S. 410, 420 (Justice Scalia dissenting from the majority and rejecting that the phrase "allowed secured claim" is ambiguous. "[T]he Court replaces what Congress said with what it thinks Congress ought to have said – and in the process disregards, and hence impairs for future use, well-established principles of statutory construction.").
[42] *Id*.
[43] Professor Ponoroff is the Samuel M. Fetgly Chair in Commercial Law, The University of Arizona James E. Rogers College of Law. His paper, *Hey, the Sun is Hot and the Water is Fine: Why Not Strip Off that Lien?*, 30 Emory Bankr. Dev. J. 13 (2013) was presented at the Consumer Bankruptcy Panel: Strip Off in Chapter 7: The Limits of *Dewsnup* at the Emory Bankruptcy Developments Journal's 11th Annual Symposium.
[44] *Id*.

bankruptcy is entirely dictated by the bankruptcy code and in particular section 506(a). A creditor is therefore only secured to the extent of the value of the collateral while 506(d) dictates that the lien is voidable. The debtor is provided a fresh start, unencumbered by valueless liens.[45]

Lender trade associations have also made their positions known, filing Amici Curiae briefs in support of Bank of America.[46] These trade associations have advanced the commercial reasons to overturn the Eleventh Circuit, focusing on the bargained for contract between a mortgagor and mortgagee and the fact that the dissolution of lien holder rights is governed by state law, generally discharged by either foreclosure or repayment.[47] To underline the point of the business expectation of this protection, the lending associations detail the over 150 year history of bankruptcy decisions that defer to state law in determining lien rights.[48] This focus is more detailed but similar in purpose to the Court's reasoning in *Dewsnup*. The question is not only one of statutory interpretation but one of business expectation – while the debtors argue that home equity loans and in particular the loss of value is a phenomenon only of recent decades, Bank of America and these lending associations argue that lien avoidance based on snapshot valuations without the protections provided for, assumed, and relied upon in the long history of bankruptcy in this country would be a seismic shift.

Oral arguments are set for March 24, 2015 with a ruling expected in June. The outcome of the case could have wide effect on the lending industry and the practice of bankruptcy.

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[45] *Generally, id*. At the conference, Prof. Ponoroff stated "In other words, bankruptcy recognizes but does not hold sacrosanct every aspect of the creditor's state law bargain. What's constitutionally protected is the value of the lien. That's why we don't protect the equity cushion, and that's why we don't compensate lost opportunity costs."

[46] The filing parties are Loan Syndications and Trading Association, American Bankers Association, Securities Industry and Financial Markets Association, The Clearing House Association L.L.C. and Community Bankers Association of Illinois.

[47] Brief of Loan Syndications and Trading Association, American Bankers Association, Securities Industry and Financial Markets Association, and The Clearing House Association L.L.C. as Amici Curiae in Support of Petitioner, p. 9.

[48] *See generally, id*.

Whatever the ruling, it will likely have a profound effect on pre-filing strategy including chapter choice.

Chapter 13 Lien Stripping
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Chapter 13 Lien Stripping

1. Overview

Under general bankruptcy principles as set forth in § 506 of the Code, an undersecured claim may be bifurcated into its secured and unsecured portions. The creditor's secured claim is therefore limited to the value of the collateral.[1] To the extent that the claim exceeds the value of the collateral, it is unsecured and may be treated less favorably. Section 1322(b)(2) of the Code permits this modification of secured claims in chapter 13. However, an exception to the general modification rule applies to claims "secured ***only*** by a security interest in ***real property*** that ***is*** the debtor's principal residence."[2]

Significantly, the protection against modification afforded to home mortgage lenders is not unlimited. In each of the following situations, a home-secured loan may be modified:

- If senior liens on the property exceed the value of the home, then a junior lien creditor whose lien effectively is "underwater" can be treated as a wholly unsecured claim in chapter 13. The creditor's security interest is rendered void and "stripped off." The circuit courts have unanimously held that this form of lien modification is not barred by the Supreme Court decision in *Nobleman*,[3] and no attempt was made by the 2005 Act to overrule these cases.

