

# Lien Stripping in Consumer Bankruptcy: Bringing or Defending Actions to Avoid Junior Mortgage Liens

TUESDAY, MARCH 12, 2019

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

Today's faculty features:

Monette W. Cope, Counsel, **Weltman Weinberg & Reis Co.**, Chicago

Marc R. Kivitz, Founder, **The Law Offices of Marc R. Kivitz**, Baltimore

The audio portion of the conference may be accessed via the telephone or by using your computer's speakers. Please refer to the instructions emailed to registrants for additional information. If you have any questions, please contact **Customer Service at 1-800-926-7926 ext. 1.**

## *Tips for Optimal Quality*

FOR LIVE EVENT ONLY

---

### Sound Quality

If you are listening via your computer speakers, please note that the quality of your sound will vary depending on the speed and quality of your internet connection.

If the sound quality is not satisfactory, you may listen via the phone: dial **1-866-873-1442** and enter your PIN when prompted. Otherwise, please **send us a chat** or e-mail [sound@straffordpub.com](mailto:sound@straffordpub.com) immediately so we can address the problem.

If you dialed in and have any difficulties during the call, press \*0 for assistance.

### Viewing Quality

To maximize your screen, press the F11 key on your keyboard. To exit full screen, press the F11 key again.

## *Continuing Education Credits*

FOR LIVE EVENT ONLY

---

In order for us to process your continuing education credit, you must confirm your participation in this webinar by completing and submitting the Attendance Affirmation/Evaluation after the webinar.

A link to the Attendance Affirmation/Evaluation will be in the thank you email that you will receive immediately following the program.

For additional information about continuing education, call us at 1-800-926-7926 ext. 2.

If you have not printed the conference materials for this program, please complete the following steps:

- Click on the ^ symbol next to “Conference Materials” in the middle of the left-hand column on your screen.
- Click on the tab labeled “Handouts” that appears, and there you will see a PDF of the slides for today's program.
- Double click on the PDF and a separate page will open.
- Print the slides by clicking on the printer icon.

# Lien Stripping in Consumer Bankruptcy: Bringing or Defending Actions to Avoid Junior Mortgage Liens

Marc R. Kivitz  
mkivitz@aol.com

I. 11 U.S.C. §§ 506(a) and (d): Wholly Unsecured and Undersecured Liens.

(§722 inapplicable to stripoff lien on real property; only applicable to personal property)

**WHAT YOU CANNOT DO IN ANY CHAPTER:**

**A. YOU CANNOT STRIPDOWN A SECURITY INTEREST – MORTGAGE/DOT --  
SECURED SOLELY BY PRINCIPAL RESIDENCE REAL PROPERTY.**

	<b>RESIDENCE</b>	
<b>\$120,000.00</b>		
Lien Balance !		!
Mortgage or DOT!	(\$81,000 undersecured)	!
on Residence <u>only</u> !		!
!		!
<b>\$39,000.00</b> !		!
Market Value !		!
!		!

These are the facts and amounts in *Dewsnup v. Timm*, 502 U.S. 410 (1992) holding that in Chapter 7, a security interest against real property collateral cannot be reduced to its value -- stripdown of mortgage debt of \$120,000 to realty's value of \$39,000 NOT permitted under § 506(d) in Chapter 7, concluding that lienholder has an allowed secured claim – thus a mortgage lien cannot be stripped down to the lower value of the house.

These are the facts of, but **not** the actual dollar figures which are not mentioned by either the Eleventh Circuit nor by the Supreme Court in, *Bank of America, N.A. v. Caulkett*, \_\_\_ U.S. \_\_\_. \_\_\_ 135 S.Ct. 1995, 2015 WL 2464049 (2015) holding that a debtor in a Chapter 7 bankruptcy case may not void a junior mortgage lien under Section 506(d) when the debt owed on a senior mortgage lien exceeds the current value of the collateral.

Modification prohibited by 11 U.S.C. § 1123(b)(5) and by 11 U.S.C. § 1322(b)(2).

**WHAT YOU CANNOT DO IN CHAPTER 7:**

**B. IN CHAPTER 7 YOU CANNOT STRIPOFF A WHOLLY UNSECURED SECOND SECURITY INTEREST – MORTGAGE/DOT -- LIEN.**

	<b>\$10,000.00</b>	<b>RESIDENCE</b>	
2 <sup>nd</sup> Mortgage or DOT!		(\$10,000 wholly unsecured)	!
	!		!
1 <sup>st</sup> Mortgage or DOT!	<b>\$40,000.00</b>	(\$1,000 undersecured)	!
	!		!
Market Value!	<b>\$39,000.00</b>		!
	!		!

These are the facts of, but ***not*** the actual dollar figures which are not mentioned by either the Eleventh Circuit nor by the Supreme Court in, *Bank of America, N.A. v. Caulkett*, \_\_ U.S. \_\_. 135 S.Ct. 1995, 2015 WL 2464049 (2015) holding that a debtor in a Chapter 7 bankruptcy case may not void a junior mortgage lien under Section 506(d) when the debt owed on a senior mortgage lien exceeds the current value of the collateral. Respondent debtors each filed Chapter 7 bankruptcy, and each owned a home encumbered with a senior mortgage lien and a junior mortgage lien. In both cases the property was not worth more than what was owed on the first mortgage. The debtors sought to void their junior mortgage liens under Section 506 of the Bankruptcy Code, which provides, “To the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void.” 11 U.S.C. Section 506(d). Order was entered on May 2, 2013, by the U.S. Bankruptcy Court for the Middle District of Florida, Case Number 6:13-BK-05537, allowing Chapter 7 debtor to “strip off” junior mortgagee’s wholly underwater lien. Junior mortgagee appealed. The District Court on January 16, 2014, Case No. 6:14-CV-00078, affirmed, and mortgagee again appealed. The U.S. Court of Appeals for the Eleventh Circuit, 566 Fed.Appx. 879, affirmed on February 25, 2014, Case No. 14-10803. In separate case, order was again entered voiding a junior mortgage lien wholly unsupported by any equity in property, and the United States Court of Appeals for the Eleventh Circuit, 556 Fed. Appx. 911, again affirmed. Certiorari was granted.

