DEWSNUP STRIKES AGAIN: LIEN-STRIPPING OF JUNIOR MORTGAGES IN CHAPTER 7 AND CHAPTER 13

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Most individuals entering bankruptcy must choose to file under either chapter 7 (liquidation) or chapter 13 (reorganization)—with some wealthier filers only having the option of filing chapter 11. Individuals make their chapter choice based on the relative costs and benefits of each option. This Note explores one of the issues that may encourage debtors to opt for chapter 13 bankruptcy: lien-stripping of wholly valueless junior home mortgages. Based on the reasoning of two U.S. Supreme Court cases, Nobelman v. American Savings Bank *and* Dewsnup v. Timm*, courts have generally allowed this type of lien-stripping in chapter 13 but not in chapter 7. This Note examines the application of these Supreme Court cases to the issues of whether strip off of valueless junior mortgages should be allowed in both chapter 7 and chapter 13. I argue that courts should harmonize these cases to allow strip off in both chapters because such an approach is more faithful to the language of the Bankruptcy Code and would implement better public policy.*

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INTRODUCTION

The U.S. Supreme Court decided two groundbreaking bankruptcy cases concerning lien-stripping of mortgages in the early 1990s.[1] While the cases were certainly significant at the time, the Court could not have foreseen their resulting effects nearly 20 years later following the subprime mortgage crisis of 2007. The sudden disastrous drop in home values left many people "underwater," owing much more debt than value in their homes. Additionally, many underwater homeowners financed their homes through multiple mortgages or took out junior home mortgages on equity that later evaporated after the real estate bubble burst. This steep drop in home values left many homeowners stuck with homes that have depreciated in value so much that their value does not even cover the debt they owe on principal mortgages, much less junior mortgages.

In the face of a mortgage industry unwilling to negotiate voluntary modifications, the slow start to President Obama's Home Affordable Modification Program ("HAMP"),[2] and Congress's failure to change the bankruptcy law to allow "cramdown"—the attempt by a debtor to reduce a secured claim to the value of the collateral—of home mortgages,[3] underwater debtors have seemingly few options to retain their homes. Debtors, however, may be able to eliminate mortgage debt through bankruptcy and make mortgage payments more manageable through lien avoidance of wholly unsecured junior mortgages. *Nobelman* and *Dewsnup* make it clear that debtors may not use the Bankruptcy Code's ("Code") valuation process under § 506(a) to "strip down" (the term for cramdown in the context of bankruptcy lien-stripping) undersecured mortgages[4] to the fair market value of the property and void the unsecured portion of the lien.[5] Thus, debtors in both chapter 7 and chapter 13 cannot modify principal mortgages because there will always be at least some value to support principal mortgages with senior liens. Yet, neither *Nobelman* nor *Dewsnup* directly addressed the situation in which there is no value to support a mortgage. In such instances, a debtor could argue that a mortgage without any underlying value cannot be considered "secured." In contrast to strip down—which, if allowed, would limit the security interest and lien on the property to the judicially determined fair market value—a "strip off" allows a court to completely remove the lien and consider the whole mortgage to be an unsecured debt. Debtors have attempted to strip off wholly unsecured mortgages in chapters 7 and 13 with differing results.

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1. Nobelman v. Am. Sav. Bank, 508 U.S. 324 (1993); Dewsnup v. Timm, 502 U.S. 410 (1992).

2. Jean Braucher, *Humpty Dumpty and the Foreclosure Crisis: Lessons from the Lackluster First Year of the Home Affordable Modification Program (HAMP)*, 52 ARIZ. L. REV. 727, 761 (2010) (discussing the poor performance of HAMP in its first year and possible solutions).

3. Phil Mattingly, *2009 Key Senate Votes: 174: Mortgage Loan Modification*, CQ WKLY., Jan. 4, 2010, at 61.

4. *Undersecured* means that part of the outstanding balance on the mortgage is matched by the property's value and some of the balance is not. *See* 11 U.S.C. § 506(a) (2006).

5. *Nobelman*, 508 U.S. at 332; *Dewsnup*, 502 U.S. at 417.

Although the strip-off issue divided the lower courts in chapter 13 cases initially,[6] the appellate-level courts have since uniformly allowed strip off in chapter 13 based on the implications of the *Nobelman* decision.[7] Bankruptcy courts have likewise been divided regarding strip off in chapter 7.[8] Conversely, the few federal appellate courts to address the issue have not allowed strip off in chapter 7 based on the decision in *Dewsnup*.[9]

This Note: (1) assesses lower courts' application of strip off in both chapters 7 and 13 since the Supreme Court's *Nobelman* and *Dewsnup* decisions; (2) analyzes the legal basis for the difference in results in the two chapters; and (3) evaluates the policy implications of allowing strip off in chapter 13 and not allowing it in chapter 7. Part I explains the basic elements of bankruptcy and the differences between chapter 7 and chapter 13, as the differences have important policy implications for lien-stripping. Part II sets the stage for strip off in bankruptcy by explaining the Supreme Court's decisions in *Dewsnup* and *Nobelman*, both of which deny the debtor the right to strip down a mortgage, albeit with very different reasoning. Part III surveys various courts' approaches to the issue of strip off in chapter 13. At the appellate level, six federal appellate courts, as well as three Bankruptcy Appellate Panels ("BAPs"), have allowed the practice and none have disallowed it.[10] Part IV examines the current division among courts

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6. *Compare* Waters v. Money Store (*In re* Waters), 276 B.R. 879 (Bankr. N.D. Ill. 2002), *with* Barnes v. Am. Gen. Fin. (*In re* Barnes), 207 B.R. 588 (Bankr. N.D. Ill. 2002), *and In re* Perry, 235 B.R. 603 (Bankr. S.D. Tex. 1999), *abrogated by* Bartee v. Tara Colony Homeowners Ass'n (*In re* Bartee), 212 F.3d 277 (5th Cir. 2000).

7. *See, e.g.*, Zimmer v. PBS Lending Corp. (*In re* Zimmer), 313 F.3d 1220 (9th Cir. 2002); Lane v. W. Interstate Bancorp (*In re* Lane), 280 F.3d 663 (6th Cir. 2002); Pond v. Farm Specialist Realty (*In re* Pond), 252 F.3d 122 (2d Cir. 2001); Tanner v. FirstPlus Fin., Inc. (*In re* Tanner), 217 F.3d 1357 (11th Cir. 2000); Bartee v. Tara Colony Homeowners Ass'n (*In re* Bartee), 212 F.3d 277 (5th Cir. 2000); McDonald v. Master Fin. Inc. (*In re* McDonald), 205 F.3d 606 (3d Cir. 2000); Fissette v. Keller (*In re* Fisette), 455 B.R. 177 (B.A.P. 8th Cir. 2011); Griffey v. U.S. Bank (*In re* Griffey), 335 B.R. 166 (B.A.P. 10th Cir. 2005); Domestic Bank v. Mann (*In re* Mann), 249 B.R. 831 (B.A.P. 1st Cir. 2000).

8. *Compare In re* Hoffman, 433 B.R. 437, 440 (Bankr. M.D. Fla. 2010), *In re* Caliguri, 431 B.R. 324, 328 (Bankr. E.D.N.Y. 2010), *and* Pomilio v. Mers, Homebridge Bankers Corp. (*In re* Pomilio), 425 B.R. 11, 18 (Bankr. E.D.N.Y. 2010), *with In re* Lavelle, No. 09-72389-478, 2009 WL 4043089, at *6 (Bankr. E.D.N.Y. Nov. 19, 2009), *and* Howard v. Nat'l Westminster Bank, U.S.A. (*In re* Howard), 184 B.R. 644, 647 (Bankr. E.D.N.Y. 1995).

9. *See, e.g.*, Talbert v. City Mortg. Servs. (*In re* Talbert), 344 F.3d 555, 562 (6th Cir. 2003); Ryan v. Homecomings Fin. Network, 253 F.3d 778, 783 (4th Cir. 2001); Laskin v. First Nat'l Bank of Keystone (*In re* Laskin), 222 B.R. 872, 875–76 (B.A.P. 9th Cir. 1998).

10. *See In re Zimmer*, 313 F.3d at 1227; *In re Lane*, 280 F.3d at 666–69; *In re Pond*, 252 F.3d at 126; *In re Tanner*, 217 F.3d at 1359–60; *In re Bartee*, 212 F.3d at 280; *In re McDonald*, 205 F.3d at 611; *In re Fisette*, 455 B.R. at 182; *In re Griffey*, 335 B.R. at 169; *In re Mann*, 249 B.R. at 831. Even in the circuits where the court of appeals has not addressed the issue, courts seem to be in agreement that strip off is permitted in the chapter 13 context. Some early bankruptcy court decisions denied strip off of wholly valueless junior mortgages in chapter 13 remain outstanding, but these opinions were issued prior to any federal appellate court ruling on the issue. *See In re Barnes*, 207 B.R. at 592–94; *In re*

regarding whether to allow strip off in chapter 7. Part V evaluates whether this disparate treatment in chapters 7 and 13 can be reconciled and whether courts should extend strip off to chapter 7 bankruptcies. Part VI considers the policy implications of allowing and disallowing strip off in chapters 13 and 7, respectively, and concludes that courts should permit strip off in both chapter 13 and chapter 7.

I. BANKRUPTCY: CHAPTER 7 VERSUS CHAPTER 13

A. Chapter 7

Although chapter 7 of the Code is known as the liquidation chapter, very little liquidation occurs in it because most cases are "no asset" cases where there is nothing to liquidate after exemptions are claimed. In this chapter, a court appoints a trustee, or sometimes the creditors elect a trustee pursuant to certain limitations.[11] The trustee is responsible for, among other duties, "collect[ing] and reduc[ing] to money the property of the estate for which such trustee serves, and clos[ing] such estate as is compatible with the best interests of parties in interest."[12] Before any liquidation can take place, the trustee must identify property of the estate[13] and determine which claims are secured and which are unsecured.[14] A debtor in chapter 7 has four options regarding secured claims. First, the debtor can surrender the property to the creditor.[15] The creditor is entitled to an unsecured claim for any deficiency unless there is an antideficiency statute under state law.[16] Second, the debtor may redeem personal property pursuant to § 722.[17] By redeeming, the debtor retains the secured personal property by paying "the amount of the allowed secured claim," i.e., the current value of the property, to the creditor.[18] Third, the debtor may enter into a reaffirmation agreement with the creditor under § 524(c).[19] Reaffirming the debt binds the debtor to a new agreement[20] with the creditor under which the debtor assumes liability for the loan after bankruptcy.[21] Finally, in some

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Robinson, 231 B.R. 30, 34 (Bankr. D.N.J. 1997). More recently, either: (1) BAPs in these circuits have disagreed with those decisions or, (2) even when a BAP has not issued a decision in the circuit, the bankruptcy courts have looked to the reasoning of the federal appellate courts in the other circuits and have allowed strip off in chapter 13. *See In re Mann*, 249 B.R. at 831; *In re* King, 290 B.R. 641, 645–46 (Bankr. C.D. Ill. 2003).