- If the claim is not secured ***"only"*** by the debtor's home, such as when additional security is provided, the mortgage may be modified or "stripped down." The 2005

[1] To satisfy the "present value" requirement of § 1325(a)(5)(B)(ii), interest generally must be paid on the secured portion of the bifurcated claim. This may present an opportunity to significantly reduce the interest paid on a high cost loan. The Supreme Court in *Till v. SCS Credit Corp.*, 124 S. Ct. 1951 (2004), held that a formula method is to be used for calculating the interest required, with the prime rate of interest as the starting point, adjusted by a factor for risk. *See* National Consumer Law Center, Consumer Bankruptcy Law and Practice § 11.6.1.3.3.6 (8th ed. 2007).

[2] 11 U.S.C. § 1322(b)(2). *See Nobleman v. Am. Savings Bank*, 508 U.S. 324 (1993).

[3] See In re Schmidt, *In re Zimmer*, 313 F.3d 1220 (9th Cir. 2002); *In re Lane*, 280 F.3d 663 (6th Cir. 2002); *In re Tanner*, 217 F.3d 1357 (11th Cir. 2000); *In re Bartee*, 212 F.3d 277 (5th Cir. 2000); *In re McDonald*, 205 F.3d 606 (3d Cir. 2000). *See also In re Mann*, 249 B.R. 831 (B.A.P. 1st Cir. 2000); *In re Lam*, 211 B.R. 36 (B.A.P. 9th Cir. 1997).

Act attempts to limit modification on these grounds by adding a definition of "debtor's principal residence" in § 101 of the Code, which is defined as "a residential structure, including incidental property. . . ." [4] A definition of "incidental property" is also added by the 2005 Act, which refers to property rights going beyond the ownership of the structure, and includes rights to "property commonly conveyed with a principal residence in the area where the property is located, easements, rights, appurtenances, fixtures, rents, royalties, mineral rights, oil or gas rights, profits, water rights, escrow funds, or insurance proceeds," as well as all replacements or additions.[5] Courts had differed prior to the 2005 Act regarding whether some of the rights enumerated in the new definition of "incidental property" were additional collateral which removed a secured claim from the protection against modification in § 1322(b)(2).[6] The specificity in the new definition of "incidental property" clarifies that security interests in types of property not enumerated, such as appliances, furniture, bank accounts, motor vehicles, or property of entities other than the debtor, will permit the mortgage loan to be modified. [7] An additional security interest in any type of property not commonly conveyed with a principal residence in the area where the property is located should permit modification. However, the new definition of incidental property will overrule decisions permitting modification based on additional security in rents and profits from the property[8] and mortgage escrow accounts.,[9] at least to the extent that this incidental property is treated as real property under state law.

- If the claim is not secured by real property that ***"is"*** the debtor's principal residence, the mortgage may be modified. The 2005 Act does not overrule decisions which had permitted modification if the security interest includes other real estate or rental units, such as multi-family homes.[10]

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[4] 11 U.S.C. § 101(13A)(A).
[5] 11 U.S.C. § 101(27B). The purpose of this amendment appears to be to further define "debtor's principal residence," which is used in § 1322(b)(2).
[6] *See* National Consumer Law Center, Consumer Bankruptcy Law and Practice § 11.6.1.2.2 (8th ed. 2007).
[7] *E.g., Sapos v. Provident Inst. of Savings*, 967 F.2d 918 (3d Cir. 1992) (wall-to-wall carpeting additional security); *In re Libby*, 200 B.R. 562 (Bankr. D.N.J. 1996) (mortgage included additional security in debtor's account at the creditor bank); *In re Escue*, 184 B.R. 287 (Bankr. M.D. Tenn.1995) ("refrigerator, space heater, and similar items" additional security even though described as "fixtures" in mortgage documents); *In re Bouvier*, 160 B.R. 24 (Bankr. D.R.I. 1993) (claim secured not only by mortgage but also by personal property of debtors' corporation).
[8] *In re Heckman*, 165 B.R. 16 (Bankr. E.D. Pa.1994) ("rents of the premises" are additional collateral); *In re DeCosta*, 204 B.R. 1 (Bankr. D. Mass.1996).
[9] *In re Donadio*, 269 B.R. 336 (Bankr. M.D. Pa. 2001) (security interest also covered escrow account for taxes and insurance); *In re Stewart*, 263 B.R. 728 (Bankr. W.D. Pa. 2001).
[10] *Lomas Mortgage, Inc., v. Louis*, 82 F.3d 1 (1st. Cir. 1996) (holder of mortgage on three-unit building that included debtor's residence not protected from modification); *In re McGregor*, 172 B.R. 718 (Bankr. D. Mass. 1994) (bifurcation permitted on four-unit