The parties did not dispute that the second mortgage claims are “allowed” under the Code. Instead, the debtors argued that the bank’s claims are not “secured” because of Section 506(a)(1) provides that “[a]n allowed claim...is a secured claim to the extent of the value of such creditor’s interest in...such property” and “an unsecured claim to the extent that the value of such creditor’s interest...is less than the amount of such allowed claim.” “Because the value of the bank’s interest here is zero, a straightforward reading of the statute would seem to favor the debtors. The Supreme Court cites its construction of Section 506(d)’s term “secured claim” in *Dewsnup v. Timm*, 502 U.S. 410, 112 S.Ct. 773, 116 L.Ed.2d 903, however, forecloses that reading and resolves the question presented here. “In declining to permit a Chapter 7 debtor to “strip down” a partially underwater lien under Section 506(d) to the value of the collateral, the Court in *Dewsnup* concluded that an allowed claim “secured by a lien with recourse to the underlying collateral...does not come within the scope of Section 506(d).” *Id.*, at 415, 112 S.Ct. 773. “Thus, under *Dewsnup*, a “secured claim” is a claim supported by a security interest in property, regardless of whether the value of that property would be sufficient to cover the claim. Pp. 1998-1999.

**WHAT YOU CAN DO:**

**C. In Chapters 11 and 13 only:** Under § 506(a) and (d) stripoff and avoid and cancel the lien of a **wholly unsecured second security interest** mortgage or deed of trust against **residence** rendering it unsecured. (Not allowed in Ch 7 under *Dewsnup* or *Caulkett*).

	<b>RESIDENCE</b>	
<b>\$10,000.00</b>		
2 <sup>nd</sup> Mortgage/DOT!		!
Lien Balance !	(\$10,000 unsecured)	!
!		!
<b>\$120,000.00</b> !		!
1 <sup>st</sup> Mortgage/ DOT!		!
Lien Balance !	(\$81,000 undersecured)	!
!		!
<b>\$39,000.00</b> !		!
Market Value !		!
!		!

**Stripoff of wholly unsecured consensual security interest** (even if there is other collateral) -- deed of trust or mortgage – permitted in Chapter 13. *Johnson v. Asset Management Group, LLC*, 226 B.R. 364 (D. Md. 1998).

**D. (Differentiating the Nature of the Collateral) What if the Mortgage or Deed of Trust Consensually Granted Security Interest were secured by INVESTMENT REALTY rather than a residence?**

<b>\$120,000.00</b> !	<b>INVESTMENT REALTY</b>	!
1 <sup>st</sup> Mortgage/ DOT!		!
Lien Balance !	(\$81,000 undersecured)	!
!		!
!		!
<b>\$39,000.00</b> !		!
Market Value !		!
!		!

1. Security interest lien on Investment Realty CAN be reduced – here, to \$39,000.00. Remainder of debt of \$81,000.00 is rendered unsecured and can be discharged.

2. Unlike Ch 13, § 1322(a)(4), Plans in Chapter 11 are NOT LIMITED to five (5) years.

3. In Chapter 13, however, the new principal balance of the lien of \$39,000.00 must be repaid in the Plan no longer than during a period of five (5) years, *In re Griffin*, 489 B.R. 638, 2013 WL 1123826 (Bank. D. Md. 2013)(Gordon, J.), § 1322(d)(2)(C), with interest most probably at the national prime rate of interest as set by *Till v. SCS Credit Corp.*, 541 U.S. 465, 124 S.Ct. 1951, 158 L.Ed.2d 787 (2004). In *Till*, the debtors’ Chapter 13 plan proposed a 9.5% rate of interest on the agreed \$4,000.00 value of a car by augmenting the national prime rate of 8% (applied by banks when making a low-risk loan) to account for the risk of nonpayment posed by borrowers in the debtors’ financial position. The Bankruptcy Court overruled the creditor’s objection to confirmation and approved 9.5% for a feasible plan. The District Court reversed, applying 21%, the rate the creditor could have obtained it if had foreclosed on the loan, sold the collateral and reinvested the proceeds.

**See, e.g.:** Michael J. Kursch Chapter 11 CASE NO. 11-23932-DK

Class 18 under Revised Second Amended Plan of Reorganization dated August 1, 2012 (Dkt. 232) confirmed by Order dated November 27, 2012, entered November 28, 2012 (Dkt. 233).

JPMorgan Chase Bank, N.A., holds a Deed of Trust dated May 5, 2008, recorded in Talbot County, MD at Liber 1620, folio 379, *et seq.*, having a balance of \$239,142.76, with a monthly payment of \$1,500.00, secured by investment/rental property at 611 Goldsboro Street, Easton, MD 21601, with a value of \$160,000.00. Lien modified to a new principal balance of \$160,000.00 at a reduced interest rate of 5.00% *per annum* amortized over an extended term of thirty (30) years payable in equal monthly installments of principal and interest each in the amount of \$858.91, with a \$79,142.76 general unsecured claim.

\$239,142.76	<b>INVESTMENT REALTY</b>
!	!
!	\$79,142.76 general unsecured claim
!	!
\$160,000.00	
!	!
Market value	<b><i>Restructure</i></b>
!	!
!	<b>Modify Interest Rate</b>
!	!
!	<b><i>Till vs. SCS Credit Corp.</i></b>
!	!
!	541 U.S. 465 (2004)
!	!

**WHAT YOU CAN DO:**

**E. (Differentiate as to the collateral of the second lien). Cramdown/Avoidance of Partially Secured Security Interests on INVESTMENT realty 11 U.S.C. §§ 506(a) and (d).**

<b>\$40,000.00</b>	<b>INVESTMENT REALTY</b>
!	2 <sup>nd</sup> Encumbrance DOT or Mortgage (or Judicial Lien) !
!	\$39,000.00 remainder of Lien is Undersecured !
<b>\$121,000</b> !	!
market value !	!
!	<b>Restructure</b> \$1,000.00 of value attributable to 2 <sup>nd</sup> Lien !
<b>\$120,000.00</b> !	Balance on 1 <sup>st</sup> DOT or Mortgage or Judgment Lien) !
1 <sup>st</sup> DOT Balance !	!
!	!

Motion to Value Collateral pursuant to F.R.B.P. 3012.

Value collateral at \$121,000.00 and prove \$120,000.00 first lien; determine extent of second lien stripped down to \$1,000.00 and \$39,000.00 balance of second lien of stripped off to be \$0.00 and treated as unsecured.

**Restructure** new terms for payment of \$1,000.00 second lien over time with interest.

RESULT: BIFURCATE LIEN (\$1,000.00 Secured and \$39,000.00 Undersecured debts).

PAY \$1,000.00 LIEN IN FULL with interest.