11. 11 U.S.C. § 702 (2006).

12. *Id.* § 704(a)(1).

13. *Id.* § 541.

14. *Id.* § 506. "An allowed claim . . . 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." *Id.*

15. *Id.* § 521(a)(2)(A).

16. *See, e.g.*, ARIZ. REV. STAT. ANN. § 33-814(G) (2011).

17. 11 U.S.C. § 722 (2006).

18. *Id.*

19. *Id.* § 524(c).

20. This new agreement may contain similar or even the exact same terms as the loan incurred prior to bankruptcy.

21. 11 U.S.C. § 524(c) (2006). In order to reaffirm, the debtor must file the agreement with the court and attach a declaration or an affidavit written by her attorney. *Id.*

instances the debtor may "ride-through" on some loans by continuing to pay the debt without redeeming or reaffirming.[22]

After the secured creditors are satisfied, the trustee liquidates the debtor's assets and distributes the money to the unsecured creditors.[23] The debtor, however, may also claim exemptions in property. The Code specifies these exemptions but also allows states to opt-out of the federal list and create their own lists of exemptions.[24] As mentioned above, most chapter 7 cases are no asset cases,[25] which means that there is generally nothing to liquidate once the debtor claims exemptions, leaving unsecured claimants with nothing. The court wraps up the bankruptcy case by issuing a discharge to the debtor.[26]

B. Chapter 13

Chapter 13 is known as a repayment chapter, in which the debtor commits post-petition income in excess of reasonable expenses to repay pre-petition debts. The debtor must first file a plan to repay the creditors.[27] The plan must have the appropriate content[28] and pass numerous tests before the court will confirm it.[29]

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§ 524(c)(3). Alternatively, if the debtor is not represented by an attorney, she must get approval from the court in a hearing. Thus, in including these procedural impediments in the Code, Congress appears to be skeptical of reaffirmation agreements. For purposes of this Note, it is important to remember that reaffirmations do not play a major role in mortgages in bankruptcy. This is because, at least in states with antideficiency statutes for homesteads, a debtor gets no greater protection from purchase-money lenders in bankruptcy than she would have under nonbankruptcy law. Whether in bankruptcy or not, the lender cannot collect a deficiency.

22. Since the 2005 amendments to the Code, § 521(a)(6) in conjunction with § 362(h) have been interpreted to preclude ride-through on personal property. *See, e.g.*, Dumont v. Ford Motor Credit Co., 581 F.3d 1104 (9th Cir. 2009). However, § 524(j) seems to allow ride-through on real estate loans. Jean Braucher, *Rash and Ride-Through Redux: The Terms for Holding on to Cars, Homes and Other Collateral Under the 2005 Act*, 13 AM. BANKR. INST. L. REV. 457, 480 (2005).

23. 11 U.S.C. § 726 (2006).

24. *Id.* § 522. For example, the state of Arizona allows debtors to claim a $150,000 exemption in a homestead and exemptions in various personal property such as furniture; food, fuel and other provisions; and personal items. ARIZ. REV. STAT. ANN. §§ 33-1101, -1123, -1124, -1125 (2011). Delaware, by contrast, lists only a few specific exemptions, including those for a personal homestead, but grants debtors a $25,000 "wildcard" exemption in personal property or equity in real property other than the homestead exemption. DEL. CODE ANN. tit. 10, § 4914 (2011).

25. *Liquidation Under the Bankruptcy Code*, U.S. CTS., http://www.uscourts.gov/FederalCourts/Bankruptcy/BankruptcyBasics/Chapter7.aspx (last visited Sept. 9, 2011).

26. 11 U.S.C. § 727 (2006).

27. *Id.* § 1321.

28. *Id.* § 1322. The plan must provide for the submission of the debtor's income necessary to execute the plan, provide for the full payment of all claims entitled to priority under § 507, provide the same treatment of claims within the same class, and the plan can pay less than the full amount to priority claims only if the plan specifies that all of the debtor's projected disposable income for a five-year period will be applied to make payments under the plan. *Id.* § 1322(a). Section 1322(b) specifies what the debtor *may* include in the plan, including the modification of the rights of holders of secured claims,

The repayment plan lasts for three to five years.[30] In chapter 13, a debtor may keep even nonexempt property if the debtor pays the value of the assets over the life of the plan.[31] The debtor generally funds the plan from post-petition income.[32] Finally, a court grants a discharge to the debtor only upon completion of the plan.[33]

C. Policies Behind the Bankruptcy Chapters

A basic understanding of the two chapters is necessary to fully comprehend the policy implications of treating junior mortgages differently in each of the chapters. Bankruptcy—chapter 7 bankruptcy in particular—is said to have the purpose of giving debtors a "fresh start."[34] This does not mean, however, that the creditors' interests in chapter 7 are nonexistent. Debtors with "regular income"[35] who do not pass the chapter 7 "means-testing"[36] must instead file under chapter 13[37] where they submit a plan to repay creditors.[38] This framework indicates that Congress prefers that individuals who are able to pay their creditors do so through a chapter 13 plan rather than get an immediate discharge through chapter 7. Still, it is unwise to push debtors into a chapter 13 repayment plan if they have little chance of success; they will not get the benefits of a bankruptcy discharge, they will be left with the same debts that they had before their filing for bankruptcy, and the creditors will not be fully paid. These policy implications are not only important for Congress's consideration in enacting legislation. They are also relevant to courts' understanding of Congress's intent in enacting the modern Code.

These general policy concerns play out in the context of lien-stripping junior mortgage liens as well. If debtors are allowed to strip off valueless junior liens on their mortgages in chapter 7 as well as chapter 13, they are more likely to file under chapter 7 where they may get a discharge of debt—including some or all of the newly unsecured debt from the junior mortgage—and get out of bankruptcy relatively quickly. This would promote the "fresh start" goal of bankruptcy. Conversely, if debtors may only strip junior mortgage liens in chapter 13, the chapter that requires a repayment plan of three to five years, debtors have a more difficult choice: attempt a repayment plan in chapter 13 in order strip the junior mortgage, or file a chapter 7 bankruptcy and allow the junior lien to remain intact in order to get a quicker discharge and an exit from bankruptcy. Such a situation encourages debtors to attempt a chapter 13 bankruptcy, which generally provides more payment to creditors.

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other than a claim secured only by a security interest in real property that is the debtor's principal residence, and of the rights of holders of unsecured claims. *Id.* § 1322(b)(2).

29. *Id.* § 1325.

30. *Id.* §§ 1325(b), 1322(d)(1)–(2).

31. *Id.* § 1325(a)(4).

32. *Id.* § 1326.

33. *Id.* § 1328.

34. *See* Marrama v. Citizens Bank of Mass., 549 U.S. 365, 367 (2007).

35. 11 U.S.C. § 109(e) (2006).

36. *Means-testing* refers to an eligibility test that limits the right of debtors to use chapter 7 if the debtor earns more than a certain "disposable income." *Id.* § 707(b).

37. *Id.*

38. *Id.* § 1321.

II. HISTORICAL DEVELOPMENT: "STRIP DOWNS" IN *DEWSNUP* AND *NOBELMAN*

A. Dewsnup v. Timm

The Supreme Court's *Dewsnup* decision stemmed from a circuit split of two U.S. courts of appeals regarding the interplay between § 506(a) and § 506(d).[39] Section 506(a) defines the terms "secured claim" and "unsecured claim."[40] Section 506(d) states: "To the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void."[41] The Third Circuit initially determined that chapter 7 debtors could avoid the unsecured part of the lien, as defined by § 506(a), by using § 506(d)'s lien-avoidance provision.[42] The court based its decision primarily on the reasoning that the creditor would be in the same position as if the creditor liquidated the property outside of bankruptcy and that Congress intended § 506 to be used for the debtor's fresh start and not only for the benefit of creditors.[43] Less than a year later, the U.S. Court of Appeals for the Tenth Circuit considered the same issue and came to the conclusion that

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39. At the time a majority of bankruptcy courts had allowed strip down in chapter 7. *See, e.g.*, *In re* Moses, 110 B.R. 962, 963–64 (Bankr. N.D. Okla. 1990); Brouse v. CSB Mortg. Corp. (*In re* Brouse), 110 B.R. 539, 541 (Bankr. D. Colo. 1990); Zlogar v. IRS (*In re* Zlogar), 101 B.R. 1, 7 (Bankr. N.D. Ill. 1989); Tanner v. Fin. Am. Consumer Disc. Co. (*In re* Tanner), 14 B.R. 933, 939 (Bankr. W.D. Pa. 1981).

40. 11 U.S.C. § 506(a)(1)–(2) (2006):

> (a)(1) An allowed claim of a creditor secured by a lien on property in which the estate has an interest, or that is subject to setoff under section 553 of this title, is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, or to the extent of the amount subject to setoff, as the case may be, and is an unsecured claim to the extent that the value of such creditor's interest or the amount so subject to setoff 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.
>
> (2) If the debtor is an individual in a case under chapter 7 or 13, such value with respect to personal property securing an allowed claim shall be determined based on the replacement value of such property as of the date of the filing of the petition without deduction for costs of sale or marketing. With respect to property acquired for personal, family, or household purposes, replacement value shall mean the price a retail merchant would charge for property of that kind considering the age and condition of the property at the time value is determined.

41. *Id.* § 506(d).

42. Gaglia v. First Fed. Sav. & Loan Ass'n, 889 F.2d 1304, 1308 (3d Cir. 1989) (noting that the risk that bankruptcy courts improperly value the property is a risk that occurs in other contexts but that the "law generally assumes that these valuations are reasonable approximations of the market").