- If the claim is not secured by a security interest in ***"real property"*** that is the debtor's principal residence, then the secured loan may be modified. Before the 2005 Act, it was clear that a lien secured by real estate upon which a manufactured or mobile home was situated was not secured solely by real property that was the debtor's principal residence if the mobile home did not constitute real property under applicable nonbankruptcy law.[11] The new definitions added by the 2005 Act may have been intended to protect mobile home lenders, by defining "debtor's principal residence" to mean a residential structure, without regard to whether it is attached to real property.[12] However, the new definition does not appear to alter the treatment of mobile homes, because no change was made to § 1322(b)(2). While a mobile home may be the debtor's principal residence under the definition, it would still be personal property under applicable nonbankruptcy law and therefore the debt would not be secured "only by a security interest in real property" that is the debtor's principal residence.[13] Only if a mobile home or cooperative is real property under applicable nonbankruptcy law would the limitations on modification apply, even though the mobile home or cooperative is considered the debtor's principal residence.[14]

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building where debtor uses one unit as residence); *In re McVay*, 150 B.R. 254 (Bankr. D. Or. 1993) (security interest in property used as "bed and breakfast" not secured solely by debtor's residence).

[11] *E.g.*, *In re Thompson*, 217 B.R. 375 (B.A.P. 2d Cir. 1998) (mobile home is personalty under New York law); *see also* National Consumer Law Center, Consumer Bankruptcy Law and Practice § 11.6.1.2.4 (8th ed. 2007).

[12] 11 U.S.C. § 101(13A). It includes an individual condominium or cooperative unit, as well as a mobile or manufactured home, or a trailer.

[13] 11 U.S.C. § 1322(b)(2). *See In re Coleman*, 2008 WL 3891480 (B.A.P. 8th Cir. Aug 25, 2008); *Kinder v. Vanderbilt Mortg. and Finance*, 2008 WL 2230694 (S.D.Ohio May 28, 2008)(remanded to determine whether mobile home qualified as real property under Ohio law); *In re Davis*, 386 B.R. 182 (B.A.P. 6th Cir. 2008)(manufactured home which is not real property under state law is not subject to § 1322(b)(2) protection); *In re Shepherd*, 381 B.R. 675 (E.D.Tenn. 2008); *Moss v. GreenTree-Al, LLC*, 378 B.R. 655 (S.D.Ala. 2007); *In re Gearheart*, 2007 WL 4463342 (Bankr.E.D.Ky. Dec 14, 2007); *In re Fuller*, 2007 WL 3244113 (Bankr.M.D.N.C. Nov 02, 2007); *In re Oliviera*, 2007 WL 3001654 (Bankr.E.D.Tex. Oct. 11, 2007); *In re Bartolome*, 2007 WL 2774467 (Bankr.M.D.Ala. Sept. 21, 2007); *In re Manning*, 2007 WL 2220454 (Bankr.N.D.Ala. Aug. 2, 2007); *In re McLain*, 376 B.R. 492 (Bankr.D.S.C. 2007); *In re Cox*, 2007 WL 1888186 (Bankr.S.D. Tex. June 29, 2007). *But see In re Lunger*, 370 B.R. 649 (Bankr.M.D.Pa. 2007).