RESTRUCTURE LIEN – repayment term of years with interest in a Plan

Modify Interest Rate *Till vs. SCS Credit Corp.*, 541 U.S. 465 (2004) – national prime rate of interest (presently 5.25%) plus additional 1% - 3% for risk of loss

\$39,000.00 Balance of Lien stripped off and wiped out upon entry of Discharge Order or upon completion of payments due under a Plan if ineligible for Discharge.

Undersecured \$39,000.00 debt receives percentage distribution in a Plan

N.B. \$39,000.00 is added to unsecured debt and must remain under Ch 13 limit of \$394,725.00 under 11 U.S.C. § 109(e).

**WHAT YOU CAN DO:**

**G. (Differentiating as to the collateral of the lien). Cramdown/Avoidance of Partially Secured Security Interest on RESIDENTIAL REALTY and OTHER Collateral 11 U.S.C. §§ 506(a) and (d). What if the Mortgage or Deed of Trust Security Interest were initially secured by RESIDENCE REALTY AND SOME OTHER ASSET – such as corporate assets as collateral?**

Facts: Loan to LLC is secured by LLC assets – a secured debt of the LLC; members of LLC personally guarantee the loan to the LLC – at that point, an Unsecured debt of the individual members, but then the Lender is given an Indemnity Deed of Trust (“IDOT”) against the members’ residential real property – now a secured debt of the individuals. Lender enforces lien on LLC assets and obtains a Confessed Judgment against the individuals on the personal guarantees for the balance remaining due which debt is also secured by the IDOT. Debtors file Chapter 13 to reduce the IDOT balance to the amount of equity remaining in their residence above first mortgage balance and to restructure secured debt and also to avoid and cancel the Confessed Judgment lien against the real property.

<b>\$40,000.00</b>	<b>RESIDENCE</b>	
	!	!
	!      2 <sup>nd</sup> Encumbrance Consensual Security Interest IDOT)	!
	!      \$39,000.00 remainder of Lien is Undersecured	!
FMV <b>\$121,000</b>	!	!
Market Value	!	!
	! <b>Restructure</b> \$1,000.00 of value attributable to 2 <sup>nd</sup> Lien	!
<b>\$120,000.00</b>	!      Balance on 1 <sup>st</sup> Mortgage or Deed of Trust Lien)	!
1 <sup>st</sup> Mortgage Bal.!	!	!
	!	!

Facts: Corporate loan secured by business equipment under Security Interest.

Debt personally guaranteed by principals of corporation.

Personal guarantees collateralized with Indemnity Deed of Trust (IDOT) against principal residence.

Debt owed under Security Interest is NOT solely secured by principal residence.

Corporate assets already foreclosed upon by secured creditor (does not alter fact that debt was not solely secured by the principal residence.

RESULT: BIFURCATE LIEN (\$1,000.00 Secured & \$39,000.00 Undersecured debts)

PAY \$1,000.00 LIEN IN FULL with interest

RESTRUCTURE LIEN – repayment term of years with interest in a Plan

Modify Interest Rate Till vs. SCS Credit Corp., 541 U.S. 465 (2004) – national prime rate of interest (presently 5.25%) plus an additional 1% - 3% for risk of loss

\$39,000.00 Balance of Lien stripped off upon entry of Discharge order upon completion of payments due under a Plan

Undersecured \$39,000.00 debt receives percentage distribution in a Plan.

### H.1. Stripoff of Wholly Unsecured Judicial Lien.

11 U.S.C. §§ 506(a) and (d) – Available in Chapters 11 and 13; Not available in Chapter 7

<b>RESIDENCE</b>	
\$ 15,155.58	2 <sup>nd</sup> Encumbrance (Judgment Lien) (Wholly Unsecured Judicial Lien)
\$121,000.00	Balance on 1 <sup>st</sup> Mortgage or Deed of Trust or Judicial Lien)
\$120,000.00	
market value	

**H.2. (Differentiate (Flip) the Numbers so that there is SOME equity/value attributable to second lien.**

**RESIDENCE**

	2 <sup>nd</sup> Encumbrance (Judgment Lien)	
\$15,155.58	\$1,000.00 Equity Attributable to Judicial Lien	
\$121,000.00	market value	
\$120,000.00	Balance on 1 <sup>st</sup> Mortgage or Deed of Trust or Judicial Lien	

RESULT: NO Cramdown of Partially Secured Security Interest Mortgage or Deed of Trust secured ONLY against RESIDENTIAL realty under 11 U.S.C. §§ 506(a) and (d).

BUT Under §§ 506(a) and (d) JUDGMENT LIEN CAN BE REDUCED TO \$1,000.00 in Chapters 11 and 13, and a Plan can propose to repay the reduced principal plus interest with the remaining balance of the debt unsecured and dischargeable.

AND although §§ 506(a) and (d) are NIOT available in Chapter 7, see Section II. as to how the Judicial Lien CAN be affected in ALL Chapters under § 522(f)(1)(A) and (2).

N.B. Effect of Conversion from Chapter 13. 11 U.S.C. § 1325(a)(5)(B)(i)(II) provides that a plan in order to be confirmed must provide that if the Chapter 13 case is dismissed or converted without completion of the plan that “such lien shall also be retained by such holder to the extent recognized by applicable non-bankruptcy law” and 11 U.S.C. § 348(f)(1)(C)(i) provides that with respect to a case converted from Chapter 13 that “the claim of any creditor holding security as of the date of the petition shall continue to be secured by that security unless the full amount of such claim determined under applicable non-bankruptcy law has been paid in full as of the date of conversion, notwithstanding any valuation or determination of the amount of an allowed secured claim made for the purposes of the case under chapter 13; and (ii) unless a pre-bankruptcy default has been fully cured under the plan at the time of conversion, in any proceeding under this title or otherwise, the default shall have the effect given under applicable non-bankruptcy law.”

**J. Reverse Mortgage on Residence Matured Pre-petition Can Be Modified.**

	<b>RESIDENCE</b>
<b>\$117,500.00</b>	
Market Value !	!
!	!
!	!
<b>\$62,602.81</b> !	!
Lien Balance !	!
Reverse Mortgage on Residence <u>only</u> !	!
!	!