43. *Id.*

debtors could not strip down undersecured liens.[44] The Tenth Circuit came to this decision for three reasons: (1) the estate does not have an interest in property abandoned by the trustee and there is no bankruptcy distributional purpose served by voiding the lien; (2) allowing this relief would give debtors more in a chapter 7 liquidation than they would receive in reorganization chapters; and (3) allowing such avoidance renders § 722 regarding redemption meaningless.[45]

The Supreme Court granted certiorari and affirmed the Tenth Circuit's holding, but applied very different reasoning.[46] In *Dewsnup*, the debtor owed $119,000 on a loan accompanied by a deed of trust granting a lien on two parcels of farmland and the bankruptcy court determined that the value of the land was $39,000.[47] The debtor argued that § 506(a) defines a claim as "secured" only to the extent of the judicially determined value and, therefore, a court could avoid any claim that was not an "allowed secured claim," as mentioned in § 506(d) and as defined in subsection (a).[48]

The *Dewsnup* Court found ambiguity in the text of § 506 and embraced the creditor's alternative argument that the phrase "allowed secured claim" in § 506(d) cannot be read as an indivisible term of art as defined in § 506(a).[49] Instead, the phrase means that the claim is first "allowed" as defined by § 502[50] and then "secured" by a lien with recourse to the underlying collateral.[51] The Court based this reading on its interpretation of the pre-Code "rule" that a lien on real property passes through bankruptcy unaffected and reasoned that Congress would

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44. Dewsnup v. Timm (*In re* Dewsnup), 908 F.2d 588, 598 (10th Cir. 1990), *aff'd*, 502 U.S. 410 (1992).

45. *Id.* at 589. The court reasoned that allowing debtors to strip down to the secured amount essentially gives the right of redemption for real property, which the redemption provision § 722 limits to personal property. *Id.* at 592. If the Supreme Court insists on denying strip down to debtors, it should follow the logical and comprehensible analysis of the Tenth Circuit. When the Tenth Circuit decided *Dewsnup*, it did not grasp for vague pre-Code policy in its reasoning. Instead, the court reasoned that § 506 was not meant to be used for "strip down" and strip off of mortgage liens in chapter 7 based on the logic that allowing debtors to do so would render § 722, the debtor's right to redemption, meaningless. The argument proceeds as follows: the Code provides the debtor with the right to redeem *personal* property in § 722 by using § 506 to bifurcate the claim into secured and unsecured parts and then paying the value of the secured part. Allowing a debtor to strip down a mortgage lien on real property could theoretically allow the debtor to redeem real property, which is not allowed under § 722. Therefore, it follows that Congress did not intend to allow debtors to use § 506 to bifurcate mortgage debt and redeem the property. This interpretation accomplishes the same result that the Supreme Court reached and is also infinitely more logical and comprehensible than the Supreme Court's attempt to divine congressional purpose over the last 100 years. *Id.* Regardless, the Tenth Circuit's reasoning still uses congressional purpose to divine the meaning of the statute when the plain meaning of § 506 is very clear.

46. Dewsnup v. Timm, 502 U.S. 410, 414, 419 (1992).

47. *Id.* at 412–13.

48. *Id.* at 414–15.

49. *Id.* at 415–17.

50. 11 U.S.C. § 502 (2006).

51. *Dewsnup*, 502 U.S. at 415.

have been more clear had it wished to depart from this rule.[52] Justice Scalia, joined by Justice Souter, dissented based on the plain meaning of § 506(d) and argued that the term "allowed secured claim" must bear the same meaning throughout the Code as a term of art defined in § 506(a).[53] Although the *Dewsnup* decision has faced harsh criticism in the intervening years (especially in its understanding of pre-Code bankruptcy practice as well as the legislative history in the enactment of the Code)[54] and is arguably qualified by the *Nobelman* case, it is the law of the land.

B. Nobelman v. American Savings Bank

Following *Dewsnup*, courts had to consider the decision's implications for claim bifurcation in the reorganization chapters, specifically in Chapter 13, and they have taken varying approaches.[55] At the appellate level, four U.S. courts of appeals determined that the debtor could look to § 506(a) to determine that debtors could bifurcate the mortgage into unsecured and secured portions and then modify the unsecured portion in bankruptcy.[56] The Fifth Circuit split from the other courts of appeals that considered the issue and rejected this approach in *In re Nobelman*.[57]

The Supreme Court granted certiorari in the *Nobelman* case to resolve the split in the same year the Court decided *Dewsnup*.[58] Here, the bank filed a proof of claim for $71,335 on the note secured by the lien on the debtor's principal residence while the debtor's chapter 13 plan valued the property at only $23,500.[59] Section 1322(b)(2) provides that a plan may "modify the rights of holders of secured claims, *other than a claim secured only by a security interest in real property that is the debtor's principal residence*, or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims."[60] The Court had to determine whether the antimodification provision in § 1322(b)(2) applied to an undersecured mortgage lien.

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52. *Id.* at 418.

53. *Id.* at 420–23 (Scalia, J., dissenting).

54. Margaret Howard, *Secured Claims in Bankruptcy: An Essay on Missing the Point*, 23 CAP. U. L. REV. 313, 314–15 (1994) (noting that the Supreme Court had only held the Frazier–Lemke Act unconstitutional due to its retroactive nature and not because Congress was not allowed to limit the creditor's recovery to the value of the collateral and pointing to the House Report in enacting the Code to show that Congress intended to strengthen debtors' hand in dealing with secured creditors).

55. Mary Josephine Newborn, *Unsecured Creditors in Bankruptcy:* Dewsnup*,* Nobelman*, and the Decline of Priority*, 25 ARIZ. ST. L.J. 547, 582–90 (1994).

56. Eastland Mortg. Co. v. Hart (*In re* Hart), 923 F.2d 1410, 1411 (10th Cir. 1991); Bellamy v. Fed. Home Loan Mortg., 962 F.2d 176, 179–80 (2d Cir. 1990); Wilson v. Commonwealth Mortg. Corp., 895 F.2d 123, 126–29 (3d Cir. 1990); Hougland v. Lomas & Nettleton Co. (*In re* Hougland), 886 F.2d 1182, 1183 (9th Cir. 1989).

57. Nobelman v. Am. Sav. Bank (*In re* Nobelman), 968 F.2d 483 (5th Cir. 1992), *aff'd*, 508 U.S. 324 (1993).

58. Nobelman v. Am. Sav. Bank, 506 U.S. 1020 (1992).

59. Nobelman v. Am. Sav. Bank, 508 U.S. 324, 326 (1993).

60. 11 U.S.C. § 1322(b)(2) (2006) (emphasis added).

Just as in *Dewsnup*, the Court concluded that debtors could not strip down the mortgage to the secured amount, but it used very different reasoning.[61] Although the Court affirmed the Fifth Circuit's conclusion, it contradicted the lower court by deeming it appropriate to look first to § 506(a) "for a judicial valuation of the collateral to determine the status of the bank's secured claim."[62] The Court next stated that "the bank is still the 'holder' of a 'secured claim,' despite its undersecured position, because petitioners' home retains $23,500 of value as collateral" and is thus entitled to the rights of a mortgagee.[63] The Court reasoned that the debtors could not reduce the mortgage principal to the fair market value "without modifying the bank's rights 'as to interest rates, payment amounts and other contract terms.'"[64] This implies that the presence of at least some value preserves the creditor's rights in regard to an undersecured mortgage. In his concurrence, Justice Stevens added that the legislative history, which suggests that the antimodification provision in § 1322(b)(2) was intended by Congress to encourage home ownership by giving more protection for loans made to purchase homes, supported the decision.[65]

C. Summary

In sum, both *Dewsnup* and *Nobelman* hold that lien avoidance, or strip down, is not allowed under either chapter 7 or chapter 13. It is important to note the differences, however, between the Court's reasoning in each case. In *Dewsnup*, the Court chose to disregard the definition of "allowed secured claim" set forth in § 506(a) to define the phrase as used in § 506(d),[66] while in *Nobelman* it indicated that it was proper to rely on § 506(a) when determining the meaning of "allowed secured claim" in § 1322(b)(2).[67]

III. STRIP OFF IN CHAPTER 13

Since the *Nobelman* decision, lower courts have been left to grapple with whether wholly unsecured mortgages may be subject to strip off. Although the issue initially divided the courts, debtors have been very successful at the appellate level in obtaining the right to avoid wholly unsecured liens in chapter 13. The first federal appellate court to rule on this issue was the Ninth Circuit Bankruptcy Appellate Panel[68] in *In re Lam* and it is generally representative of the reasoning

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61. *Nobelman*, 508 U.S. at 331–32.
62. *Id.* at 328.
63. *Id.* at 329.
64. *Id.* at 331.
65. *Id.* at 332 (Stevens, J., concurring).
66. Dewsnup v. Timm, 502 U.S. 410, 412–13 (1992).
67. *Nobelman*, 508 U.S. at 328–29.
68. Circuit courts of appeals' judicial councils may constitute a BAP in their respective circuits, and a majority of district court judges in that circuit may empower the BAP to hear cases. If a circuit has not constituted and empowered a BAP, parties instead appeal cases from bankruptcy courts to district courts. Also, the precedential value of BAPs is questionable; their rulings may or may not be binding on bankruptcy courts. *See* Jonathan Remy Nash & Rafael I. Pardo, *An Empirical Investigation into Appellate Structure and the Perceived Quality of Appellate Review*, 61 VAND. L. REV. 1745, 1753–69 (2008).

used later by federal courts of appeals in allowing strip off in chapter 13.[69] In that case, the chapter 13 debtors' personal residence had a fair market value of $300,000 and was encumbered by four deeds of trust in the following amounts: (1) $164,222, (2) $61,824, (3) $560,000, and (4) $17,193.[70] Thus, the fourth lien was wholly unsupported by any value. In allowing the debtors to strip off the fourth lien, the court focused on the plain language of the statute and the legislative history, while later appellate courts used a very similar rationale and also added policy-based reasons.