[14] The 2005 Act also attempts to limit cramdown rights by adding language at the end of § 1325(a) that removes certain claims based on purchase money security interests from the provisions of § 1325(a)(5). However, the first type of purchase money security interest covered by this new language is for a debt incurred within 910 days preceding the filing of the petition, if the collateral consists of a motor vehicle, as defined in 49 U.S.C. § 30102. This language would not include a mobile home, because a mobile home does

- If a mortgage has a final payment that comes due during the pendency of a chapter 13 plan, it may be modified.[15] This can be helpful in dealing with short-term, high-cost mortgages, particularly those having balloon payment obligations.

2. Timing for Determining Debtor's Principal Residence

If a creditor's mortgage claim is not secured by a security interest in real property that is the debtor's principal residence, the anti-modification provision in § 1322(b)(2) does not apply and the mortgage may be stripped down.[16] In cases in which there has been a change in the use of the property, the question may arise as to what should be the applicable time period for determining whether the property is the debtor's principal residence. For example, if the debtor moves to another state for employment purposes, and rents the home that formerly had been the debtor's residence, does the anti-modification provision apply to the mortgage on the home in a subsequent chapter 13 case filed by the debtor?

Some courts have held that the relevant period should be the time when the mortgage transaction was entered into.[17] By considering the use of the collateral at the time of the loan transaction, or the intent of the parties in entering into the transaction, courts that favor this approach believe it is more consistent with the policy objectives of the anti-modification provision. These courts also contend that the transaction date avoids potential gamesmanship, such as a debtor who might rent a garage on the property just before filing in order to avoid the anti-modification provision.

According to the Ninth Circuit BAP, however, the better view and majority position is that the use of the property on the date of the petition should control.[18] Courts

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not fit within the referenced definition. The second type of claim encompassed by this new language is a purchase money security interest for a debt incurred within one year preceding the filing of the petition, if the collateral consists of any other thing of value. This could potentially apply to a mobile home, but the new language does not limit the debtor's right to cure a default on a purchase money mortgage under § 1322(b)(3) and § 1322(b)(5), or to otherwise modify a mortgage under § 1322(b)(2) to the extent that the limitation in that subsection for home secured loans is not applicable. *See* National Consumer Law Center, Consumer Bankruptcy Law and Practice § 11.6.1.2.4 (8th ed. 2007).

[15] 11 U.S.C. § 1322(c)(2); *see also Am. Gen. Fin. v. Paschen (In re Paschen)*, 296 F.3d 1203 (11th Cir. 2002).

[16] *See* NCLC *Consumer Bankruptcy Law & Practice*, § 11.6.1.2.2.5 (10th edit. 2012).

[17] *In re* Scarborough, 461 F.3d 406 (3d Cir. 2006); *In re* Moore, 441 B.R. 732 (Bankr. N.D. N.Y. 2010).

[18] *In re* Benafel, 461 B.R. 581, 589 (B.A.P. 9th Cir. 2011) ("we find that the majority of cases interpreting § 1322(b)(2) favor use of the petition date to determine principal residence"). *See also In re* Christopherson, 446 B.R. 831, 835 (Bankr. N.D. Ohio

adopting this position in part rely upon the statutory phrase "that is" in section 1322(b)(2), which is cast in the present tense. That argument may have been bolstered by a 2010 technical amendment to the Bankruptcy Code, which added to the definition of "debtor's principal residence" the requirement that the structure be "used as the principal residence by the debtor." This reference to the present use of the property by the debtor supports the petition date rather than the loan transaction date as the relevant time period.[19]

3. Date of Valuation

Section 506(a) states that "value shall be determined in light of the purpose of the valuation and of the proposed use or disposition of such property ...." Because this language does not explicitly set a valuation date, courts are divided on this issue. Some courts make this determination for lien strip-off purposes based on the value of the property at the time of the bankruptcy filing.[20] These courts conclude that the petition date is appropriate because debtors typically have used the property as their principal residence throughout the bankruptcy case beginning with the petition date.