A residential consensual **reverse mortgage** lien that matures prior to filing of Chapter 13 can be repaid in full under a five-year Chapter 13 Plan under 11 U.S.C. § 1322(c)(2) and the interest rate can be modified.. *In re Griffin*, 489 B.R. 638, 2013 WL 1123826 (Bank. D. Md. 2013)(Gordon, J.), citing *In re Brown*, 428 B.R. 672 (Bankr. SC 2010). Judge Gordon’s preliminary statement captures the gist of the case:

This dispute draws into question the ability of a Chapter 13 debtor to utilize 11 U.S.C. § 1322(c)(2) to modify the payment of a secured claim that arises from the type of consumer financing known as a “reverse mortgage”. For the reasons explained below, the Court concludes that such modification is permitted by that subsection of the Code. Therefore the automatic stay shall remain in place, the objections of the mortgage holder shall be overruled and the Debtor’s plan shall proceed to a final confirmation hearing.

K. Stripoff of Wholly Unsecured Security Interest on Personalty under 11 U.S.C. § 506(a).

<b>VEHICLE</b>	
<b>\$1,494.66</b>	
2 <sup>nd</sup> Security Lien	!
Balance	!
	(Mariner Finance \$1,494.66 wholly unsecured)
	!
<b>\$20,609.84</b>	!
1 <sup>st</sup> Security Lien	!
Balance	!
	(Hyundai Finance undersecured)
	!
<b>\$15,000.00</b>	!
Market Value	!
	!

Wholly unsecured second lien held by Mariner Finance LLC., can be stripped off entirely and rendered unsecured and discharged upon completion of a Chapter 11 and Chapter 13 Plan.

L. Stripdown of Security Interest on Personalty under §§ 506(a) and (d) – which can be paid over time with interest in Chapters 11 and 13 -- unlike § 722 redemption which must be paid in a lump sum.

		<b>VEHICLE</b>	
<b>\$1,494.66</b>			
2 <sup>nd</sup> Security Lien	!		!
Balance	!	(Mariner Finance \$1,494.66 wholly unsecured)	!
	!		!
<b>\$20,609.84</b>			
1 <sup>st</sup> Security Lien	!		!
Balance	!	(Hyundai Finance undersecured)	!
	!		!
<b>\$15,000.00</b>			
Market Value	!		!
	!		!

Partially secured and underscored first lien held by Hyundai Motor Finance LLC., can be stripped down to the value of the vehicle and the new, reduced principal lien balance – equal to the value of the car – can be repaid with interest over time – five (5) years maximum in Chapter 13 and longer, if necessary, in Chapter 11, and the balance of the debt that exceeds the value of the car is rendered unsecured and discharged upon completion of a Chapter 11 and Chapter 13 Plan.

### **WHAT YOU CAN DO:**

E. In *Canelos v. Mignini t/a Tam-D Construction, et al. (In re Canelos)*, 216 B.R. 159, 163-64 (Bankr. D. Md. 1997)(Schneider, J.), the court addressed the issue of disputing a claimed exemption in the context of a lien avoidance action. The court acknowledged the Supreme Court's holding in *Taylor v. Freeland & Kronz, et al*, 503 U.S. 638 (1992)(unless a party in interest objects to an exemption within 30 days after the conclusion of the meeting of creditors, the property is exempt in the amount claimed. 11 U.S.C. § 522(1); Fed.R.Bankr.P. 4003(b). This is true even if the debtor had no colorable basis for claiming the exemption); *see also, Williams v. Peyton (In re Williams)*, 104 F.3d 688 (4<sup>th</sup> Cir. 1997). Judge Schneider supported the exemption, however, the court held that a creditor may contest an exemption for the first time in defense to a motion to avoid a lien. The exemption itself may not be attacked, but the amount of the exemption may be attacked for the purpose of limiting the amount of the lien to be avoided even after the time period for raising an objection to a claimed exemption has expired. Therefore, objections to exemptions may be a defense to a lien avoidance action under 11 U.S.C. § 522(f). *Id.*

The court in *Canelos* analyzed and applied 11 U.S.C. § 522(f)(2)(A) in determining the amount of a judgment that might be avoided as an impairment of an exemption.

Amount of respondent's judicial lien	\$15,155.58
Other liens on the property:	
Lee Servicing Co. (first mortgage)	56,600.00
Signet Bank (second mortgage)	14,500.00
Exemption	+ <u>5,500.00</u>
Total	= \$91,755.58
Debtor's interest (fair market value)	- <u>\$83,000.00</u>
Extent to which lien impairs exemption	\$ 8,755.58
Amount of respondent's judicial lien	\$15,155.58
Extent to which lien impairs exemption	- <u>8,755.58</u>
Amount of respondent's lien remaining	\$ 6,400.00

The "debtor's interest" as used in the Section 522(f)(2)(A) formula is the fair market value of the real property. *Fitzgerald v. Davis* (In re *Fitzgerald*), 729 F.3d 306 (4th Cir. 1984); *In re Abrahamzadeh*, 162 B.R. 676 (Bankr. D. N.J. 1994); *In re Gonzalez*, 149 B.R. 9 (Bankr. D. Mass. 1993), rev'd on other grounds sub nom. *Gonzalez v. First National Bank of Boston*, 191 B.R. 2 (D. Mass 1996). The debtors need not have equity in the property as a condition of avoiding a lien encumbering the property, so long as the lien impairs an exemption they had validly claimed in the property. *Hoffman v. Internal Revenue Service* (In re *Hoffman*), 28 B.R. 503 (Bankr. D.Md. 1983); *In re Ford*, 3 B.R. 559 (Bankr. D.Md. 1980), aff'd sub nom. *Greenblatt v. Ford*, 638 F.2d 14 (4th Cir. 1981). See 4 *Collier on Bankruptcy* ¶ 522.11[3] (citing 140 Cong.Rec. at H10769 (daily ed. Oct. 4, 1994)). Lien avoidance under Section 522(f) has the effect of protecting the debtor's interest in property in the future. Once the lien is avoided, it does not reattach to the property; the property is forever free of the lien. Therefore, the future increase in value or equity of the property is not encumbered by the lien.