A. Plain Language: Looking to Section 506(a) for Definitions

First, the BAP deemed it appropriate to begin the analysis by looking to § 506(a) to determine whether the creditor is a "holder of a secured claim" under § 1322(b)(2).[71] The court stated: "*Nobelman*'s reference to § 506(a) is 'meaningless unless some portion of the claim must be secured under § 506(a) analysis before the creditor is entitled to retain the rights it has under state law.'"[72] Indeed, Justice Thomas's majority opinion in *Nobelman* confirms: "[T]he bank is still the 'holder' of a 'secured claim,' because petitioners' home retains $23,500 of value as collateral. The portion of the bank's claim that exceeds $23,500 is an 'unsecured claim component' under § 506(a)."[73] Later, in another decision allowing strip off, the Fifth Circuit reasoned that the Supreme Court had rejected its previous determination that § 506(a) did not apply to § 1322(b)(2) in the *Nobelman* case and instead "confirm[ed] that § 506(a) is the starting point in the analysis."[74]

The conundrum present in *Nobelman*, when there is a lien with some value, is absent in the case of the valueless junior mortgages. While the *Nobelman* Court determined that it was appropriate for a debtor to use judicial valuation as set forth in § 506(a), it held that "that determination does not necessarily mean that the 'rights' the bank enjoys as a mortgagee, which are protected by § 1322(b)(2), are limited by the valuation of its secured claim."[75] The Court determined that an undersecured debtor is still entitled to certain state-law rights and that modification of the unsecured part of the mortgage would inevitably result in the modification of the secured part and its associated rights.[76] If a bankruptcy court stripped down a mortgage to its judicially determined value, for instance, it would reduce the term of the note to preserve the interest rate and amount of each monthly payment.[77] The Court held that the antimodification provision of § 1322(b)(2) cannot allow such inevitable modification.[78] The result of the reduced term would

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69. Lam v. Investors Thrift (*In re* Lam), 211 B.R. 36 (B.A.P. 9th Cir. 1997).
70. *Id.* at 37.
71. *Id.* at 40.
72. *Id.*
73. Nobelman v. Am. Sav. Bank, 508 U.S. 324, 329 (1993).
74. Bartee v. Tara Colony Homeowners Ass'n (*In re* Bartee), 212 F.3d 277, 286 (5th Cir. 2000).
75. *Nobelman*, 508 U.S. at 329.
76. *Id.* at 329–31.
77. *Id.* at 331.
78. *Id.*

be a type of modification necessitated by the strip down, yet not allowed under the antimodification provision. In the case of wholly unsecured loans, there is no partially secured portion of the loan that would implicate any rights regarding interest rate, payment length, and total payment; a strip off of a valueless junior mortgage would not affect any of these corollary rights.

B. Legislative History

The Ninth Circuit BAP relied on the legislative history behind § 1322(b)(2) in allowing strip off of wholly unsecured junior mortgages in chapter 13.[79] This can be broken into two sections: (1) encouragement of home lending and (2) distinguishing between an unsecured claim and an unsecured creditor.

1. Encouragement of Home Lending

The court cited Justice Stevens's concurrence in *Nobelman* noting that "protecting 'holders of secured claims' is consistent with the congressional intent of encouraging home lending by residential mortgagees."[80] Because "second mortgages are not in the business of lending money for home purchases, the same policy reasons for protection of first mortgagees under § 1322(b)(2) do not exist for second mortgages."[81]

2. Unsecured Claims Versus Unsecured Creditors

The court observed that "the legislative history indicates that Congress intended to distinguish between secured and unsecured claims, rather than between secured and unsecured creditors."[82] Since *In re Lam*, two other BAPs and five U.S. courts of appeals (including the decision of the Ninth Circuit affirming the BAP's decision in *In re Lam*) have also determined that strip off is allowed in chapter 13 and came to the conclusion based largely on the same reasoning.[83] The Third Circuit stated that "while the antimodification clause uses the term 'claim' rather than 'secured claim' and therefore applies to both the secured and unsecured part of a mortgage, the antimodification clause still states that the claim must be 'secured only by a security interest in . . . the debtor's principal residence.'"[84] Thus, if the holder's claim is wholly unsecured, the creditor is not the holder of a

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79. Lam v. Investors Thrift (*In re* Lam), 211 B.R. 36, 41 (B.A.P. 9th Cir. 1997).

80. *Id.*

81. *Id.*

82. *Id.*

83. Zimmer v. PBS Lending Corp. (*In re* Zimmer), 313 F.3d 1220, 1224 (9th Cir. 2002); Lane v. W. Interstate Bancorp (*In re* Lane), 280 F.3d 663, 667 (6th Cir. 2002); Pond v. Farm Specialist Realty (*In re* Pond), 252 F.3d 122, 125–26 (2d Cir. 2001); Tanner v. FirstPlus Fin., Inc. (*In re* Tanner), 217 F.3d 1357, 1359 (11th Cir. 2000); Bartee v. Tara Colony Homeowners Ass'n (*In re* Bartee), 212 F.3d 277, 286, 292 (5th Cir. 2000); McDonald v. Master Fin. Inc. (*In re* McDonald), 205 F.3d 606, 609–10, 613 (3d Cir. 2000); Griffey v. U.S. Bank (*In re* Griffey), 335 B.R. 166, 170 (B.A.P. 10th Cir. 2005); Domestic Bank v. Mann (*In re* Mann), 249 B.R. 831, 837, 839 (B.A.P. 1st Cir. 2000).

84. *In re McDonald*, 205 F.3d at 612.

claim secured by the debtor's principal residence.[85] The Third Circuit also emphasized that the purported rights of a junior mortgagee have little legal or practical significance when the lien is completely unsecured.[86] The Ninth Circuit BAP aptly contrasted a wholly unsecured junior mortgagee's rights with those of the mortgage holder in *Nobelman*:

> Nothing secures the "right" of the lienholder to continue to receive monthly installment payments, to retain the lien until the debt is paid off, or the right to accelerate the loan upon default, if there is no security available to the lien holder to foreclose on in the event the debtor fails to fulfill the contract payment obligations.[87]

This argument relates back to the "rights" to which secured and undersecured mortgagees would be entitled. Essentially, wholly unsecured mortgagees have no practical rights to the collateral property under nonbankruptcy law, so they should not get more than what they are entitled to simply because the debtor is in bankruptcy.

C. Policy-Based Reasons

1. Arbitrariness

Creditors also argued that assignment of value to the property by the court, which is a question of fact, could arbitrarily determine the secured or unsecured status of a mortgage.[88] For example, having one dollar of value beyond the balance of the senior mortgage renders a junior mortgage partially secured, whereas assigning a value to the property one dollar less than the amount of the senior mortgage results in an unsecured junior mortgage. In *In re Lane*, the Sixth Circuit addressed this issue by simply stating: "[W]e live in a world that abounds with arbitrary distinctions. . . . [T]his court holds no warrant to cleanse the United States Code of arbitrary distinctions."[89] The Third Circuit agreed, maintaining that "bright-line rules that use a seemingly arbitrary cut-off point are common in the law."[90] It listed as an example: "[I]n bankruptcy law a chapter 7 trustee cannot contest the validity of a debtor's claimed exemption when the 30-day period for objecting has expired and the trustee failed to obtain an extension . . . ."[91] "What these examples show," continued the Third Circuit, "is that line drawing is often required in the law and, at the boundary, the appearance of unfairness is unavoidable. Simply pointing out that some arbitrariness occurs is not a compelling objection."[92]

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85. *Id.*
86. *Id.*
87. *In re Lam*, 211 B.R. at 40.
88. *See, e.g.*, *In re McDonald*, 205 F.3d at 613.
89. Lane v. W. Interstate Bancorp (*In re* Lane), 280 F.3d 663, 669 (6th Cir. 2002).
90. *In re McDonald*, 205 F.3d at 613.
91. *Id.*; FED. R. BANKR. P. 4003(b).
92. *In re McDonald*, 205 F.3d at 613.

2. Lesser Protection for Junior Mortgages

The Fifth Circuit delved further into the legislative history. In addition to the legislative history regarding only § 1322(b)(2), the court looked to the subsequent legislative history surrounding § 1322(b)(2) and found that "Congress repeatedly studied ways to reduce the protection of subordinate and 'short term' mortgages in chapter 13 cases."[93] It determined that, "by enactment of § 1322(b)(2), Congress sought to withdraw antimodification protection from certain classes of 'second mortgages,' including 'short-term, high-interest rate home equity loans.'"[94] In enacting this exception, Congress "intend[ed] to maintain the protections afforded home mortgage lenders, while preventing 'thinly disguised personal' lending from taking advantage of those protections."[95]

3. Chapter Choice

The courts were also cognizant of the effect that enforcing the antimodification clause would have on debtors' choice of chapter to file under. The Fifth Circuit commented that allowing strip off of wholly unsecured junior mortgages in chapter 13 "better serves the policy imperatives of the Bankruptcy Code by encouraging debtors to first consult chapter 13 before seeking either to reorganize pursuant to the more expensive and cumbersome chapter 11 or liquidate pursuant to chapter 7."[96] The Third Circuit agreed with the assessment that Congress prefers individual debtors to use chapter 13 instead of chapter 7.[97] In that case, the creditor argued that chapter 7 did not offer a viable alternative because the Supreme Court rejected lien-stripping in chapter 7 in the *Dewsnup* case.[98] The court mentioned in passing that the courts are split as to whether *Dewsnup*'s rejection of lien-stripping in chapter 7 applies to a wholly unsecured lien, but held that, regardless, chapter 7 offers discharge of personal liability so that "*Dewsnup* does not eliminate the incentive to switch from chapter 13 to 7 in order to escape debt on a home that far exceeds the home's value."[99] Thus, the courts allowing strip off in chapter 13 see strip off as an incentive to induce debtors to file under chapter 13 rather than chapter 7, signaling one possible reason that they are reluctant to allow strip off in chapter 7.

IV. STRIP OFF IN CHAPTER 7

As with the case of strip off in chapter 13, the issue of whether to allow strip off has divided courts in the case of chapter 7 debtors.[100] Only three appellate-

93. Bartee v. Tara Colony Homeowners Ass'n (*In re* Bartee), 212 F.3d 277, 286, 293–94 (5th Cir. 2000).
94. *Id.* at 294.
95. *Id.*
96. *Id.* at 294–95.
97. *In re McDonald*, 205 F.3d at 614.
98. *Id.*
99. *Id.* at 614–15.
100. *Compare* Talbert v. City Mortg. Servs. (*In re* Talbert), 344 F.3d 555 (6th Cir. 2003), Ryan v. Homecomings Fin. Network, 253 F.3d 778 (4th Cir. 2001), Laskin v. First Nat'l Bank of Keystone (*In re* Laskin), 222 B.R. 872 (B.A.P. 9th Cir. 1998), *In re* Hoffman, 433 B.R. 437 (Bankr. M.D. Fla. 2010), *In re* Caliguri, 431 B.R. 324 (Bankr. E.D.N.Y.

level courts have addressed the issue thus far.[101] Of those, the two courts of appeals and one BAP have held that unsecured liens may not be stripped off in a chapter 7 proceeding by using § 506(d).[102] There are still, however, some district courts that have allowed strip off in chapter 7. These decisions remain good law.[103] Furthermore, only three appellate-level courts have addressed the issue, so the question remains open in most circuits.[104]

A. Courts that Have Not Allowed Strip Off in Chapter 7

Both the Fourth and the Sixth Circuits have denied strip off in the chapter 7 context and have extrapolated their reasoning from *Dewsnup*. The argument of these courts breaks down into two parts: (1) analysis of the statutory language[105] and (2) the general rule that liens on real property pass through bankruptcy unaffected and the lack of evidence that Congress intended to change that rule.[106] Additionally, the courts list two justifications that can be thought of as derivative of the latter "rule." First, the mortgagor and mortgagee bargained for a consensual lien on the real property that would pass through bankruptcy.[107] Second, any increase in value of the property accrues to the benefit of the creditor and not the debtor.[108]

2010), *and* Pomilio v. Mers, Homebridge Bankers Corp. (*In re* Pomilio), 425 B.R. 11 (Bankr. E.D.N.Y. 2010), *with In re* Lavelle, No. 09-72389-478, 2009 WL 4043089 (Bankr. E.D.N.Y. Nov. 19, 2009), *and* Howard v. Nat'l Westminster Bank, U.S.A. (*In re* Howard), 184 B.R. 644 (Bankr. E.D.N.Y. 1995).

