Chapter 13: Fees, Lienstripping and Other Current Developments Regarding Consumer Mortgages

Nathan E. Curtis | Geraci Law, LLC; Chicago.

Keisha M. Hooks | Staff Attorney, Chapter 13 Trustee
Chicago

Berton J. Maley | Codilis & Associates PC
Burr Ridge, Ill.

Faiq Mihlar | Heavner, Scott, Beyers & Mihlar, LLC
Decatur, Ill.

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CHAPTER 20: THE UNRESOLVED MORTGAGE STRIPPING ISSUE

Chapter 20 Background

DEFINITION: A Chapter 20 means filing a Chapter 7, and then after that case has been discharged, filing a subsequent Chapter 13. Usually, the Chapter 13 is filed right after the Chapter 7 is discharged.

REASONS: Besides attempting to strip a wholly unsecured mortgage, Chapter 20's are often filed because debtors cannot deal with their unsecured debt and take care of other secured or non-dischargeable debt. A debtor will file a Chapter 7 to eliminate his unsecured debt and then file a 13 to deal with one or more of the following types of debts, and usually pay them in full:

- Mortgage arrears
- Tax debts
- Domestic support debts
- Student loans

OLD LAW: Under the pre-BAPCPA code, Debtors could file a Chapter 7, obtain a discharge, and immediately file a Chapter 13, in which they would also be awarded a discharge upon completion of the plan.

NEW LAW: BAPCPA added §1328(f), which states:

Notwithstanding subsections (a) and (b), the court shall not grant a discharge of all debts provided for in the plan or disallowed under section 502, if the debtor has received a discharge--

(1) in a case filed under chapter 7, 11, or 12 of this title during the 4-year period preceding the date of the order for relief under this chapter, or

(2) in a case filed under chapter 13 of this title during the 2-year period preceding the date of such order.

Therefore, under BAPCPA, a Debtor who has received a discharge in a Chapter 7 filed less than 4 years before the filing of a subsequent 13 is not eligible to receive a discharge in the Chapter 13

Common Fact Pattern:

Debtor files a Chapter 7 bankruptcy and is awarded a discharge under 11 U.S.C. §727. Less than 4 years later, the Debtor files a Chapter 13 bankruptcy. Debtor is ***not*** eligible for a discharge pursuant to §1328(f) since the Debtor had filed a Chapter 7 in which he received a discharge within 4 years of filing the Chapter 13. Debtor owns a home which has a first mortgage whose balance exceeds the value of the home. Debtor has a second mortgage that is considered fully unsecured, and could have been stripped without question if the Debtor had filed a Chapter 13 instead of the 7.

Common Issue:

Can the Debtor successfully strip off the wholly unsecured mortgage if he is not entitled to receive a discharge?

Majority View	Minority View
♦ §348(f)(1)(C) and §349(b)(1)(C) are analogous in that they provide for the reinstatement of liens in converted and dismissed cases	♦ §348(f)(1)(C) and §349(b)(1)(C) are not analogous; they specifically apply to converted and dismissed cases, not cases that are completed and closed
♦ §506 cannot be used to avoid a lien in a Chapter 7 case; by filing a no-discharge Chapter 13 after receiving a discharge in a Chapter 7, debtor is attempting to do essentially the same thing	♦ §506 can be used to avoid a lien because this is not a Chapter 7 case; if the Court feels that the sole reason for filing the Chapter13 is to strip the lien, then the plan can be dismissed for bad faith
♦ §506(d) only avoids liens on disallowed claims; since the second mortgage has a valid *in rem* claim, there is no basis to disallow the claim	♦ §506(d) does not require a claim to be disallowed; since there is nothing for the claim to be secured by, the lien is simply avoided
♦ §1322(b)(2) is what allows a secured claim to be modified	♦ §1322(b)(2) does not apply to wholly unsecured mortgages because they are not secured claims
♦ §§1325(a)(5)(B)(i)(I)(aa) and (bb) state that the holder of an allowed secured claim retains their lien until the debt is considered paid under nonbankruptcy law, or until the case is discharged under §1328; if there is no discharge, then the creditor retains their lien until the debt is paid	♦ §1325(a)(5) refers to allowed secured claims provided for by the plan; since the mortgage is wholly unsecured, it is not an allowed secured claim; further, §1325(a)(5)(B)(i)(II) states that liens are retained to the extent as recognized by nonbankruptcy law only if the plan ***is not completed***; a plan can be completed without obtaining a discharge
♦ The debtor must be eligible for a discharge to be able to strip a wholly unsecured lien in a Chapter 13	♦ There is no language anywhere in the Code which states that a Debtor's right to modify or strip off wholly unsecured liens is conditioned on the debtor's eligibility for a discharge

