

DETROIT CONSUMER BANKRUPTCY CONFERENCE  
NOVEMBER 11, 2008  
DETROIT MARRIOTT-TROY, MICHIGAN

**ONLY CRAMDOWN LEFT?**  
**§ 506 LIEN STRIPPING & VALUATION**

HON. THOMAS J. TUCKER – (MODERATOR), U.S. BANKRUPTCY COURT (E.D. MICH.); DETROIT, MICH.  
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11 U.S.C. § 1322 (b): Subject to subsections (a) and (c) of this section, the plan may- (2) 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...

11 U.S.C. § 506 (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.

- I. **WHAT DOES IT MEAN TO STRIP THE LIEN?** 11 U.S.C. § 506 describes how to determine whether a claim is secured. Section 506(a)(1) explains bifurcation (division) of an allowed claim into secured and unsecured parts—the secured part being “secured” by the collateral’s value, the unsecured part being the remaining amount of the claim in excess of the collateral’s value. For example, an allowed claim of \$200,000 with collateral valued at \$170,000 is bifurcated between a secured claim of \$170,000 and an unsecured claim of \$30,000, resulting in “lien stripping” of \$30,000. If the \$170,000 collateral is related to an allowed first claim of \$200,000 and an allowed second claim of \$10,000, the \$10,000 claim can be “stripped” as well. The distinction may be identified as “stripping down” (or a “cramdown” of) the lien to the value of the collateral or “stripping off” the lien completely.
- II. **CHAPTER 7 CASES – UNSECURED JUNIOR MORTGAGE MAY NOT BE STRIPPED OFF.**

*Dewsnup v. Timm*, 502 U.S. 410 (U.S. 1987) prohibited Chapter 7 debtors from using 11 U.S.C. § 506(d) to void an undersecured lien on real property. Case law has extended *Dewsnup* to prohibit lien stripping on wholly unsecured liens (in Chapter 7 cases), holding that unless and until there is a claims allowance process, there is no basis for the debtor to avoid a lien under 11 U.S.C. § 506. The legislative history of Section 506 also makes it clear that lien stripping is permissible in reorganization chapters, but not in Chapter 7. See *In re Talbert*, 344 F.3d 555 (6th Cir. 2003), *Concannon v. Imperial Capital Bank (In re Concannon)*, 338 B.R. 90 (Bankr.Fed.App. 2006).

### III. CHAPTER 13 CASES – UNSECURED JUNIOR MORTGAGE MAY BE STRIPPED OFF.

- a. *Nobelman v. American Savings Bank*, 508 U.S. 324 (U.S. 1993). A “strip down” or “cramdown” of claim that is secured by real property that is the debtor’s primary residence is prohibited. The United States Supreme Court held that after applying 11 U.S.C. § 1322(b)(2) and 11 U.S.C. § 506, a lien “strip down” of an *undersecured* home mortgage lien is impermissible in a chapter 13 case for a claim secured by the debtor’s principal residence, because it modifies the total package of rights for which such a claim holder bargained.
- b. 11 U.S.C. § 1322(b), commonly known as the anti-modification clause, prevents debtors from changing the rights of creditors whose claims are secured only by a security interest in real property that is the debtor's principal residence. Under various Circuit Court decisions interpreting *Nobelman* in Chapter 13 cases, §1322(b)(2) protections are no longer available to a creditor whose lien is a junior lien, and where the amount due to the senior lienholder(s) is greater than the value of the property pledged as security to that loan. Such creditor’s claims may be treated as an unsecured claim in the plan and paid consistent with other unsecured claimholders.
- c. ***Majority view:*** While the anti-modification clause in § 1322(b) uses the term "claim" rather than "secured claim" and, therefore, applies to both the secured and unsecured part of a mortgage, the anti-modification clause still states that the claim must be "secured only by a security interest in ... the debtor's principal residence." 11 U.S.C. § 1322(b)(2) (emphasis added). If valuation of the property under §506(a) determines that a junior mortgage holder's claim is wholly unsecured, then the bank is not in any respect a “holder of a claim secured by the debtor's residence” under §1322(b). Accordingly, the junior mortgage holder simply has an unsecured claim and the anti-modification clause does not apply. On the other hand, if any part of the mortgagee's claim is secured, then, under *Nobleman’s* interpretation of the term "claim," the entire claim, both secured and unsecured parts, cannot be modified.