101. *In re Talbert*, 344 F.3d 555; *Ryan*, 253 F.3d 778; *In re Laskin*, 222 B.R. 872. Although the Fourth Circuit Court of Appeals affirmed the district court's holding in *Ryan*, it abrogated rulings by other district courts in the Fourth Circuit that had allowed strip off in chapter 7. *See* Warthen v. Smith (*In re* Smith), 247 B.R. 191 (W.D. Va. 2000); Yi v. Citibank (*In re* Yi), 219 B.R. 394, 397 (E.D. Va. 1998). Likewise, the *Talbert* decision affirmed the district court's decision, but overruled the bankruptcy court's decision to allow strip off in chapter 7. *See* Farha v. First Am. Title Ins. (*In re* Farha), 246 B.R. 547 (Bankr. E.D. Mich. 2000); Zempel v. Household Fin. Corp. (*In re* Zempel), 244 B.R. 625 (Bankr. W.D. Ky. 1999).

102. *In re Talbert*, 344 F.3d at 559; *Ryan*, 253 F.3d at 783; *In re Laskin*, 222 B.R. at 876.

103. *In re Lavelle*, 2009 WL 4043089; *In re Howard*, 184 B.R. 644.

104. *In re Talbert*, 344 F.3d at 562; *Ryan*, 253 F.3d at 783; *In re Laskin*, 222 B.R. at 875–76. Again, as noted, decisions from BAPs have questionable precedential value so the *Laskin* case may not be binding on bankruptcy courts. Moreover, Congress passed the Bankruptcy Abuse Prevention and Consumer Protection Act in 2005 after some of the decisions regarding strip off, so it is at least arguable that Congress meant to continue the distinction and allow strip off in chapter 13 but not in 7. Alternatively, Congress's silence may mean that it did not consider the issue at all.

105. Dewsnup v. Timm, 502 U.S. 410, 413 (1992); *In re Talbert*, 344 F.3d at 559; *Ryan*, 253 F.3d at 781.

106. *In re Talbert*, 344 F.3d at 560; *Ryan*, 253 F.3d at 781.

107. *In re Talbert*, 344 F.3d at 561; *Ryan*, 253 F.3d at 782.

108. *In re Talbert*, 344 F.3d at 559; *Ryan*, 253 F.3d at 781–82.

1. Interpretation of the Statutory Language

The courts relied on the *Dewsnup* Court's interpretation of the statutory language itself. The Fourth Circuit focused on the following language in *Dewsnup*:

> Section 506(d) does not allow petitioner to "strip down" respondents' lien, *because respondents' claim is secured by a lien* and has been fully allowed pursuant to § 502. Were we writing on a clean slate, we might be inclined to agree with the petitioner that the words "allowed secured claim" must take the same meaning in § 506(d) as in § 506(a).[109]

The Supreme Court rejected the interpretation that "allowed secured claim" in § 506(d) must be a term of art defined in § 506(a).[110] Instead, the Court interpreted the terms "secured" and "allowed" separately where "secured" means that there is a lien securing the property and "allowed" takes its definition under § 502.[111] Although the Fourth Circuit did not explicitly state as much, its citation of the above paragraph shows that it believes that having a lien gives the creditor a security interest in the property regardless of the property's valuation.[112]

The Sixth Circuit came to the same conclusion. Based on its reading of *Dewsnup*, the Sixth Circuit held that the terms "allowed" and "secured" should be read term by term so that a lien is "secured" if the "claim is secured by a lien."[113] Thus, both courts of appeals recognize the junior mortgage as being secured simply because the junior mortgage has a recorded lien, and not based on any value. This conclusion rests on the assumption that the *Dewsnup* Court meant that, even without the assistance of § 506(a)'s definition of "allowed secured claim," "secured by a lien" means the same thing whether the loan is supported by some value or none at all. Consequently, courts have interpreted the inclusion of the term "allowed secured claim" in § 506(d) to mean that § 506(d) only voids a lien when the claim it has secured has not been allowed.[114]

2. Liens on Real Property Pass Through Bankruptcy Unaffected

Courts have also denied strip off in chapter 7 on the basis of a general policy that liens on real property pass through bankruptcy unaffected. The Fourth Circuit quoted the Supreme Court when it noted that it was not plausible that Congress had the intention to grant a debtor a "broad new remedy" of stripping off a junior mortgage in chapter 7 without mentioning the new remedy in the Code or in the legislative history.[115] The Sixth Circuit quoted the same language from the

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109. *Dewsnup*, 502 U.S. at 417 (emphasis added); *In re Talbert*, 344 F.3d at 560; *Ryan*, 253 F.3d at 781.

110. *Dewsnup*, 502 U.S. at 417.

111. *Id.*

112. *See Ryan*, 253 F.3d at 781.

113. *In re Talbert*, 344 F.3d at 559.

114. *See, e.g.*, Laskin v. First Nat'l Bank of Keystone (*In re* Laskin), 222 B.R. 872, 876 (B.A.P. 9th Cir. 1998).

115. *Ryan*, 253 F.3d at 782 (citing *Dewsnup*, 502 U.S. at 417–18).

Dewsnup decision and added that "Congress must have enacted the Code with a full understanding of [the practice of letting liens on real property pass through bankruptcy]."[116] If Congress did not clearly intend to change the treatment of mortgages in bankruptcy in enacting the Code, the *Dewsnup* Court reasoned, then it makes sense to turn to pre-Code treatment of mortgages in bankruptcy.[117] The *Dewsnup* Court pointed out that it had been the practice to allow liens on real property to survive bankruptcy.[118] The Fourth Circuit and the Sixth Circuit apply this logic to strip offs.[119] If the pre-Code common law rule allowed liens on real property to pass through bankruptcy, and assuming that Congress did not intend to change this general rule, then it makes sense to apply the general rule to both undersecured as well as completely unsecured mortgage liens in chapter 7.

Furthermore, both the Fourth Circuit and the Sixth Circuit reasoned that the creditor's lien stays with real property until the foreclosure because this is what was bargained for by the mortgagor and mortgagee.[120] This again draws from the same reasoning as the *Dewsnup* Court[121] and rests on the presumption that liens on real property pass through bankruptcy regardless of their valuation. Otherwise, there would be no reason why the mortgagor and mortgagee would assume that this was the bargain. Although both the *Dewsnup* Court and the appellate courts used this analysis in their holdings, there is an important difference: In *Dewsnup*, the Court considered strip down of a principal mortgage[122] whereas the Fourth and Sixth Circuits, as well as the Ninth Circuit BAP, addressed strip off of junior mortgages.[123] In the strip-off cases, the courts paid little to no attention to whether holders of junior mortgages bargained for the same set of rights as holders of principal mortgages.[124] Instead, they focused narrowly on whether there was a lien.[125]

Next, the Fourth Circuit reasoned that voiding a junior lien would grant a "windfall" to debtors because any increase in the value of the property would accrue to the debtor and that the creditor is entitled to any increase in value.[126] This closely parallels the *Dewsnup* Court's reasoning in disallowing strip down of a junior lien in chapter 7.[127] The Sixth Circuit agreed with this assessment and suggested that a piece of real estate may increase in value during the bankruptcy proceedings so that there will be some value to cover the junior mortgage.[128] Again, this relies on the presumption that liens on real property pass through

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116. *In re Talbert*, 344 F.3d at 560 (citing *Dewsnup*, 502 U.S. at 411).
117. *Dewsnup*, 502 U.S. at 416, 417–19.
118. *Id.* at 418.
119. *In re Talbert*, 344 F.3d at 561; *Ryan*, 253 F.3d at 782.
120. *Ryan*, 253 F.3d at 782.
121. *Dewsnup*, 502 U.S. at 423.
122. *Id.* at 412.
123. *In re Talbert*, 344 F.3d 555; *Ryan*, 253 F.3d at 779; Laskin v. First Nat'l Bank of Keystone (*In re* Laskin), 222 B.R. 872, 873 (B.A.P. 9th Cir. 1998).
124. *Ryan*, 253 F.3d at 783.
125. *Id.*; *In re Talbert*, 344 F.3d at 559; *In re Laskin*, 222 B.R. at 876.
126. *Ryan*, 253 F.3d at 781–82.
127. *Dewsnup*, 502 U.S. at 417.
128. *In re Talbert*, 344 F.3d at 561.

bankruptcy unaffected because, otherwise, creditors would not have an expectation that they would receive the increase in value of the property.

None of the courts considered the likelihood of such an increase in value under the particular facts of their respective cases. Moreover, none of the courts considered the possibility of a decrease in the value of the property. In the case of a decreasing value, there would be no windfall to the debtor and, in fact, the debtor would be in an overall worse position. While the holder of a valueless junior mortgage on a home that has decreased in value since the debtor filed bankruptcy would be no worse off—the holder would still not be able to collect anything on a foreclosure—the debtor would be even more underwater and, upon the eventual foreclosure by the senior lien holder, could possibly be liable for an even greater deficiency.

3. Section 506 Should Not be Applied to Chapter 7 Cases

The Ninth Circuit BAP reasoned that § 506 "was only intended to facilitate valuation and disposition of property in the reorganization chapters of the Code, not to confer an additional avoiding power on a chapter 7 debtor."[129] The Sixth Circuit also emphasized this assessment in its holding that chapter 7 debtors cannot strip off junior mortgages.[130] Whereas the holder of a stripped-off junior mortgage in a chapter 13 bankruptcy at least has the possibility of obtaining some repayment from the debtor as the holder of an unsecured claim, the holder of a stripped-off junior mortgage in a chapter 7 bankruptcy would generally get nothing as an unsecured creditor.[131]

B. Courts that Have Allowed Strip Off in Chapter 7

Although no appellate court has embraced the idea of allowing strip off in chapter 7 cases, several district courts have allowed the practice.[132] They have reached this conclusion by distinguishing the case of strip off, both factually and legally, from the strip-down decision in *Dewsnup* and by applying reasoning gleaned from the *Nobelman* decision.