Applying the analysis in *Canelos* to the fact pattern above:

	<u>2005</u>	<u>2016</u>
Amount of respondent's judicial lien	\$ 40,000.00	\$ 40,000.00
Liens on the property: first mortgage	75,000.00	75,000.00
Exemption	+ <u>22,000.00</u>	<u>23,675.00</u> <sup>1</sup>
Total	= \$137,000.00	= \$138,675.00
Debtor's interest (fair market value)	- <u>\$ 80,000.00</u>	- <u>\$ 80,000.00</u>
Extent to which lien impairs exemption	\$ 57,000.00	\$ 58,675.00
Amount of respondent's judicial lien	\$ 40,000.00	\$ 40,000.00
Extent to which lien impairs exemption	- <u>57,000.00</u>	- <u>58,675.00</u>
Amount of respondent's lien remaining	\$ 0.00	\$ 0.00

Revised Facts: If the judicial lien were in the amount of \$10,000.00 but the real property had a market value of \$100,000.00, then the result is as follows:

Amount of respondent's judicial lien	\$ 10,000.00	\$ 10,000.00
Liens on the property: first mortgage	75,000.00	75,000.00
Exemption	+ <u>22,000.00</u>	<u>23,675.00</u>
Total	= \$107,000.00	= \$108,675.00
Debtor's interest (fair market value)	- <u>\$100,000.00</u>	- <u>\$100,000.00</u>
Extent to which lien impairs exemption	\$ 7,000.00	\$ 8,675.00
Amount of respondent's judicial lien	\$ 10,000.00	\$ 10,000.00
Extent to which lien impairs exemption	- <u>7,000.00</u>	- <u>8,675.00</u>
Amount of respondent's lien remaining	\$ 3,000.00	\$ 1,375.00

<sup>1</sup> ACM, CJ 11-504(f)(1)(ii) is \$23,675.00 but is limited to one spouse and may violate 11 U.S.C. § 522(m) which is explicit in its provision that “[s]ubject to the limitation in subsection (b)<sup>1</sup>, this section shall apply *separately* with respect to each debtor in a joint case.” (emphasis added). See, *In re Nguyen*, 211 F.3d 105 (4<sup>th</sup> Cir. 2000)(car claimed under Va. homestead exemption permitted); *Cheeseman v. Nachman*, 656 F.2d 60, 63 (4<sup>th</sup> Cir. 1981)(liberal exemption construction allows both husband and wife to be householders). Exemption in ACM, CJ 11-504(f)(1)(i) is limited to personal property, however, the \$6,000.00 exemption in ACM, CJ 11-504(b)(5) is not, so the maximum exemption might be \$29,675.00 for one spouse, or \$47,450.00 or perhaps \$59,350.00 for two spouses filing a joint petition. “The test of whether a State statute conflicts with federal bankruptcy legislation and is therefore unconstitutional in light of the Supremacy Clause is set forth in the leading case of *Perez v. Campbell*, 402 U.S. 637, 91 S.Ct.1704, 29 L.Ed.2d 233 (1971).” *Rubenstein, Trustee v. Sachs, et al. (In re Locarno)*, 23 B.R. 622, 629 (Bankr. D.Md. 1982)(Schneider, J.).

**F. (Differentiating from the Facts above):**

**What if the nature of the lien were a wholly unsecured Judicial Lien?**

	<b>RESIDENCE</b>
<b>\$10,000.00</b>	
Judicial Lien	!
Balance	(\$10,000 wholly unsecured)
	!
<b>\$120,000.00</b>	
Judicial Lien	!
Balance	(\$81,000 undersecured)
	!
<b>\$39,000.00</b>	
Market Value	!

**As to the Second Judicial Lien, it can be entirely avoided:**

Amount of respondent's 2 <sup>nd</sup> judicial lien	\$ 10,000.00
Liens on the property: 1 <sup>st</sup> judicial lien	121,000.00
Exemption	+ <u>23,675.00</u>
Total	= \$154,675.00
Debtor's interest (fair market value)	- \$ <u>39,000.00</u>
Extent to which lien impairs exemption	\$115,675.00

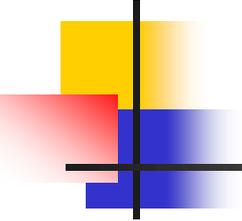
Amount of respondent's judicial lien	\$ 10,000.00
Extent to which lien impairs exemption	- <u>115,675.00</u>
Amount of respondent's lien remaining	\$ 0.00

**AND As to the First Judicial Lien, it can be partially avoided:**

Amount of respondent's 1 <sup>st</sup> judicial lien	\$121,000.00
Liens on the property: 2 <sup>nd</sup> judicial lien	10,000.00
Exemption	+ <u>23,675.00</u>
Total	= \$154,675.00
Debtor's interest (fair market value)	- \$ <u>39,000.00</u>
Extent to which lien impairs exemption	\$115,675.00

Amount of respondent's judicial lien	\$121,000.00
Extent to which lien impairs exemption	- <u>115,675.00</u>
Amount of respondent's lien remaining	\$ 5,325.00

G. Proceeding By Motion. F.R.B.P. Rule 7001(2) requires a proceeding to determine the extent, priority, or validity of a lien be commenced by an adversary proceeding through the filing of a complaint if the issues go beyond the valuation of the property subject to the lien. However, a motion to value the collateral is sufficient under F.R.P.B. Rule 3012 if the proceeding is solely to strip down the lien. *Harmon v. U.S.*, 101 F.3d 574 (8th Cir. 1996); *Keene v. Charles*, 222 B.R. 511 (E. D. Va. 1998), *aff'd* 178 F.3d 1284 (4th Cir. 1999).



---

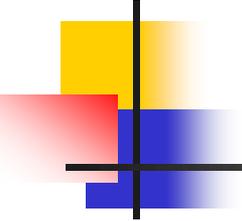
# **DEFENSES TO MORTGAGE LIEN STRIPPING IN CONSUMER BANKRUPTCY**

**Presented by:  
Monette W. Cope  
Counsel**

**Weltman, Weinberg, & Reis Co. L.P.A.  
180 N. LaSalle St. Suite 2400  
Chicago, IL 60601  
312-782-9676**

**[mcope@weltman.com](mailto:mcope@weltman.com)**

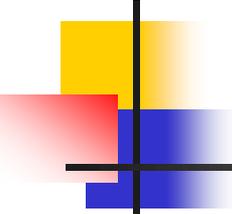
**© 2019**



# ULTIMATE DEFENSE: YOU HAVE AN "ALLOWED SECURED CLAIM"

---

- THE CLAIM SECURED BY YOUR LIEN IS CONSIDERED TO BE AN "**ALLOWED SECURED CLAIM**" UNDER ONE OR MORE OF THESE BANKRUPTCY CODE SECTIONS:
  - 11 U.S.C. § 506(a)
  - 11 U.S.C. § 502
  - 11 U.S.C. § 1322(b)(2)
  - 11 U.S.C. § 1325(a)(5)(B)(i)
- These sections protect liens on "ALLOWED SECURED CLAIMS"



# STATUTORY BASIS TO VALUE SECURED CLAIM

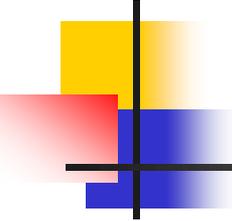
---

## 11 U.S.C. § 506 Determination of secured status

(a) (1) ***An allowed claim*** of a creditor secured by a lien on property in which the estate has an interest, ... ***is a secured claim*** to the extent of the value of such creditor's interest in the estate's interest in such property, ..., ***and is an unsecured claim*** to the extent that the value of such creditor's interest ... is less than the amount of such allowed claim. Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest.