The several Circuit Courts that have ruled on the issue, including the Sixth Circuit, support the majority position allowing lien stripping of wholly unsecured junior mortgage liens. See *Pond v. Farm Specialist Realty (In re Pond)*, 252 F.3d 122 (2nd Cir. 2001); *McDonald v. Master Fin., Inc. (In re McDonald)*, 205 F.3d 606 (3d Cir. 2000), *cert. denied*, 531 U.S. 822, 121 S.Ct. 66, 148 L.Ed.2d 31 (2000); *Bartee v. Tara Colony Homeowners Ass’n (In re Bartee)*, 212 F.3d 277 (5th Cir.2000); *Lane v. W. Interstate Bancorp (In re Lane)*, 280 F.3d 663 (6th Cir.2002); *Zimmer v. PSB Lending Corp. (In re Zimmer)*, 313 F.3d 1220, (9th Cir. 2002); *Tanner v. FirstPlus Fin., Inc. (In re Tanner)*, 217 F.3d 1357 (11th Cir. 2000). The only variance in this uniformity among the circuits is an Eleventh Circuit opinion, which disagrees with the *In re Tanner* panel that originally decided the issue, but which followed the *Tanner* decision as established precedent in that circuit. See *In re Dickerson*, 222 F.3d 924 (11th Cir.2000). See also *Domestic Bank v. Mann (In re Mann)*, 249 B.R. 831, 833 (B.A.P. 1st Cir. 2000); *Griffy v. U.S. Bank (In re Griffy)*, 335 B.R. 166 (B.A.P. 10th Cir. 2005); *Waters v. The Money Store (In re Waters)*, 276 B.R. 879 (Bankr.N.D.Ill. 2002); *In re King*, 290 B.R. 641 (Bankr.C.D.Ill. 2003).

- d. **Minority view.** While the Circuit Courts are nearly uniform in support of the majority view, some Bankruptcy Courts take a minority view. They hold that a properly perfected mortgage claim is literally “secured only by a security interest in real property that is the debtor's principal residence” within the meaning of §1322(b), irrespective of whether the claim is wholly or partially secured, or totally unsecured after the application of §506(a). They reason that this view is consistent with the emphasis in the *Nobelman* decision on the state law contractual rights bargained for by the mortgagor and mortgagee, and with the legislative history which indicates that §1322(b) was intended to encourage the flow of capital into the home lending market and to exempt such Mortgages from valuations and bifurcations as the result of an application of § 506(a). Cases following minority view include *Barnes v. American Gen. Fin.* (*In re Barnes*), 207 B.R. 588 (Bankr.N.D.Ill.1997).
- e. The Hon. Keith Lundin has expressed support for the minority view, that *Nobleman* was concerned about protecting the state law rights of the residential mortgagee and did not consider the issue to be a question of valuation. Lundin’s view and the minority view is there is no justification, following the *Nobelman* decision, for courts to focus on the value, at the date of the petition, of the real property securing a debt as the threshold of whether the rights of the mortgagee may be modified. In the majority view, a mortgagee with \$1.00 in equity receives the anti-modification protection of §1322(b), while the mortgagee with no equity does not. Keith M. Lundin, Chapter 13 Bankruptcy, 3d. Ed. §14.1, p. 221 (2000 & Supp. 2004)
- f. Lien stripping in the Seventh Circuit
  - i. Although every circuit court of appeals that has considered the question has followed the majority view, the Seventh Circuit Court of Appeals has not directly ruled on the issue; thus, lower courts in the Seventh Circuit may follow either the majority or the minority view.
  - ii. In the Northern District of Illinois, the cases go both ways. *Barnes v. American Gen. Fin.* (*In re Barnes*), 207 B.R. 588 (Bankr. N.D. Ill. 1997) (follows the minority view that 11 U.S.C. §1322(b)(2) prohibits stripping off wholly unsecured mortgages.) *Waters v. Money Store* (*In re Waters*), 276 B.R. 879 (Bankr. N.D. Ill. 2002) follows the majority position after a thorough analysis of both views. Also in the Northern District of Illinois, the district court in *In re Holloway v. United States*, 2001 U.S. Dist. LEXIS 16898 (N.D. Ill. Oct. 16, 2001) follows the majority view.
  - iii. In the Central District of Illinois, *In re King*, 290 B.R. 641 (Bankr. C.D. Ill. 2003) adopted *Waters, supra*.
  - iv. In *In re Black*, 2002 Bankr. LEXIS 1752 (Bankr. N.D. Ind. 2002), the Northern District of Indiana provides a comprehensive review of cases following the majority and minority views, and decides that stripping off a wholly unsecured mortgage from the debtor’s residence “represents the most appropriate reading of both [11 U.S.C.] § 1322(b)(2) and *Nobelman*.”