1. Distinguishing Strip-Off Cases from Strip Down in Dewsnup

Courts considering the issue find it significant that, unlike the undersecured lien at issue in *Dewsnup*, the junior mortgages are wholly unsecured. Indeed, the creditor would not be able to receive anything from the sale of a property outside bankruptcy.[133]

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129. *In re Laskin*, 222 B.R. at 876.

130. *In re Talbert*, 344 F.3d at 561–62.

131. *In re Laskin*, 222 B.R. at 876.

132. Warthen v. Smith (*In re* Smith), 247 B.R. 191 (W.D. Va. 2000), *abrogated by* Ryan v. Homecomings Fin. Network, 253 F.3d 778, 781–82 (4th Cir. 2001); Yi v. Citibank (*In re* Yi), 219 B.R. 394 (E.D. Va. 1998), *abrogated by Ryan*, 253 F.3d at 781–82.

133. Howard v. Nat'l Westminster Bank, U.S.A. (*In re* Howard), 184 B.R. 644, 647 (Bankr. E.D.N.Y. 1995).

In *In re Lavelle*, the bankruptcy court for the Eastern District of New York stated that the "second mortgage cannot be considered a secured claim under § 506(a), because the junior claim is wholly unsecured."[134] This implies that it is not enough simply to have a lien against the property to be considered "secured" under § 506(a). While the courts that have denied strip off in chapter 7 have narrowly interpreted § 506(d) to mean that liens may only be voided where the claim has not been allowed,[135] courts permitting strip off in chapter 7 give meaning to the "secured" part of the term "allowed secured claim" in § 506(d) beyond merely having an allowable claim with a deed of trust or mortgage claiming a security interest despite the lack of value.[136] Indeed, to deny strip off as long as the claim is "allowed" effectively ignores that the term "secured" is used in § 506(d) and that § 506(d)'s language mandates avoidance of liens that are unsecured.[137]

Second, the *Lavelle* court also pointed out that the *Dewsnup* Court limited its holding to the specific facts at issue.[138] Therefore, the factual difference between a completely unsecured junior mortgage and an undersecured junior mortgage may be significant.[139] The courts that have not allowed strip off in chapter 7 pay scant attention to this important declaration by the *Dewsnup* Court.[140] Certainly not all factual distinctions serve to materially distinguish a case, but the factual distinction between a wholly unsecured lien as opposed to an undersecured lien would seemingly deserve more examination.

Third, some courts show resistance to abandoning the use of § 506(a) in determining the meaning of "allowed secured claim" and have used the subsection to distinguish a wholly unsecured claim from an undersecured claim.[141] This approach would seem incongruous with the holding of the *Dewsnup* decision at first blush, but it illuminates courts' basic understanding of a security interest. For

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134. No. 09-72389-478, 2009 WL 4043089, at *6 (Bankr. E.D.N.Y. Nov. 19, 2009).

135. *In re Laskin*, 222 B.R. at 876.

136. *See In re Lavelle*, 2009 WL 4043089, at *6.

137. *In re Yi*, 219 B.R. at 397–98.

138. *In re Lavelle*, 2009 WL 4043089, at *6. In *Dewsnup*, the Court stated:

> The foregoing recital of the contrasting positions of the parties and their *amici* demonstrates that § 506 of the Bankruptcy Code and its relationship to other provisions of that Code do embrace some ambiguities. Hypothetical applications that come to mind and those advanced at oral argument illustrate the difficulty of interpreting the statute in a single opinion that would apply to all possible fact situations. We therefore focus upon the case before us and allow other facts to await their legal resolution on another day.

Dewsnup v. Timm, 502 U.S. 410, 416–17 (1992) (citations omitted).

139. Courts are split on whether the difference between consensual and nonconsensual liens makes a case distinguishable from *Dewsnup*. The nonconsensual nature of a judicial lien, for example, undermines the argument that the debtor and creditor bargained for a loan that passes through bankruptcy unaffected. *See* Howard v. Nat'l Westminster Bank, U.S.A. (*In re* Howard), 184 B.R. 644, 647 (Bankr. E.D.N.Y. 1995).

140. Of the appellate courts, only the Sixth Circuit addressed the issue at all. *See* Talbert v. City Mortg. Servs. (*In re* Talbert), 344 F.3d 555, 561–62 (6th Cir. 2003).

141. *See In re Yi*, 219 B.R. at 397–400.

example, in *In re Yi*, the court advanced the argument that § 506(a)'s provision that a lien "is a secured claim to the extent of the value of its interest in the estate's interest in the property" means that a lien without any underlying value could not be secured.[142] The court, however, immediately turned to a more common sense reading for an understanding of the term "secured" when it stated: "The code does not generally classify creditors based on the existence of a piece of paper purporting to give a creditor rights in specified collateral, but rather on whether a creditor actually holds a claim supported by valuable estate property."[143] Moreover, courts still looking to § 506(a) despite the decision in *Dewsnup* may do so because the Supreme Court's later decision in *Nobelman* deemed § 506(a) the appropriate starting place.[144]

2. Nobelman *Applies to Chapter 7 Strip-Off Cases*

Although the court in *In re Yi* attempted to use § 506(a) in distinguishing a wholly unsecured mortgage lien from an undersecured lien, it borrowed much of its reasoning from the *Nobelman* decision and the resulting strip-off cases in chapter 13.[145] Other courts upholding the use of strip off in chapter 7 have also looked to the *Nobelman* reasoning and its progeny in chapter 13 strip off. For instance, in *In re Lavelle*, the bankruptcy court found that cases in chapter 13 demonstrate the appropriateness in distinguishing between partially unsecured liens and wholly unsecured liens.[146] Likewise, the bankruptcy court in *Howard* found that the *Nobelman* decision allowed courts to look to § 506(a) to determine the status of the secured claim in question and found that the holder of the junior mortgage in that case held a completely unsecured claim under § 506(a).[147] Furthermore, the court in *In re Yi* concluded that, by downplaying the *Dewsnup* holding in its decision, the *Nobelman* Court meant to either limit the precedential effect of *Dewsnup* or to disagree with *Dewsnup*.[148] Again, the courts denying strip off in chapter 7 do not acknowledge the possible precedential effect of the *Nobelman* decision on *Dewsnup*. This is probably due to the fact that the *Dewsnup* Court considered a chapter 7 strip-down case, whereas *Nobelman* wrestled with strip down in chapter 13. Yet, it is too simplistic to disregard the possible precedential effect of *Nobelman* because both examined § 506, a section within a chapter that is generally applicable to all bankruptcies.

3. Rebutting the Arguments of Courts Denying Strip Off

Courts denying strip off in chapter 7 rely on the *Dewsnup* Court's reasoning that "the creditor's lien stays with real property until the foreclosure,"

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142. *Id.* at 397.
143. *Id.* at 398.
144. Nobelman v. Am. Sav. Bank, 508 U.S. 324, 328 (1993).
145. *In re Yi*, 219 B.R. at 397–99.
146. *In re* Lavelle, No. 09-72389-478, 2009 WL 4043089 (Bankr. E.D.N.Y. Nov. 19, 2009).
147. Howard v. Nat'l Westminster Bank, U.S.A. (*In re* Howard), 184 B.R. 644, 647 (Bankr. E.D.N.Y. 1995).
148. *In re Yi*, 219 B.R. at 398 n.14.

and liens are "to pass through bankruptcy unaffected."[149] Courts allowing strip off in chapter 7, however, point out that to extend this reasoning to strip offs would essentially write § 506(d) out of the Code.[150] The courts reason that § 506(d), which provides in pertinent part that "[t]o the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void,"[151] "clearly contemplates that some liens—those that are unsecured—will not 'stay with the real property until the foreclosure' and will not 'pass through bankruptcy unaffected.'"[152]

That is, taken to their extremes, the policy of liens passing through bankruptcy cited by *Dewsnup* would completely overwhelm the statutory language in § 506(d). It would mean that the section could not be used to void any liens on real property at all. This means that there must be a line drawn that limits the effect of these policies to harmonize them with the statutory language. The *Dewsnup* Court certainly found the policies to override the supposed ambiguity in the text in the context of undersecured liens, but it is not clear that it meant to do the same for completely unsecured liens.

Courts allowing strip off in chapter 7 also rebut the notion that debtors will receive a windfall if they are allowed to strip off wholly unsecured junior mortgages. First, they argue that markets are uncertain, and it is not inevitable that the debtor's property will appreciate in value.[153] Indeed, due to the recent subprime mortgage crisis and the drop in home values, it is unlikely that home prices will return to their pre-subprime mortgage crisis levels in the near future.[154] Although there may be instances where a home appreciates enough during the period between the filing of a bankruptcy petition and the chapter 7 discharge to the point that there would be some value to cover previously valueless junior mortgages, these cases are likely to be the exception rather than the rule for the foreseeable future.

Second, the creditor's right to foreclose will not result in any monetary gain for the creditor if the junior mortgage has no underlying value.[155] This renders meaningless the right of a holder of a valueless junior mortgage to foreclose. Again, because home prices are not expected to return to pre-subprime mortgage crisis levels in the foreseeable future, [156] most junior mortgage holders do not have a realistic prospect of collecting anything on a foreclosure of outstanding junior mortgages. Thus, the same concerns that so thoroughly vexed the *Dewsnup* Court should be far less problematic in the current context of strip off in chapter 7.

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149. Dewsnup v. Timm, 502 U.S. 410, 417–18 (1992).

150. *See In re Yi*, 219 B.R. at 400.

151. 11 U.S.C. § 506(d) (2006).

152. *In re Yi*, 219 B.R. at 400.

153. *In re* Lavelle, No. 09-72389-478, 2009 WL 4043089, at *6 (Bankr. E.D.N.Y. Nov. 19, 2009).

154. Renae Merle, *Long Road to Housing Recovery; Decade of Doldrums? Economists Warn of Inability to Regain Equity*, WASH. POST, Jan. 27, 2010, at A12.

155. *In re Lavelle*, 2009 WL 4043089, at *6.

156. *See* Merle, *supra* note 154.

V. STRIP OFF SHOULD BE ALLOWED IN CHAPTER 7

A. Strip Off Can Be Distinguished from Strip Down Under Dewsnup

The courts' rulings that debtors may not strip off liens of wholly unsecured junior mortgages do not recognize any distinction from undersecured liens such as in *Dewsnup*. Courts addressing the issue ignore the significant factual distinction that the lien in *Dewsnup* was supported by some value while the liens they confront do not have any value at all. This Note argues that they ignore such a distinction at their peril.