Other courts use the effective date of the chapter 13 plan as the valuation date, which is usually the date of the confirmation hearing (or 14 days after entry of the confirmation order), unless the plan states otherwise.[21] These courts find that because the valuation is being done in the context of determining the amount of the creditor's allowed secured claim for purposes of plan confirmation, the appropriate date of valuation should be the confirmation hearing.

Finally, because § 506(a) does not refer to the "effective date of the plan," and based on legislative history for the provision, some courts have adopted a "flexible approach to valuations, rather than a single, fixed method."[22]

Depending upon whether the real estate market is declining or improving, there may be an advantage for debtors to argue for an earlier or later valuation date.

2011); *In re* Jordan, 330 B.R. 857, 860 (Bankr. M.D. Ga. 2005); *In re* Leigh, 307 B.R. 324, 331 (Bankr. D. Mass. 2004); *In re* Bosch, 287 B.R. 222, 226 (Bankr. E.D. Mo. 2002); *In re* Schultz, 2001 WL 1757060 (Bankr. D. N.H. 2001); *In re* Larios, 259 B.R. 675 (Bankr. N.D. Ill. 2001); *In re* Churchill, 150 B.R. 288 (Bankr. D. Maine 1993); *In re* Dinsmore, 141 B.R. 499 (Bankr. W.D. Mich.1992).

[19] *See* 8 Collier on Bankruptcy, § 1322.06[1][a] (Alan N. Resnick & Henry J. Sommer, eds., 16th ed. 2011).

[20] *In re* Vallejo, 2010 WL 520698 (Bankr. N.D. Cal. Feb. 9, 2010); *In re* Dean, 319 B.R. 474 (Bankr. E.D. Va. 2004). *See also In re* Wade, 354 B.R. 876 (Bankr. N.D. Iowa 2006).

[21] *In re* Roach, 2010 WL 234959 (Bankr. W.D. Mo. Jan. 15, 2010); *In re* Crain, 243 B.R. 75 (Bankr. C.D. Cal. 1999).

[22] *In re* Aubain, 296 B.R. 624, 636 (Bankr. E.D.N.Y. 2003).

5. Application in No Discharge "Chapter 20" Cases

The most controversial issue dividing the courts at present is whether the debtor may strip off a mortgage in a no-discharge chapter 13 case. Due to Code amendments made in 2005, a debtor may not receive a discharge if the debtor received a discharge in an earlier chapter 7 case filed within the four-year period before the current chapter 13 case (a so-called "chapter 20" case), or if the debtor received a discharge in a chapter 13 case filed during the two-year period before the current chapter 13 case.[23] Courts generally are in agreement that the inability to receive a discharge does not make a debtor ineligible for chapter 13 relief.[24] Moreover, the Supreme Court decision in *Johnson v. Home Bank*[25] makes clear that a mortgage creditor has a claim against the debtor's property in a chapter 13 case even though the debtor's personal obligation on the mortgage loan has been discharged in an earlier chapter 7 case.

The controversy lies to some extent in the method used to achieve a lien strip off in a chapter 13 case. In fact, the outcome in no-discharge cases may depend upon how the debtor argues the basis for the strip off. By arguing that the lien is voided under section 506(d), debtors invite the response that a chapter 20 is being used to circumvent the decision in *Dewsnup v. Timm*,[26] which prohibits application of section 506(d) in chapter 7 cases. Some courts have been persuaded by this view and have found chapter 20 filings made for strip off purposes to be improper.[27] They conclude that section 506(d) alone cannot be used to strip a lien,[28] or that the only way to make a strip off under section 506(d) "permanent" is to obtain a discharge.[29] These courts generally equate a chapter 20 filing with a case conversion, and rely upon Congressional intent expressed in section 348(f)(1)(C)(I).[30] Despite the creditor's lack of an allowed secured claim based on section 506(a), another reason often stated is that section

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[23] 11 U.S.C. § 1328(f).