IV. **EXCEPTIONS TO ANTI-MODIFICATION: - NOBELMAN EXCEPTIONS -** § 1322(b)(2) provides that the Chapter 13 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. §1123(b)(5) says the same thing for Chapter 11 cases.

a. **Debtor's Principal Residence** –

Principal Residence defined U.S.C. 101(13A) The term “debtor's principal residence”--(A) means a residential structure, including incidental property, without regard to whether that structure is attached to real property; and (B) includes an individual condominium or cooperative unit, a mobile or manufactured home, or trailer.

b. Liens on attached property or curtilage?

c. When is the Principal Use determined?

i. Origination date or petition date?

ii. Is pre-petition “use planning allowed?”

d. **“Secured Only By”** - Effect of lien on residence as well as upon other assets.

- i. Additional security interests in mortgage escrow accounts. A majority of courts have ruled that the grant of a security interest in an escrow fund for insurance and taxes by a Chapter 13 debtor's second mortgage did not convey additional collateral. The anti-modification provision continues to apply. The debtor retained no interest in the funds once placed in escrow and so any grant of a security interest in such funds was meaningless and conveyed essentially no interest at all. *1<sup>st</sup> 2<sup>nd</sup> Mortgage Co. of NJ., Inc. v. Ferandos (In re Ferandos)*, 402 F.3d 147 (3d Cir. 2005). *See also Boehmer v. Essex (In re Boehmer)*, 240 B.R. 837 (Bankr. E.D.Pa. 1999); *Rodriguez v. Mellon Bank, N.A. (In re Rodriguez)*, 218 B.R. 764 (Bankr. E.D. Pa. 1998); *In re Abruzzo*, 245 B.R. 201 (Bankr. E.D. Pa. 1999), vacated *In re Abruzzo*, 245 B.R. 2000 U.S. Dist. LEXIS 4936 (E.D. Pa. Apr. 7, 2000), on remand *In re Abruzzo*, 249 B.R. 78 (Bankr. E.D. Pa. 2000)
- ii. Other view: Residential mortgage debt was not one secured “only by a security interest in real property” that was debtor's principal home, within meaning of anti-modification provision of Chapter 13, where mortgagee had also been granted security interest in escrow for taxes and insurance premiums; mortgagee had additional security interest in escrowed funds, notwithstanding that, on petition date, that interest had not been perfected by delivery. *Stewart v. U.S. Bank*, 263 B.R. 728 (Bankr.W.D. Pa. 2001).
- iii. Secured by additional assets other than the residence; cross collateralization clauses, overly broad security agreement?
  1. Fixtures: will a security interest in fixtures destroy §1322 anti-modification protection?
  2. Mortgage extending mortgagee's security interest to non-fixture appliances, as well as other personalty, removed mortgagee's claim from category of claims secured only by residential realty, for purpose of preventing Chapter 13 debtor from modifying mortgagee's rights. *In re Caster*, 77 B.R. 8 (Bankr. E.D. Pa. 1987).

iv. **Valuation** Under § 506 (a)(1), “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”(emphasis added). If a valuation of the property under §506(a) determines that a junior mortgage holder's claim is wholly unsecured, then the mortgagee is not in any respect a “holder of a claim secured by the debtor's residence” and the jr. mortgage holder’s claim may be modified and treated as an unsecured claim.