In the view of these courts, the *Dewsnup* Court's interpretation of an "allowed secured claim" as first "allowed" and then "secured" means that § 506(a) does not apply.[157] Instead, a claim is "secured" because there is a lien with recourse to the underlying property.[158] This essentially means that a claim is secured as long as there is a written document considered to be a lien and the claim is allowed. Indeed, the Sixth Circuit, citing the Supreme Court, confirmed this by stating that this reading "gives the provision the simple and sensible function of voiding a lien whenever a claim secured by the lien itself has not been allowed."[159] This, however, cannot mean that courts may simply ignore the term "secured" altogether. Courts must give the term some meaning and it seems overly simplistic to assume that all that is required to prove that one has a lien is "a piece of paper purporting to give a creditor rights in specified collateral."[160]

Even if one accepts the proposition that the phrase "allowed secured claim" in § 506(d) is not a term of art as defined by § 506(a), one must still determine what these individual terms actually mean. The words cannot be defined simply by what they *do not* mean. It is still possible to distinguish wholly unsecured liens from undersecured liens even if the definition of "allowed secured claim" in § 506(a) is not used and "secured" must be defined on its own using common understanding. By using the ordinary meaning of "secured," one could certainly interpret "secured by a lien" to mean more than simply a piece of paper claiming a security interest. The phrase "secured by a lien" more likely means that the property on which the creditor has a lien must have some value as that comports with more practical notions of taking security interests. For example, when negotiating a loan, it would be nonsensical to say that the creditor has a security interest in something that has no value. Having such a "security interest" would defeat the purpose of having a security interest in the first place. Furthermore, taking a security interest in a piece of property that is later destroyed would yield a worthless security interest.[161]

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157. Talbert v. City Mortg. Servs. (*In re* Talbert), 344 F.3d 555, 559 (6th Cir. 2003).

158. *Id.*

159. *Id.*

160. Yi v. Citibank (*In re* Yi), 219 B.R. 394, 397 (E.D. Va. 1998), *abrogated by* Ryan v. Homecomings Fin. Network, 253 F.3d 778, 781–82 (4th Cir. 2001).

161. The exception to this rule would occur when the borrower has obtained insurance for the property and the creditor is entitled to the insurance payments as proceeds implicitly under Uniform Commercial Code section 9-203(3) or explicitly through contract.

Similarly, it would make little sense to grant a security interest to a creditor without any prospects of collecting on a lien outside of bankruptcy. This important practical observation clearly distinguishes between undersecured liens and wholly unsecured liens with respect to real property. Outside of bankruptcy, a foreclosure sale would not yield any money to the holder of a junior lien where the selling price is insufficient to cover the senior mortgage. The same foreclosure, however, would yield at least some money to a junior lien holder if the price exceeded the senior mortgage amount, even if that excess amount did not fully satisfy the junior mortgage. Once one understands that wholly unsecured liens and partially secured liens on real property are treated differently outside of bankruptcy, it would not be distressing if they were to be treated differently in bankruptcy as well.

Moreover, most lienholders are not in the position to hold these underwater real properties and wait to see if market values recover; they must foreclose on the property promptly once they are able to do so.[162] Banks and other lending institutions are not in the business of property management and simply do not want to deal with caring for homes over the long term. Thus, courts' concern that the creditor will lose the benefit of any increase in the value of the property between the bankruptcy and the ultimate foreclosure sale is overstated to say the least.[163] It would make little sense to treat undersecured liens and wholly unsecured liens the same in bankruptcy simply because a piece of paper claims that the latter is secured.

This practical distinction offers a way for courts to distinguish strip off in chapter 7 from the strip down in *Dewsnup*. The term "secured" used in § 506(d), even if not defined by § 506(a), can be read in its ordinary meaning to mean that the lien must have some value. It is certainly a reasonable interpretation given the practical implications (as shown by the effect outside of bankruptcy). Moreover, making such a distinction gives real meaning to the word "secured." As it is currently interpreted, considering any lien to be an "allowed secured claim" merely because it is "allowed" under § 502 essentially writes out the word "secured" from § 506(d) altogether.[164] Practical considerations strongly call for an alternative statutory interpretation of § 506(d)'s "allowed secured claim."

B. Section 506 Is Useful in Chapter 7

Some courts denying strip off have claimed that § 506 "was intended to facilitate valuation and disposition of property in the reorganization chapters of the Code, not to confer an additional avoiding power on a chapter 7 debtor."[165]

A holder of a junior mortgage that has lost value, on the other hand, may or may not have been so fortunate to have obtained insurance against the borrower's possible default.

162. Jane Kaufman Winn, *Lien Stripping After* Nobelman, 27 LOY. L.A. L. REV. 541, 587 (1994).

163. *See* Ryan v. Homecomings Fin. Network, 253 F.3d 778, 781–82 (4th Cir. 2001).

164. This is a fairly low bar considering that claims are generally allowed unless a claim is both objected to and the court then determines that one of the specified exceptions to claim allowance applies. *See* 11 U.S.C. § 502(a)–(b) (2006).

165. *Ryan*, 253 F.3d at 783.

However, this is not entirely accurate. For example, § 103(a) of the Code explicitly states that the general provisions of chapters 1, 3, and 5 apply to cases under chapters 7, 11, 12, and 13.[166] These first three chapters essentially provide the building blocks for the more specific chapters that follow. Everything in chapters 1, 3, and 5 was meant to aid in the execution of bankruptcies, whether they are quick and easy chapter 7 consumer bankruptcies or massive, time-consuming chapter 11 business reorganizations.[167]

Moreover, § 506 is regularly used in another chapter 7 context: redemption. Section 722 allows debtors to redeem personal property in chapter 7 "by paying the holder of such lien the amount of the allowed secured claim," with "allowed secured claim" meaning the term of art as defined in § 506(a).[168] Consequently, it is inaccurate to say that § 506 was only intended to facilitate valuation in the reorganization chapters. Not only is there no statutory support for that claim, there is actual practice to the contrary. Whether § 506(d) was meant to confer an additional avoiding power on a chapter 7 debtor is another matter, which relates back to the interpretation of the statute itself, but this argument used by courts denying strip off stands on shaky ground.

C. Applying the Reasoning of Nobelman

The *Dewsnup* decision and its reasoning have been thoroughly criticized,[169] but it is the law of land.[170] Courts should consider whether the *Nobelman* decision overruled *Dewsnup*'s reasoning though not its ultimate conclusion that strip down should be denied.

Courts denying strip off in chapter 7 have rebuffed attempts by debtors to make this argument.[171] These courts make the distinction between the two Supreme Court cases based solely on the different bankruptcy chapters that they were decided under.[172] Specifically, the courts point out that *Nobelman* concerned a specific section in chapter 13, § 1322(b), whereas *Dewsnup* addressed § 506(d) in the context of chapter 7 liquidation. Of course this is clearly a factual

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166. 11 U.S.C. § 103(a) (2006).

167. Occasionally, chapters 7, 11, or 13 will contain provisions that supplement or supersede the general rules found in chapters 1, 3, and 5. *See, e.g.*, *id.* §§ 1101, 1129. Still, § 103's application of chapters 1, 3, and 5 predominates.

168. *Id.* § 722.

169. Howard, *supra* note 54, at 314–15 (noting that the Supreme Court had only held the Frazier–Lemke Act unconstitutional due to its retroactive nature and not because Congress was not allowed to limit the creditor's recovery to the value of the collateral and pointing to the House Report in enacting the Code to show that Congress intended to strengthen debtors' hand in dealing with secured creditors); *see also* Winn, *supra* note 162, at 598 (noting that, following the Supreme Court's striking down of the Frazier–Lemke Act as an unconstitutional impairment of the mortgagee's property rights, Congress passed minor amendments to the act which were then upheld by the Court).

170. *Ryan*, 253 F.3d at 783.

171. *Id.* at 782; Laskin v. First Nat'l Bank of Keystone (*In re* Laskin), 222 B.R. 872, 875 (B.A.P. 9th Cir. 1998).

172. *Ryan*, 253 F.3d at 782; *In re Laskin*, 222 B.R. at 875.

distinction, but it is questionable whether this distinction is significant enough to ignore *Nobelman* altogether when examining whether to allow strip off.

Also, both Supreme Court cases centered on the interpretation of the phrase "allowed secured claim" as defined in § 506(a).[173] The only difference between the cases is that one interpreted this phrase as it was used in § 506(d) and the other interpreted the phrase as it was used in § 1322. It would be puzzling for the Court to interpret the same term defined in § 506(a) differently based on the use of the phrase, and yet that is exactly what courts have done. Courts denying debtors the right to strip off junior mortgages reason that "allowed secured claim" is a term of art defined by § 506(a) in the chapter 13 context and yet courts divide "allowed secured claim" and interpret each word separately in the chapter 7 context. This undermines the task of creating reliable terms of art for parties involved in bankruptcy to use throughout the Code.

Instead, courts should harmonize the reasoning in *Dewsnup* and *Nobelman*. They could do so by adopting the Court's interpretation of § 506(a)'s "allowed secured claim" in the *Nobelman* decision and applying it to all other sections that use this term of art, regardless of the chapter.[174] Under this reasoning, § 506(a) would be the appropriate place to look for the definition of § 506(d) as well as § 1322(b)(2). Debtors would not be able to strip down liens where it would affect any of the creditor's residual state-law rights, whether in chapter 7 or 13.[175] Thus, when there is enough value to cover at least some of the junior lien and the holder of the junior lien has an actual prospect of collecting money from a foreclosure sale, then the lien should not be stripped down. Instead, the lien should be left in place to allow the junior lien holder to collect whatever it can using its state-law rights outside of bankruptcy. Conversely, when there is no value supporting the junior lien, especially when the home is significantly underwater and has little prospect of appreciating enough to cover the junior lien in the near future, then there are practically no state-law rights available that would benefit the junior lien holder and the court should be able to strip off the lien.

VI. POLICY IMPLICATIONS

It is only appropriate that courts look to policy in consideration of this complex bankruptcy issue. After all, it is policies such as promoting home ownership, the desire to grant debtors in bankruptcy a "fresh start," and paying creditors in bankruptcy as much as possible that create the tension for strip off in chapters 7 and 13.[176] Moreover, the allowance or disallowance of strip off has effects both in and out of bankruptcy.

A. Chapter Choice

The outcome of the strip-off issue will have a significant effect on debtors' chapter choice when filing for bankruptcy. Congress has shown a

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173. Nobelman v. Am. Sav. Bank, 508 U.S. 324 (1993); Dewsnup v. Timm, 502 U.S. 410 (1992).

174. *Nobelman*, 508 U.S. at 329.

175. *See id.* at 328–29.