[24] *E.g., In re* Bateman, 515 F.3d 272 (4th Cir. 2008).

[25] 501 U.S. 78 (1991).

[26] 502 U.S. 410 (1992).

[27] *In re* Mendoza, 2010 WL 736834 (Bankr. D.Colo. Jan 21, 2010); *In re* Blosser, 2009 WL 1064455 (Bankr. E.D. Wis. Apr. 15, 2009); *In re* Jarvis, 390 B.R. 600 (Bankr. C.D. Ill. 2008).

[28] *In re* Gerardin, 447 B.R. 342 (Bankr. S.D. Fla. 2011).

[29] *In re* Victorio, 454 B.R. 759 (Bankr.S.D. Cal. 2011), *aff'd*, 470 B.R. 545 (S.D. Cal. 2012).

[30] *Id*.

1325(a)(5)(B)(II) prohibits lien stripping in no-discharge cases.[31] Even if this provision were applicable, one court has noted that its plain language makes lien strip off permanent based on plan completion, not on a discharge.[32]

However, a growing consensus among the appellate courts finds that a debtor may strip off a wholly unsecured junior lien in a chapter 13 case that follows a chapter 7 bankruptcy, even though the debtor is not eligible for a discharge.[33] In these cases, debtors typically argue that section 1322(b)(2) alone or in combination with section 1327(c) provides the authority for lien stripping. In these cases, courts have held that the discharge entered under section 1328(a) deals only with the debtor's personal liability and has nothing to do with lien avoidance. Rather, it is plan completion that voids the lien. They reason further that the language added by BAPCPA in section 1328(f) to preclude a discharge in certain cases makes no mention of lien avoidance, no other provision in the Code makes lien stripping dependent upon receipt of a discharge, and section 1325(a)(5)(B)(II) is simply not applicable.[34] As one court has stated, it is not a discharge but rather "completion of the plan and performance under the new contract created under the Bankruptcy Code which result in the debtors having the right to demand and receive the release of the lien."[35]

Moreover, the availability of no-discharge lien stripping, in courts that permit it, is no guarantee that the debtor's plan will be confirmed. If an objection to confirmation is filed, the debtor will need to show that the plan has been filed in good faith.[36] In one

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[31] *In re* Lindskog, 2011 WL 1576561 (Bankr. E.D. Wis. Apr 13, 2011); *In re* Woolsey, 438 B.R. 432 (Bankr. D. Utah 2010); *In re* Fenn, 428 B.R. 494 (Bankr. N.D.Ill. 2010); *In re* Jarvis, 390 B.R. 600 (Bankr. C.D. Ill.2008).

[32] *In re* Tran, 431 B.R. 230, 235 (Bankr. N.D. Cal. 2010). Section 1325(a)(5)(B)(i)(II) provides that "if the case under this chapter is dismissed or converted *without completion of the plan*, such lien shall also be retained by such holder to the extent recognized by applicable nonbankruptcy law."

[33] See *Wells Fargo Bank N.A. v. Scantling*, 754 F.3d 1323 (11th Cir. 2014); *Branigan v. Davis,* 716 F.3d 331 (4th Cir. 2013); *In re Cain,* 513 B.R. 316 (B.A.P. 6th Cir. 2014); *Fisette v. Keller,* 455 B.R. 177 (B.A.P. 8th Cir. 2011).