1. Date of Valuation –

a. Loan Origination Date or Date of Bankruptcy Petition?

2. Methodology of Valuation. Market value or liquidation value? When a Chapter 11 debtor or a Chapter 13 debtor intends to retain property subject to a lien, the purpose of a valuation under section 506(a) is not to determine the amount the creditor would receive if it hypothetically had to foreclose and sell the collateral. Neither the foreclosure value nor the costs of repossession are to be considered because no foreclosure is intended. . . . The fair market value is not ‘replacement value’ because the house is not being replaced. The fair market value is the price which a willing seller under no compulsion to sell and a willing buyer under no compulsion to buy would agree upon after the property has been exposed to the market for a reasonable time. *Taffi v. United States (In re Taffi)*, 68 F.3d 306, 309 (9th Cir. 1995)

3. Current use or highest-best use? Should not calculate the value of the property on the value such property could demand if it were converted to some other use. The purpose of the valuation is to determine how much the creditor will receive for the debtor’s continued possession . . . The foreclosure value is not relevant because no foreclosure is intended by the Plan. . . . Consequently, the value has to be the fair market value of what the debtors are using. *Taffi v. United States (In re Taffi)*, 68 F.3d 306, 309 (9th Cir. 1995)

Cannot deduct for hypothetical costs of sale – *Huntington Nat’l Bank v. Pees (In re McClurkin)*, 31 F.3d 401 (6<sup>th</sup> Cir. 1994)

v. **When is the Lien Stripped Off?** The unsecured junior lien is not stripped off at confirmation. To allow lien strip at confirmation would encourage “mischief” such as the debtor’s post-confirmation sale of the property to an unsuspecting purchaser. Under BAPCPA section 1325(a)(5)(B)(i)(I)(bb), the plan must provide that the claim holder “retain[s] the lien securing such claim until . . . discharge under section 1328....”

1. The junior lien is deemed satisfied and lien should be discharged or released only upon conclusion of the bankruptcy case. *In re Jones*, 152 B.R. 155 (Bankr. E.D. Mich. 1993).

2. The right to avoid a lien has not fully matured in a Chapter 13 context until a discharge is granted upon successful completion of the Chapter 13 Plan. Accordingly, the order confirming the Debtors' plan will specifically provide that the Debtors' house shall remain property of the estate, and shall *not* re-vest in the Debtors, until the Debtors are granted a discharge. *Castle v. Parrish*, 29 B.R. 869, 874 (Bankr. S.D. Ohio 1983)
  3. A plan is inconsistent with the provisions of Chapter 13 when it purports to effectuate irrevocable lien avoidance on plan confirmation. *In re McMillan* 251 B.R. 484, 490 (Bankr. E.D. Mich.2000)
  4. If the Debtor is ineligible to receive a discharge due to prior discharge under 11 U.S.C. 1328(f) then the Debtor may not benefit from the lien stripoff. *See In re Akram*, 259 B.R. 371, 378-79 (Bankr.C.D.Cal.2001); *In re King*, 290 B.R. 641, 651(Bankr. C.D. Ill.2003)
- vi. **Hardship discharge?** If the Debtor receives only a “hardship discharge” under 11 U.S.C. 1328(b) is the debtor entitled to the benefit of the lien strip and a discharge of the junior mortgage lien?
1. One line of cases holds that a creditor's lien may be extinguished pursuant to the debtor's plan. These cases use the following two lines of reasoning: First, the creditor's lien is void upon the payment of the allowed secured claim pursuant to 11 U.S.C. § 506(d); and second, where §1322(b)(2) does not prevent a modification to the creditor's lien rights, any concern about the debtor dismissing his case after the creditor's lien is released, but prior to full payment under the plan, is outweighed by the policy of affording the debtor a fresh start. *See, e.g., Bank One, NA v. Flowers*, 183 B.R. 509 (N.D. Ill. 1995); *In re Nicewonger*, 192 B.R. 886 (Bankr.N.D.Ohio 1996); *In re Hernandez*, 175 B.R. 962 (N.D. Ill. 1994); *In re Wilson*, 174 B.R. 215 (Bankr. S.D. Miss. 1994); *McDonough v. Plaistow Coop. Bank (In re McDonough)*, 166 B.R. 9 (Bankr. D. Mass. 1994); *In re Cooke*, 169 B.R. 662 (Bankr. W.D. Mo.1994); *In re Schultz*, 153 B.R. 170 (Bankr. S.D. Miss.1993); *In re Lee*, 156 B.R. 628 (Bankr. D. Minn.1993).
  2. Another line of cases holds that a debtor may not obtain a release of a secured creditor's lien until he successfully completes the confirmed plan and receives a §1328(a) discharge. *See, e.g., In re Zakowski*, 213 B.R. 1003 (Bankr. E.D. Wis.1997); *In re Pruitt*, 203 B.R. 134 (Bankr. N.D. Ind. 1996); *In re Scheierl*, 176 B.R. 498 (Bankr. D. Minn.1995); *In re Jordan*, 164 B.R. 89 (Bankr. E.D. Mo.1994); *In re Jones*, 152 B.R. 155 (Bankr. E.D. Mich.1993); *Gibbons v. Opechee Distribs. (In re Gibbons)*, 164 B.R. 207 (Bankr. D.N.H. 1993).