Good Faith Concerns

There must be a good reason to file the second case. If it is to pay debts that were not discharged in the Chapter 7, pay substantial arrears on the first mortgage, or if the debtor's financial situation has changed, the Courts appear to be more likely to find that there is no bad faith filing. They may also look at the time between the discharge of the 7 and the filing of the 13.

If, however, the 13 is immediately filed right after the 7 is discharged, and there are minimal other debts being paid, if any, Courts will likely find the filing to be in bad faith and dismiss the case.

Is there a Public Policy Argument to be Made?

What are Potential Pitfalls for Debtors Attorneys?

CASE SUMMARIES

***In re Jarvis*, 390 B.R. 600 (Bankr.C.D.Ill. 2008)** This appears to be the first case to issue a written opinion on this issue. The Court's previous opinion in *In re King* stated that a wholly unsecured lien could be stripped in a Chapter 13 plan, and although the confirmed plan's lien-avoiding effect is established at the time of confirmation, the Court also stated that the actual avoidance of the lien would only occur upon the completion of the plan and receipt of a discharge. *In re King*, 290 B.R. 641, 651 (Bankr. C.D.Ill. 2003). The Court noted that in King, there was no bar to receiving a discharge in a 13 following a 7, but BAPCPA changed that. The Court then relied on its opinion in In re Lilly, where the Court stated "Where a debtor does not receive a discharge, however, any modifications to a creditor's rights imposed in the plan are not permanent and have no binding effect once the term of the plan ends." *In re Lilly*, 378 B.R. 232, 236 (Bankr. C.D.Ill. 2007). That Court went on to say that although a debtor not eligible for a discharge under §1328 had the right to modify the rights of a secured creditor under §1322(b)(2), such a modification would only be binding during the term of the plan. *Id.* Finally, the Lilly Court noted that this result regarding secured claims would be consistent with cases that are converted or dismissed because in all of them, no discharge is received. *Id*. At 237. The *Jarvis* Court agreed, stating that although a Chapter 7 eliminates a debtor's personal liability on a mortgage, the creditor still retains an *in rem* claim which can only be permanently modified by completing a Chapter 13 plan and obtaining a discharge.

***In re Blosser*, 2009 WL 1064455 (Bankr.E.D.Wis. 2009)** The Court relied squarely on the Jarvis decision, stating that allowing a debtor to discharge all dischargeable debts in a Chapter 7 and then immediately file a Chapter 13 to strip a wholly unsecured mortgage would be comparable to simply avoiding the unsecured lien in the Chapter 7, even though §506 cannot be used to avoid liens in a Chapter 7 pursuant to *Dewsnup v. Timm*, 502 U.S. 410 (1992). The Court also noted the provisions in §348(f)(1)(C) and §349(b)(1)(C) which cause avoided liens to return on converted or dismissed cases.

***In re Winitzky*, 08-19337 (unpublished) (Bankr.C.D. Cal. 2009)** The Court echoed Judge Kelley's sentiments in *Blosser*, stating that the Supreme Court ruled in *Dewsnup* that a debtor cannot strip a mortgage in a Chapter 7, and to allow a Chapter 13 debtor to strip a mortgage in a no-discharge 13 would allow a debtor to do indirectly what he cannot do directly in a Chapter 7. The Court said that to allow a debtor to strip a lien in a no-discharge case would create a special lien discharge, which cannot be supported by any language in the Code. The Court also said that by allowing liens to be reinstated in converted or dismissed cases prevents the Court from permanently modifying the creditors underlying state law lien rights without a legitimate purpose in bankruptcy.