[34] *In re* Fisette, 455 B.R. 177 (B.A.P. 8th Cir. 2011), *appeal dismissed*, 695 F.3d 803 (8th Cir. 2012); Zeman v. Waterman (*In re* Waterman), 469 B.R. 334 (D. Colo. 2012); *In re* Fair, 450 B.R. 853 (E.D. Wis. 2011); Hart v. San Diego Credit Union, 449 B.R. 783 (S.D. Cal. 2010); *In re* Scantling, 465 B.R. 671 (Bankr. M.D. Fla. 2012); *In re* Gloster, 459 B.R. 200, 205 (Bankr. D.N.J.2011); *In re* Jennings, 454 B.R. 252 (Bankr. N.D. Ga. 2011); *In re* Okosisi, 451 B.R. 90 (Bankr. D. Nev. 2011); *In re* Davis, 447 B.R. 738 (Bankr. D. Md. 2011); *In re* Hill, 440 B.R. 176 (Bankr. S.D. Cal. 2010); *In re* Grignon, 2010 WL 5067440 (Bankr. D. Or. Dec 07, 2010); *In re* Tran, 431 B.R. 230 (Bankr. N.D. Cal. 2010).

[35] *In re* Frazier, 448 B.R. 803, 810 (Bankr. E.D. CA 2011).

[36] 11 U.S.C. § 1325(a)(3)(plan should be "proposed in good faith and not by any means forbidden by law"); *see also* 11 U.S.C. § 1325(a)(7)(petition); *In re Dolinak*, 497 B.R. 15 (Bankr. D.N.H. 2013); *In re Okosisi*, 451 B.R. 90 (Bankr. D. Nev. 2011).*In re* Tran, 431

of the leading cases supporting strip off in a chapter 20 case, the court nevertheless denied confirmation in both consolidated cases.[37] The court found that one debtor was proposing to pay nothing on more than $93,000 in unsecured debt and the other debtor, who had almost no debt besides the underwater mortgage and was "solvent in a balance sheet sense," appeared to be filing solely to strip off the mortgage. In general, a chapter 13 case filed immediately after the debtor has received a discharge in a chapter 7 case will be subject to scrutiny and will require a showing of compelling facts to overcome an objection on bad faith grounds.

In *In re Okosisi*,[38] the court relied upon the following factors in finding that the debtors' plan in a no-discharge lien stripping case was filed in good faith:

Debtors are insolvent and in need of bankruptcy relief other than strip off;
Debtors have an arrearage on the first mortgage that will be cured under the plan and was not generated solely to justify filing chapter 13 case;[39]
Debtors have priority tax claims that will be paid under the plan;
Debtors are proposing to make substantial plan payments over a five year period (even though dividend to unsecured creditors will be small), devoting all disposable income and future tax refunds to plan;[40]
Debtors did not use serial filings to avoid payments to creditors.

6. Treatment of Creditor's Stripped-Off Claim in No-Discharge Case

Courts have not agreed on whether a debtor may strip off a wholly underwater mortgage in a chapter 13 case in which the debtor may not receive a discharge due to the application of § 1328(f). A number of recent opinions permit strip off in no-discharge cases,[41] though there are certainly those that adopt the contrary view.[42] Even

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B.R. 230 (Bankr. N.D. Cal. 2010).
[37] *In re* Tran, 431 B.R. 230 (Bankr. N.D. Cal. 2010).
[38] 451 B.R. 90 (Bankr. D. Nev. 2011).
[39] *See also In re* Frazier, 448 B.R. 803 (Bankr. E.D. CA 2011)($20,000 arrearage); *In re* Hill, 440 B.R. 176 (Bankr. S.D. Cal. 2010)($18,000 arrearage).
[40] *See also In re* Frazier, 448 B.R. 803 (Bankr. E.D. CA 2011)(plan payments totaling $164,580).
[41] *In re* Fisette, 455 B.R. 177 (B.A.P. 8th Cir. 2011); *In re* Waterman, 469 B.R. 334 (D. Colo. 2012); *In re* Fair, 450 B.R. 853 (E.D. Wis. 2011); Hart v. San Diego Credit Union, 449 B.R. 783 (S.D. Cal. 2010); *In re* Scantling, 465 B.R. 671 (Bankr. M.D. Fla. 2012); *In re* Gloster, 459 B.R. 200 (Bankr. D. N.J. 2011); *In re* Jennings, 454 B.R. 252 (Bankr. N.D. Ga. 2011); *In re* Okosisi, 451 B.R. 90 (Bankr. D. Nev. 2011); *In re* Frazier, 448 B.R. 803 (Bankr. E.D. Cal. 2011); *In re* Davis, 447 B.R. 738 (Bankr. D. Md. 2011); *In re* Hill, 440 B.R. 176 (Bankr. S.D. Cal. 2010); *In re* Tran, 431 B.R. 230 (Bankr. N.D. Cal. 2010).
[42] *In re* Sadowski, 473 B.R. 12 (Bankr. D. Conn. 2011); *In re* Victorio, 454 B.R. 759 (Bankr.S.D. Cal. 2011), *aff'd*, 470 B.R. 545 (S.D. Cal. 2012); *In re* Gerardin, 447 B.R. 342 (Bankr. S.D. Fla. 2011); *In re* Lindskog, 2011 WL 1576561 (Bankr. E.D. Wis. Apr