§ 506(a) (Emphasis added)

- The value of a secured claim is the value of the property which secures the claim.
- 506(a) allows bifurcation of claims
- Wholly unsecured claims are valued under 506(a)



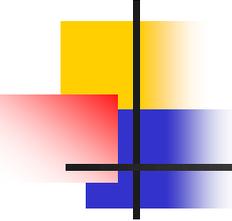
# "ALLOWED" CLAIM AS DEFINED BY § 502

## 11 U.S.C. § 502 Allowance of claims or interests

- (a) A claim or interest, proof of which is filed under section 501 ... is ***deemed allowed***, unless a party in interest... objects.
- (b) ***Except as provided*** in subsections (e)(2), (f), (g), (h) and (i) of this section, if such objection to a claim is made, the court, after notice and a hearing, shall determine the amount of such claim in lawful currency of the United States as of the date of the filing of the petition, and ***shall allow such claim*** in such amount, except to the extent that--...

§ 502 (Emphasis added)

- A claim is allowed unless objected to.
- §502 states exclusive grounds under which a filed claim may be disallowed.
- Claims valued at \$0 are allowed
- A claim, filed as secured, is an "allowed" claim
- A claim, valued at \$0 and backed by a lien, is an allowed secured claim



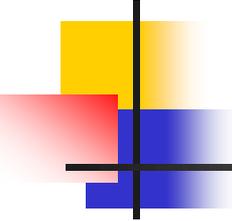
# CLAIMS THAT ARE "NOT ALLOWED SECURED CLAIMS" ARE VOID

## 11 U.S.C. § 506 Determination of secured status

(d) To the extent that a lien secures a claim against the debtor that *is not an allowed secured claim, such lien is void*, unless--  
.....

§506(d) (Emphasis added)

- If a lien is valued at \$0 under § 506(a), is it "not an allowed secured claim?"
- Can this section be used to void a wholly unsecured mortgage lien?
  - As an unsecured claim, it could be considered to be "not an allowed secured claim", and so, void.
- Does this section operate to void wholly unsecured liens on its own or in conjunction with 506(a)?



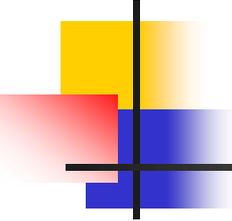
# § 506(d) MAY NOT BE USED TO VOID LIENS ALLOWED UNDER § 502

---

## *Dewsnup v. Timm*, 502 U.S. 410, 417 (U.S. 1992)

Chapter 7 debtor attempted to "strip down" a mortgage lien to the value of the real estate and declare the unsecured balance of the claim void under 506(d).

- Liens survive bankruptcy.
- 506(d) voids claims that are disallowed under § 502.
- 506(d) does not void claims that are not secured under a 506(a) valuation.
- A Chapter 7 debtor may not "strip down" a mortgage lien to the value of the property.
- The unsecured portion of a mortgage lien may not be voided under 506(d).
- "Allowed Secured Claim" may have a different meaning in other Code sections.



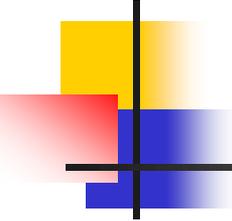
# VALUATION OF LIENS UNDER 506(a) IN CHAPTER 13 BANKRUPTCY

---

## *Nobelman v. American Sav. Bank, 508 U.S. 324 (U.S. 1993)*

Chapter 13 debtor may not strip down the mortgage lien to the secured value of his residence

- The interplay between § 506(a) and §1322(b)(2).
- § 506(a) is used to value a claim secured by a mortgage lien.
- §1322(b)(2) prohibits modification of a creditor's rights when its lien is "secured only by a security interest in the debtor's principal residence".
- If a lien is partially secured by a debtor's principal residence, then the creditor's rights may not be modified in a Chapter 13 plan.
- May not Strip Down (Bifurcate) a mortgage under § 506(a) that is "secured only by a security interest in the debtor's principal residence".



# UNSECURED MORTGAGE LIENS

---

***Lane v. W. Interstate Bancorp (in Re Lane), 280 F.3d 663, 669 (6th Cir. Tenn. 2002)***

Chapter 13 debtor permitted to strip off wholly unsecured mortgage lien from residence

- A lien secured only by a debtor's principal residence is subject to valuation under § 506(a).
- If the lien has any value (even \$1) it is a secured claim and is subject to anti-modification provision of §1322(b)(2).
- If the lien has \$0 value, the claim is unsecured.
- §1322(b)(2) only prohibits modification of claims that are secured.
- If the lien on a debtor's principal residence is wholly unsecured, it is not a secured claim under §1322(b)(2) and so the lien may be "stripped off" in a Chapter 13 bankruptcy

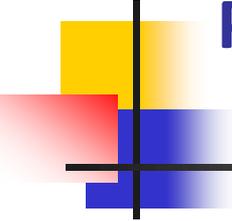
# DEFENSES TO LIEN STRIPPING

## A. Chapter 20

### A. Minority View: If Debtor is Not Eligible for a Discharge, the Debtor May Not Strip Lien

**Pro-Creditor Law:** Chapter 20 Debtors may not strip wholly unsecured liens on principal residence if they are not eligible for a Chapter 13 discharge

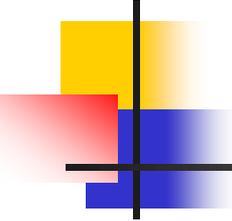
- Debtor is not eligible for a discharge under 11 U.S.C. § 1328(f)(1)
- Creditor has lien retention rights under 11 U.S.C. § 1325(a)(5)(B)(i)
- If the debtor is not eligible for a Chapter 13 discharge, the creditor is entitled to retain its lien until the debt as determined under nonbankruptcy law is paid, and it may not be stripped off.
- Permitting a lien strip would amount to a de facto discharge when debtor is not entitled to a discharge.