V. **IS AN ADVERSARY PROCEEDING REQUIRED?** Chapter 13 debtors may not need to file an adversary proceeding to strip the mortgagee's lien. One court summarized the cases:

[I]t appears that no adversary proceeding is needed simply to value and declare void a totally unsecured claim. The majority of courts therefore hold that "the appropriate procedure for lien avoidance under Section 506 is by motion because lien avoidance is the inevitable byproduct of valuing a claim, which is accomplished by motion pursuant to Bankruptcy Rule 3012." *In re Sadala*, 294 B.R. 180, 183 (Bankr. M.D. Fla. 2003) (collecting cases); *see also*, *In re Millspaugh*, 302 B.R. 90 (Bankr. D. Idaho 2003); *In re Fisher*, 289 B.R. 544 (Bankr. W.D.N.Y. 2003) (court allows proceedings to be prosecuted by motion in the absence of a specific objection by the mortgage holder that the proceeding be converted to an adversary proceeding); but *see, e.g.*, *In re Kressler*, 252 B.R. 632 (Bankr. E.D. Pa. 2000) (espousing the minority view that an adversary proceeding is required); ...Once the value of the secured claim is determined, the attendant lien is stripped off automatically under Section 506(d)." *In re Sadala*, 294 B.R. 180, 183 (Bankr. M.D. Fla. 2003)

*In re Robert*, 313 B.R. 545, 549 (Bankr. N.D. N.Y. 2004).

These Courts have determined that lien stripping is a valuation issue, not a challenge to the "validity, priority, or extent of a lien" of F.R.B.P. 7001, requiring an adversary proceeding.

a. Courts have considered the "lien-stripping" effect of § 506 in the context of:

- i. an adversary proceeding. *See, e.g.*, *Gaglia v. First Federal Sav. & Loan Asso.*, 889 F.2d 1304, 1305 (3d Cir. Pa.1989), *overruled by Dewsnuip v. Timm*, 502 U.S. 410 (U.S. 1992); *In re Lindsey*, 823 F.2d 189, 191 (7th Cir. Ill. 1987); *In re Cobb*, 122 B.R. 22, 24(Bankr.E.D. Pa.1990); *Bellamy v. Federal Home Loan Mortg. Corp.*, 122 B.R. 856, 857 (Bankr. D. Conn. 1991), *aff'd In re Bellamy*, 132 B.R. 810 (D.Conn.1991), *aff'd In re Bellamy*, 962 F.2d 176 (2d Cir. Conn. 1992); *Goins v. Diamond Mortg. Corp.*, 119 B.R. 156, 157 (Bankr. N.D. Ill.1990); *In re Garnett*, 88 B.R. 123, 124 (Bankr. W.D. Ky.1988), *aff'd United States on behalf of Farmers Home Admin. v. Garnett*, 99 B.R. 757 (W.D. Ky. 1989); *In re Crouch*, 80 B.R. 364, 365 (Bankr. W.D. Va.1987); *In re O'Leary*, 75 B.R. 881, 882(Bankr. D. Or. 1987);
- ii. a motion to avoid a lien. *See, e.g.*, *In re Jablonski*, 88 B.R. 652, 653 (E.D. Pa. 1988); *In re Chavez*, 117 B.R. 733, 734 (Bankr. S.D. Fla. 1990); *In re Marshall*, 111 B.R. 325, 326 (Bankr. D. Mont. 1990); *In re Demoff*, 109 B.R. 902, 903 (Bankr. N.D. Ind.1989); *In re Anderson*, 88 B.R. 877, 878 (Bankr. N.D. Ind. 1988), *In re Robert*, 313 B.R. 545 (Bankr. N.D.N.Y. 2004) and,