among courts that permit strip off in a no-discharge "chapter 20" case, controversy surrounds the treatment of the creditor's claim in the subsequent chapter 13 case.

Some courts have held that the creditor should be permitted to have its avoided lien treated as an allowed unsecured claim.[43] Relying in part on *Johnson v. Home State Bank*,[44] the court in *In re Okosisi* held that the earlier chapter 7 discharge effectively converts the creditor's claim into a nonrecourse debt. The court concluded that: "Once the lien is so avoided, the unsecured claim that is represented by this nonrecourse debt becomes an unsecured claim in the bankruptcy case."[45]

The court in *In re Sweitzer* rejected this approach, reasoning that this would convert the creditor's nonrecourse claim into a recourse claim.[46] The court noted that unlike chapter 11 cases, in which § 1111(b) makes a deficiency claim held by a nonrecourse creditor allowable, there is no comparable provision in chapter 13. Similarly, the court in *In re* Scantling held that the creditor does not have a secured or unsecured claim because "[c]onfirmation of the plan in such cases, instead, implements the debtor's right under § 1322(b)(2) to modify— *not the claim*—but the 'rights' that the holder of the previously discharged claim has under applicable nonbankruptcy law."[47]

6. "Chapter 20" and Lien Avoidance

Prior to the 2005 amendments to the Code, courts were divided on whether lien avoidance under section 522(f)(1)(A) was effective immediately or whether it could be conditioned on the completion of debtor's chapter 13 plan and subsequent entry of discharge.[48] However, pre-BAPCPA, debtors who completed their plans received a discharge as a matter of course. The question for lien avoidance post-BAPCPA, as in lien stripping, is whether two conditions are necessary (plan completion and discharge) when previously the second condition (discharge) was purely derivative of the first condition (plan completion). Few courts have had to tackle the issue in lien avoidance actions where the debtor is not eligible for a discharge. It is likely, however, that courts will split along the same lines as they do in the lien stripping area.

13, 2011); *In re* Woolsey, 438 B.R. 432 (Bankr. D. Utah 2010); *In re* Fenn, 428 B.R. 494 (Bankr. N.D. Ill. 2010).

[43] *In re* Jennings, 454 B.R. 252 (Bankr. N.D. Ga. 2011); *In re* Okosisi, 451 B.R. 90, 96 (Bankr. D. Nev. 2011); *In re* Hill, 440 B.R. 176 (Bankr. S.D. Cal. 2010).

[44] 501 U.S. 78 (1991).

[45] *In re* Okosisi, 451 B.R. 90, 96.

[46] *In re* Sweitzer, 476 B.R. 468 (Bankr. D. Md. 2012).

[47] *In re* Scantling, 465 B.R. 671, 680 (Bankr. M.D. Fla. 2012).

[48] *Compare In re Prince*, 236 B.R. 746, 750-51 (Bankr. N.D. Okla. 1999) (completion and discharge required) *with In re Mulder*, 2010 WL 4286174 (Bankr. E.D.N.Y. Oct. 26, 2010) (order for 522(f) lien avoidance may be effective immediately).