## PRO-CREDITOR REASONING SUMMARY

---

- *Dewsnup's* definition of "**Allowed Secured Claim**" is adopted.
- Lien retention rights under § 1325(a)(5) is linked with ineligibility for discharge under § 1328(f)(1).
- Amounts to a de facto discharge when debtor not eligible for a discharge



## Chapter 20 Lien Strip Not Allowed

---

### **7<sup>th</sup> Cir.**

*In re Fenn*, 428 B.R. 494 (Bankr. N.D. Ill. 2010)

*Erdmann v. Charter One Bank (In re Erdmann)*, 446 B.R. 861 (Bankr. N.D. Ill. 2011)

*In re Jarvis*, 390 B.R. 600 (Bankr. C.D. Ill. 2008)

*Lindskog v. M&I Bank FSB (In re Lindskog)*, 451 B.R. 863 (Bankr. E.D. Wis. 2011)\*

### **11<sup>th</sup> Cir.**

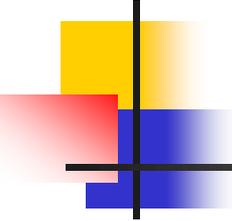
*Colbourne v. Ocwen (In re Colbourne)*, 550 Fed. Appx. 687 (11<sup>th</sup> Cir. 2013)

### **5<sup>th</sup> Cir.**

No Case Law

\**But see, In re Fair*, 450 B.R. 853 (E.D. Wis. 2011). (Chapter 20 Lien Strip permitted).

**Note:** The majority of courts hold under the doctrine of stare decisis that a bankruptcy court is not bound by a district court decision from a multi-judge district court.

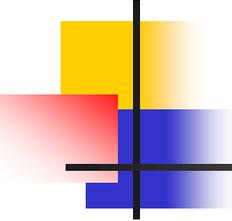


## Chapter 20 Lien Strip Allowed

---

### MAJORITY VIEW: WHOLLY UNSECURED LIENS MAY BE STRIPPED IN CHAPTER 20:

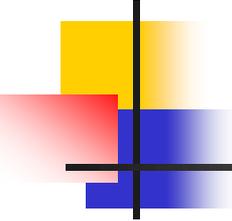
- Decisions adopt *Nobelman* 's definition of "**Allowed Secured Claim**".
- Because the creditor does not have an "**Allowed Secured Claim**" it is not entitled to the lien retention provisions of 11 U.S.C. § 1325(A)(5)(B)(i).



## Pro Debtor Reasoning under §1328(f)

---

- If debtor obtained a Chapter 7 discharge within 4 years of filing for relief under Chapter 13, debtor is ineligible for a Chapter 13 discharge under §1328(f)
- Nothing in §1328(f) ties discharge to lien stripping or lien retention rights
- Completion of plan payments, rather than discharge, effectuates lien strip.



## Chapter 20 Lien Strip Allowed

---

### Circuit Court Cases

*Branigan v. Davis* (In re Davis), 716 F.3d 331 (4th Cir. 2013)

*In re Cain*, 513 B.R. 316 (6th Cir. B.A.P. 2014)

*Fisette v. Keller* (In re Fisette), 455 B.R. 177 (8th Cir. B.A.P. 2011)

*Boukatch v. MidFirst Bank* (In re Boukatch), 533 B.R. 292 (9th Cir. B.A.P. 2015)

### District Court Cases

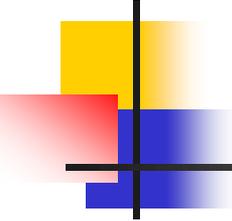
*In re Dolinak*, 497 B.R. 15 (Bankr. D. N.H. 2013)

*Curwen v. Whiton*, 557 B.R. 39 (D. Conn. 2016)

*In re Scotto-DiClemente*, 459 B.R. 558 (Bankr. D. N.J. 2011)

*In re Fair*, 450 B.R. 853 (E.D. Wis. 2011)

*Zeman v. Waterman* (In re Waterman), 469 B.R. 334 (D. Colo. 2012)



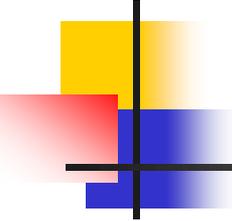
## B. Chapter 20 - GOOD FAITH

---

- If lien strip is permitted in your jurisdiction in Chapter 20, you may still prevail on a good faith objection.
- A good faith analysis in lien strip cases:
  - 1) the proximity in time of the chapter 13 filing to the chapter 7 filing;
  - 2) whether the debtor has incurred some change in circumstances between the filings that suggests a second filing was appropriate and that the debtor will be able to comply with the terms of the chapter 13 plan;
  - 3) whether the two filings accomplish a result that is not permitted in either chapter standing alone; and
  - 4) whether the two filings treat creditors in a fundamentally fair and equitable manner or whether they are rather an attempt to manipulate the bankruptcy system or are an abuse of the purpose and spirit of the Bankruptcy Code.

*Davis v. TD Bank, N.A. (In re Davis)*, 447 B.R. 738, 750 (Bankr. D. Md. 2011)

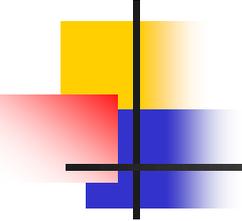
Tip: Include a good faith objection to a Chapter 20 plan with your objection to lien stripping without discharge.



## More Good Faith considerations

---

- Review for a classic good faith objection - totality of the circumstances.
- Review for good faith as if Debtor is asking the court to extend or impose the automatic stay after successive Chapter 13 filings.
- Was the Petition filed in Good Faith?
- Has the plan been proposed in Good Faith?
  - Compare debts in Chapter 7 and Chapter 13 cases. Is the mortgage the only debt?
  - Compare income and expenses.
  - Why is this Chapter 13 justified - is there an independent reason for the filing other than a lien strip?
  - Compare values of property - Did debtor schedule different value in Chapter 7 than Chapter 13?

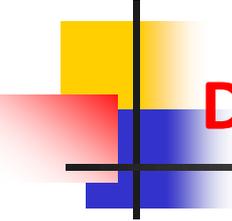


## C. VALUATION – THE ULTIMATE WEAPON

---

- Creditor has an "**Allowed Secured Claim**" because there is equity in the property that attaches to the claim.
- 506(a) valuation
- Get an inside and outside appraisal from a reputable appraiser.
- Verify the balances of any senior lienholders.
- Scrutinize the debtor's appraisal.
  - Suggested Listing Price Evaluations are not appraisals and may be inflated.
  - Date of appraisal.
  - Compare considered factors and assigned values in both appraisals.
  - Are comparables truly comparables?
- If real estate is primary residence, and there is even \$1 in equity, debtors may not strip lien.
- If real estate is non-residential, debtor may "cram down" the lien to the value of the property.