iii. in an objection to a proof of claim. *See, e.g., In re Jablonski*, 88 B.R. 652, 653 (E.D. Pa. 1988); *In re Chavez*, 117 B.R. 733, 734 (Bankr. S.D. Fla. 1990); *In re Marshall*, 111 B.R. 325, 326 (Bankr. D. Mont. 1990); *In re Demoff*, 109 B.R. 902, 903 (Bankr. N.D. Ind. 1989); *In re Anderson*, 88 B.R. 877, 878 (Bankr. N.D. Ind. 1988).

b. **Eastern District Court of Michigan**- The Court has not to date required an adversary proceeding in any published opinion. In the case, *In re Jones* 152 B.R. 155 (Bankr. E.D. Mich. 1993); the Hon. Arthur Spector held that F.R.Bankr.P. 3012 permits § 506 valuations to be requested by motion, and noted that the advisory committee note relating to that rule distinguishes valuation proceedings from those subject to F.R.Bankr.P. 7001, and ruled that the debtor need not file an adversary proceeding to avoid a creditor's lien under § 506. *In re Hoskins*, 262 B.R. 693 (Bankr. E.D. Mich. 2001)

c. **Western District of Michigan**- a junior lien which is totally unsupported by any equity in property may be extinguished through Chapter 13 plan confirmation process, without need for adversary proceeding, as long as language in plan is sufficiently clear to put lienholder on notice of debtor's intentions) (*See also, In re Hoskins*, 262 B.R. 693 (Bankr. E.D. Mich. 2001) (Judge Spector), *In re Fuller* 255 B.R. 300, 306 (Bankr. W.D. Mich. 2000); *In re Hudson*, 260 B.R. 421 (Bankr. W.D. Mich. 2001); see also, *In re Calvert*, 907 F.2d 1069, 1072 (11th Cir. Ala. 1990);

i. Best Practice- Circuits have not specifically ruled. Debtors may wish to be cautious when deciding whether an adversary proceeding is required. If future appellate court decisions decide that an adversary proceeding is required, the lien strip-off may be subject to collateral attack. *Cf. Rueble v. Educ. Mgmt. Corp. (In re Rueble)*, 412 F. 3d 679, 680 (6<sup>th</sup> Cir. 2005) (student loan discharge in plan void because adversary proceeding required).

VI. **EFFECT OF DISMISSAL** – A dismissal acts to undo bankruptcy and to restore property rights to the position in which they were found at commencement of case, as far as practicable, given facts of each case. Bankr.Code, 11 U.S.C. § 349(b).

i. Unless the court indicates otherwise, the general effect of an order of dismissal is to "restore the status quo ante; "it is as if the bankruptcy petition had never been filed. *France v. Lewis & Coulter, Inc. (In re Lewis & Coulter, Inc.)*, 159 B.R. 188, 190 (Bankr. W.D. Pa. 1993); *Lawson v. Tilem (In re Lawson)*, 156 B.R. 43, 45 (B.A..P. 9<sup>th</sup> Cir. Cal. 1993)).

ii. The legislative history of 11 U.S.C. § 349 states: The basic purpose of the subsection is to undo the bankruptcy case, as far as practicable, and to restore all property rights to the position in which they were found at the commencement of the case.... Where there is a question over the scope of the subsection, the court will make the appropriate orders to protect rights acquired in reliance on the bankruptcy case. H.R.Rep. No. 595, 95th Cong., 1st Sess., 338 (1977); 1978 U.S.Code Cong. & Admin.News, 5963, 6294.

iii. 11 U.S.C. § 1325(a)(5)(B)(i)(II) requires a plan to provide that if a Chapter 13 case is "dismissed or converted without completion of the plan," the lien is

retained by the lien holder “to the extent recognized by applicable nonbankruptcy law.”