176. *See* Winn, *supra* note 162, at 577.

preference for reorganization, under chapters 11 or 13, rather than liquidation, under chapter 7.[177] Chapter 13 reorganization is seen as preferable to chapter 7 liquidation because debtors who are eligible for chapter 13, and able to pay some of their creditors back at least a portion of what they owe, should not be able to use chapter 7 liquidation to escape the debt on which they are able to pay.[178]

It should also be the aim of bankruptcy to make sure that chapter 13 debtors have a reasonable likelihood of success. The debtor only gets the benefit of a chapter 13 discharge when he or she completes the plan,[179] so a failed attempt will not be beneficial to debtors. Likewise, creditors will again find themselves in the frustrating position of trying to collect from the debtor if the debtor's plan fails. Therefore, from the creditor's perspective, chapter 13 may be preferable to chapter 7 only when the debtor's reorganization plan has a reasonable prospect of success, but the bankruptcy system must be careful not to push debtors into reorganization when they are unlikely to be able to complete a chapter 13 plan.

In the context of lien-stripping, the courts of appeals have allowed debtors to strip off junior mortgages in chapter 13,[180] but have denied their right to do so in chapter 7.[181] More recently, the Tenth Circuit BAP affirmed that debtors are entitled to discharge valueless junior mortgages in chapter 13, but only after completion of the plan pursuant to §§ 1325(a) and 1328(f) and not at confirmation of the plan.[182] This means that debtors using strip off in chapter 13 must wait three to five years while they complete their plan before they get the benefit of stripping off the junior mortgage lien.

The allowance of strip off in chapter 13 but not in chapter 7 also provides an incentive for debtors to attempt a chapter 13 plan to obtain the strip off rather than get a more immediate "fresh start" in chapter 7. Debtors with underwater homes and a junior mortgage, if filing for bankruptcy, would be hard pressed to find a countervailing incentive to file under chapter 7 that would be greater than

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177. Dewsnup v. Timm (*In re* Dewsnup), 908 F.2d 588, 592 (10th Cir. 1990), *aff'd*, 502 U.S. 410 (1992).

178. *Id.*

179. 11 U.S.C. § 1328(a) (2006).

180. Zimmer v. PBS Lending Corp. (*In re* Zimmer), 313 F.3d 1220, 1224 (9th Cir. 2002); Lane v. W. Interstate Bancorp (*In re* Lane), 280 F.3d 663, 667 (6th Cir. 2002); Pond v. Farm Specialist Realty (*In re* Pond), 252 F.3d 122, 125–26 (2d Cir. 2001); Tanner v. FirstPlus Fin., Inc. (*In re* Tanner), 217 F.3d 1357, 1359 (11th Cir. 2000); Bartee v. Tara Colony Homeowners Ass'n (*In re* Bartee), 212 F.3d 277, 286, 292 (5th Cir. 2000); McDonald v. Master Fin. Inc. (*In re* McDonald), 205 F.3d 606, 609–10, 613 (3d Cir. 2000); Griffey v. U.S. Bank (*In re* Griffey), 335 B.R. 166, 169 (B.A.P. 10th Cir. 2005); Domestic Bank v. Mann (*In re* Mann), 249 B.R. 831, 837, 839 (B.A.P. 1st Cir. 2000); Lam v. Investors Thrift (*In re* Lam), 211 B.R. 36, 41–42 (B.A.P. 9th Cir. 1997).

181. Talbert v. City Mortg. Servs. (*In re* Talbert), 344 F.3d 555 (6th Cir. 2003); Ryan v. Homecomings Fin. Network, 253 F.3d 778 (4th Cir. 2001); Laskin v. First Nat'l Bank of Keystone (*In re* Laskin), 222 B.R. 872, 875 (B.A.P. 9th Cir. 1998).

182. *See* Bank of the Prairie v. Picht (*In re* Picht), 428 B.R. 885, 890 (B.A.P. 10th Cir. 2010). This is in contrast to some bankruptcy courts that allowed strip off of valueless junior mortgages at confirmation. *See, e.g.*, *In re* Tran, 431 B.R. 230 (Bankr. N.D. Cal. 2010); Grandstaff v. Casey (*In re* Casey), 428 B.R. 519 (Bankr. S.D. Cal. 2010).

the chance to strip off a junior mortgage in chapter 13. For example, if a debtor owned a home worth $80,000 with a senior mortgage of $100,000 and a junior of $20,000, the debtor could potentially strip off the junior mortgage in a chapter 13 plan. The debtor could then treat the junior mortgage as unsecured debt and pay cents on the dollar to the lender under the plan. In some cases, this might be enough to allow the debtor to make the payments on the senior mortgage and retain the home.

On the other hand, the debtor would not be able to strip off the lien in chapter 7. The debtor would likely surrender or reaffirm the junior mortgage in a chapter 7 bankruptcy. If the debtor still could not afford to make payments on the home, either the senior or junior mortgage holder would eventually foreclose and the debtor would not be able to retain the property. Thus, if the debtor wishes to retain the property, which debtors often do even if it may not be in their best economic interests, she would need to file under chapter 13. This liability resulting from a reaffirmation of thousands of dollars still left on the junior mortgage would certainly motivate a debtor to file under chapter 13 to attempt a strip off of the junior mortgage lien, even if the prospects of the plan are not very good. In general, Congress favors debtors to attempt chapter 13 plans[183] so courts may view this incentive as preferable, but it also means more potential chapter 13 failure.

B. Purchase Money Security Interest Loans Versus Home Equity Loans

A more nuanced approach to the treatment of junior mortgages in bankruptcy may be necessary in chapter 7. For instance, when determining the secured status of a junior lien, it may be more appropriate to examine whether the loan was made for the purchase of the home as with antideficiency statutes and § 1322(b)(2)[184] or whether the lien is against a home equity loan. In the former case, the holder of the junior mortgage provided money to help the borrower actually purchase a home. Such a transaction appears to grant the lien holder an actual expectation in the collateral. More importantly, recognizing the existence of such a lien comports with Congress's intent to promote home ownership.[185]

Home equity loans, on the other hand, are made not for the purchase of homes, but for other consumer purposes.[186] These types of loans do not promote home ownership as Congress intended. Moreover, because the loans were made after the purchase of the home, the lender does not necessarily have the same expectation of the continued value of the home as a senior mortgage holder. The holder of the senior mortgage lien knows that the property will virtually always have at least some value upon which it can collect. The same cannot be said for a junior lien holder. For these reasons, there could be a distinction made between

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183. *In re Dewsnup*, 908 F.2d at 592.

184. 11 U.S.C. § 1322(b)(2) (2006); ARIZ. REV. STAT. ANN. § 33-814(G) (2011).

185. Nobelman v. Am. Sav. Bank, 508 U.S. 324, 332 (1993) (Stevens, J., concurring).

186. *See* Julia Patterson Forrester, *Mortgaging the American Dream: A Critical Evaluation of the Federal Government's Promotion of Home Equity Financing*, 69 TUL. L. REV. 373, 376 (1994).

partially secured and wholly unsecured junior liens when bankruptcy courts consider lien-stripping.

C. Protection of Creditors

The courts denying the use of strip off have advanced the argument that any increase in value of the property by the time of foreclosure should accrue to the creditor rather than the borrower. Aside from the courts' assumption that the real property will rise in value and not stagnate or fall, the courts do not consider the ex ante effects of a ruling allowing strip off. If courts generally allowed strip off of wholly unsecured junior mortgage liens, lenders with these liens could simply factor that into their cost of making such loans. Lenders should be able to cope with the prospect of strip off in bankruptcy just as they do with antideficiency statutes in the context of foreclosure.[187] Thus, concern that future junior lien holders will be treated "unfairly" if the courts allow strip off is overstated. It is also questionable that allowing strip off would be unfair to lenders who already have such junior mortgage liens. Lenders already know that they take a relatively higher risk by taking a junior lien on real property. Even if the homeowner does not file bankruptcy, the junior lien holder knows that it will not realize anything from foreclosure on an underwater home. Therefore, such a lien holder should not expect greater protection while in bankruptcy.

CONCLUSION

Courts that have yet to decide the issue of whether to allow strip off of completely unsecured liens in chapter 7 should carefully consider the statutory language in § 506, the practical effect of strip off as compared with nonbankruptcy state law remedies for similarly situated lien holders, and the policy implications of allowing or denying strip off. Even though courts must follow *Dewsnup* as precedent, they may still distinguish a partially secured lien from a wholly unsecured lien. For one, *Nobelman* may have overruled *Dewsnup*'s interpretation of § 506(a). Under either the *Dewsnup* or *Nobelman* reasoning, a partially secured lien must be considered "secured."[188] A completely valueless lien, however, cannot practically be considered secured and should not be considered as such by bankruptcy courts. Treating valueless junior mortgages as unsecured and allowing strip off makes sense because holders of valueless junior mortgages do not have any greater recourse than an unsecured creditor. Finally, the courts should allow strip off to avoid steering debtors into chapter 13 plans when the debtors are doing so only to retain their homes and when they are not truly capable of completing the plan.

The Supreme Court can also resolve this issue and use it as an opportunity to revisit its much-maligned decision in *Dewsnup* by explicitly limiting the decision to cases involving undersecured liens, as opposed to completely unsecured liens. The Court could use its rationale from the *Nobelman* decision and allow strip off of wholly unsecured junior mortgages by revising its

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187. *See* Winn, *supra* note 162, at 585–86.

188. *Nobelman*, 508 U.S. at 331–32; Dewsnup v. Timm, 502 U.S. 410, 415 (1992).

interpretation of the term "allowed secured claim" found in § 506(d) to conform to the definition of that term in § 506(a). The Court would very likely have the opportunity to do exactly that if it were to take up the issue of strip off in chapter 7, especially if at least one of the many courts of appeals that has yet to address this issue takes such a case and allows strip off, thereby creating a circuit split. It could also address the issue if a federal court of appeals disagrees with the six other federal courts of appeals that have allowed debtors to strip off junior mortgages in chapter 13 bankruptcy, though this seems far less likely considering the broad consensus among the appellate courts as well as the more reasoned interpretation of "allowed secured claim" drawn from the *Nobelman* decision.

Debtors' ability to strip liens from valueless junior mortgages in bankruptcy remains largely unsettled and may take years to resolve. In fact, by the time courts are able to resolve the issue, the economy will, hopefully, have recovered to the point where most people are not in dire economic straits and have the income to make their mortgage payments. Yet, the housing market could take ten years or more to return to the level it was at before the housing bubble burst.[189] So, even when the economy has fully recovered, individuals may be saddled with underwater homes for years to come, and this includes valueless junior mortgages. The availability of strip off as a tool in both chapter 7 and chapter 13 would enable debtors to escape at least some of this crippling debt and harmonize judicial interpretation of an important section in the Code.

189. *See* Merle, *supra* note 154.