Beware: You may win the battle, but lose the war. Debtor may chose to convert to Chapter 7 and give up the home if the lien must be paid in a Chapter 13 plan.



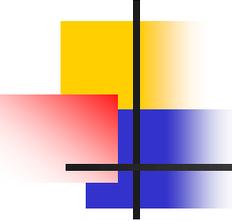
## D. Tenancy by the Entirety

---

- Lien strip may be prohibited when only one spouse files and seeks to strip a mortgage lien, but property is held in a tenancy by the entirety.
- Tenancy by the Entirety: An interest in property where married couples hold a concurrent interest in real estate, each with the right of survivorship. The couple is considered “one unit” and neither can transfer their interest without the other’s consent. It dissolves upon death, divorce or by consent. Created by state law.
- One spouse cannot unilaterally strip a lien on property held in a tenancy by the entirety. What one does, the other must do. They must be co-debtors.

*In re Pierre*, 468 B.R. 419 (Bankr. D. Fla. 2012)

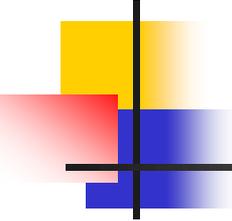
*Erdmann v. Charter One Bank (In re Erdmann)*, 446 B.R. 861 (Bankr. N.D. Ill. 2011)



## Tenancy by the Entirety, Cont.

---

- The Chapter 13 plan binds only the debtor and creditor; the bankruptcy court has no jurisdiction over the non-filing co-debtor in a tenancy by the entirety.  
*Alvarez v. HSBC Bank USA, N.A. (In re Alvarez)*, 733 F.3d 136 (4th Cir. 2013) (Cert. Denied).
  - Lien may be stripped in tenancy by the entirety even when only one debtor files when Circuit Court law holds that interpretation of bankruptcy law is not controlled by state property law.  
*Citizens Bank v. Tomasi (In re Tomasi)*, 2010 U.S. Dist. LEXIS 144692 (E.D. Mich. 2010)
- Note:* Note: 6<sup>th</sup> Cir. holds that interpretation of bankruptcy law is not controlled by state property law. *In re Arango*, 992 F.2d 611 (6th Cir. 1993)



## E. LOAN MODIFICATION OR CONSENSUAL STRIP DOWN

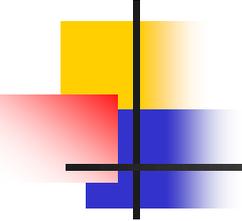
---

### Consensual Strip Down:

- Parties agree to bifurcate the loan.
- Debtor typically pays secured amount in full through the plan, and the remaining balance is paid as an unsecured claim.
- Business decision
- Debtor entitled to lien release after completing all payments under the plan and discharge.

### Loan Modification:

- Lender would need to have a program and Debtor would have to be eligible for the program.
- Long-term solution - outlives bankruptcy case.



## F. COLLATERAL ATTACKS

---

### 1. Due Process

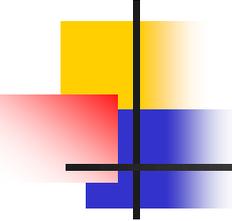
- Creditor may vacate a lien strip order if Creditor did not get notice of lien strip in time to object.
- Caveat: If confirmed plan orders lien strip and Creditor was given proper notice, the Creditor may not later contest the lien strip.

*United Student Aid Funds, Inc. v. Espinosa*, 130 S. Ct. 1367 (2010)

### 2. Res Judicata

- If a prior order was entered regarding the value of the real estate and which shows equity for junior lien, it may not be contested later.
  - Chapter 13 Debtor obtained confirmation of plan which showed a small amount of equity for the junior lienholder, but later brought adversary proceeding to strip junior lien using an appraisal showing a lower value than the confirmed value. Confirmation order set the value of the real estate as scheduled.

*Charlick v. Cmty. Choice Credit Union (In re Charlick)*, 444 B.R. 762 (Bankr. E.D. Mich. 2011)

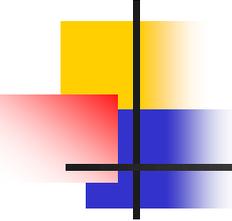


## G. Object to Plan

---

Is there an independent reason to object to the plan?

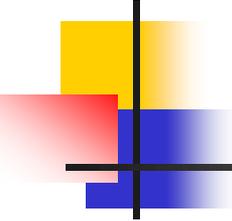
- Review plan for compliance with § 1322 and § 1325.
  - If Claim is wholly unsecured, has debtor devoted all disposable income to the plan?
  - Lien retention: If lien is to be stripped, does plan provide creditor retains lien if case is converted or dismissed?
    - Liens are revived upon dismissal or conversion.  
§ 349 (b)(1)(C) & § 348(f)(1)(C)(i).  
If Jurisdiction allows, § 1325(a)(5)(B)(i).



## H. Move to Dismiss Case

---

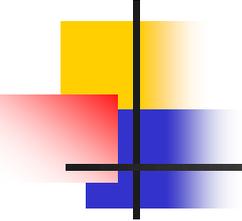
- Before and after confirmation.
- Review § 1307 for possible grounds.
  - Default in plan payments.
  - Unreasonable delay.
  - "Material Default" - Failure to pay 1st mortgage holder.
- § 109(g) - Eligibility for Chapter 13.



## I. Procedural Road Blocks

---

- If jurisdiction or court requires lien strip be brought by motion or adversary, but application is not in proper form, object.
  - May not be best practice as court will usually require the proper format.
  - The real issue is whether the lien is an "allowed secured claim", not the format of the pleading.
  
- Does Debtor propose to strip lien by operation of § 506(a) in conjunction with § 506(d)?
  - These two sections alone may not void a lien.  
*Dewsnup v. Timm*, 502 U.S. 410, 417 (U.S. 1992)  
*Orkwis v. MERS (In re Orkwis)*, 457 B.R. 243 (Bankr. E.D.N.Y. 2011)



# BEST PRACTICES

---

- Always file a secured proof of claim.
- Always review for a Chapter 20 filing.
- Do a good faith review.
- Always ensure lien survives dismissal or conversion.
- Always ensure lien strip occurs upon Chapter 13 discharge (or plan completion) and not at confirmation.
- And finally:
  - Know when to fold 'em.
    - Your client will not always have a secured claim.
    - Sometimes the best you can do is enter into an agreed order protecting the lien in case of dismissal or conversion.