## **VII. CREDITOR DEFENSES**

### **a. Mortgage is not a “Junior Lien”**

- i. Failure to record or properly record a senior mortgage. If junior lienholder lacked notice of the prior lien, consider action to determine whether a “junior lien” has priority.
  - ii. Defective/invalid liens. If a senior lien has defects that render the security instrument void, consider action to determine lien priority (e.g., acknowledgment, signatures, witnesses, description of the property).
  - iii. Can junior lienholder compel Ch. 13 Trustee or Debtor to avoid a senior lien, thus preserving Jr. lien? No, because any such senior lien avoided would be preserved to the bankruptcy estate to prevent a junior lienholder from improving his position. 11 U.S.C. § 551
- b. **Valuation of property supports Junior Lien-** Appraisals of property may establish that the property actually is worth more than the amount of the senior lienholder’s secured claim.

1. Claims of senior lienholder may be overstated. In a close case, it may be useful to examine the claim of the senior lienholder for components that may improperly inflate the amount of the claim. Consider objections to the claim for:
  - a. Fees and costs incurred after the petition was filed;
  - b. Property taxes, insurance premiums, or property preservation expenses that were incurred after the petition was filed;
  - c. Fees and costs that are not authorized to be charged to the borrower under the note and mortgage, unless or until notice to the debtor is given;
  - d. Unlawful fees and costs;
  - e. Whether funds in escrow account should be credited.

### **c. Motions to convert case to chapter 7.**

- i. See note above, regarding §1325(a)(5)(B)(i)(II) (effect of dismissal or conversion)
- ii. General grounds to convert case. Strategic reasons to convert to Chapter 7? The borrower cannot strip lien in Ch. 7 case. *Nobelman v. American Savings Bank*, 508 U.S. 324 (U.S. 1993); *In re Talbert*, 344 F.3d 555 (6th Cir. 2003).

VIII. SETTLEMENT CONSIDERATIONS /CREDITOR CONCEDES THAT LIEN STRIP IS AUTHORIZED- WHAT NEXT?

- a. Seek a judgment, plan provision, or order that protect junior lienholder until conclusion of the case.
  - i. Order should confirm lien is preserved until successful completion of all payments and issuance of § 1328(a) Order of Discharge.
  - ii. The judgment and the order confirming the plan should state that any property encumbered by liens securing an allowed secured claim shall remain property of the estate until the plan is fully performed.
  - iii. Seek favorable judgment provisions that protect the junior lienholder until the case is concluded, such as “Future Default” provisions , and provisions requiring maintenance of adequate hazard insurance coverage, and prompt payment of property taxes.
- b. Make a close examination of Debtor’s Income and Expenses and file timely objections to under reported income, and unsubstantiated, unreasonable and luxury expenditures, to maximize dividends to unsecured creditors.
- c. Consider valid objections to untimely or defective claims of other unsecured creditors to maximize junior lienholder’s pro rata share.
- d. Monitor plan payments, prompt payment of property taxes, and maintenance of adequate hazard insurance and seek dismissal in appropriate circumstances.

IX. OTHER EXCEPTIONS:

- a. **Short Term Mortgages** – *First Union Mortg. Corp. v. Eubanks (In re Eubanks)*, 219 B.R. 468 (B.A.P. 6<sup>th</sup> Cir. 1998) (Section 1322(c)(2) creates a statutory exception to the protection from modification for “short term” home mortgages in Chapter 13 cases; debtor can bifurcate undersecured second mortgage and pay allowable secured portion in full with interest consistent with § 1325(a)(5), while paying unsecured portion with other unsecured claims.)