***In re Begley*, 2009 WL 2513410 (Bankr.D. Neb. 2009)** The Court found that §1322(b)(2) would not apply for a wholly unsecured mortgage. They also found that the lien would not be avoided until the Chapter 13 plan was completed. The Court made no mention of requiring a discharge for the lien to be avoided.

***In re Mendoza*, 2010 WL 736834 (Bankr.Dist. Col. 2010)** The Court here followed the rulings of *Jarvis*, *Blosser* and *Winitzky*, holding that a debtor could not strip a wholly unsecured mortgage if he was not entitled to a discharge. The Court found that the creation of §1328(f) in BAPCPA was a clear indication of congressional intent regarding the ability to discharge debts in a Chapter 13, after receiving a discharge in a Chapter 7. The Court stated that allowing a debtor to strip away a mortgage in a Chapter 13 following a Chapter 7, would be equivalent to giving them a discharge in that debt, which would render §1328(f) meaningless, violating one of the canons of statutory construction.

***Hart v. San Diego Credit Union et. al*, 09 CV 1017 (unpublished) (S.D. Cal. 2010)** This is the first known case under BAPCPA to state that a wholly unsecured mortgage could be stripped off in a Chapter 13 in which the debtor was not entitled to a discharge. The Court relied primarily on *In re Greyer*, 23 B.R. 726 (Bankr.S.D.Cal. 1996), which found that a wholly unsecured second mortgage could be stripped off under §506(d). The Greyer Court found that when the estate's interest in the property is zero (due to there being no equity for the lien to attach to) the claim under §506(a) is fully unsecured and is therefore not entitled to the anti-modification protections of §1322(b)(2). *Id*. at 729-30. Although the Court took note of the Jarvis decision and the cases following that opinion, the Court noted that the reason for the Jarvis decision was due to the precedent set in the King decision, stating that the actual lien avoidance did not occur until the case had been discharged. The Court noted that there was no similar precedent in the 9th Circuit, and that the actual plain language of the Bankruptcy Code does not require a discharge to avoid liens under §506.

***In re Fenn*, 428 B.R. 494 (Bankr.N.D. Ill. 2010)** The Court rejected the Debtor's argument that §§506(a) and (d) could be used to avoid the lien of the unsecured second mortgage without a discharge. The Court held that §506(d) only avoids liens if the underlying claim has been disallowed. Simply because the amount of security on a claim is zero, that does not make it a disallowed claim. The Court found that a claim can only be disallowed under §502(b) and there had been no objection to the claim of the junior mortgage holder in this case. The Court further stated that under BAPCPA, the Code added 2 new specific lien retention provisions in Chapter 13: §§1325(a)(5)(B)(i)(I)(aa) and (bb), which state that the holder of a secured claim retains their lien until the underlying debt determined under nonbankruptcy law has been paid, or until the case is discharged under §1328. Even though §§506, 1322(b)(2) and 1325(a)(5) all address secured liens in Chapter 13 cases, where there is a conflict between the statutes, the more specific provisions of §§1322(b)(2) and 1325(a)(5) prevail over the more general provisions of §§506(a) and (d). NOTE: Subsequently, the Debtors objected to the claim of the junior mortgage, which had been filed. The Court overruled the objection, stating there was no legal authority to disallow the claim.

***In re Tran*, 431 B.R. 230 (Bankr.N.D. Cal. 2010)** This is the first published case allowing a junior mortgage to be stripped where a debtor is not eligible for a discharge. The Court found that a debtor's right to strip off a wholly unsecured mortgage is not conditioned upon the debtor receiving a discharge, but rather on the debtor's confirmation and completion of a Chapter 13 plan that meets all statutory requirements. The Court noted that there was no language in §506, §1322, or in any other section of the Code which states that a Debtor's right to modify or strip off wholly unsecured liens is conditioned on the debtor's eligibility for a discharge. The Court

further stated that although §349(b)(1)(C) states that liens avoided under §506 are reinstated upon dismissal of a case, as long as the plan is completed, the case is closed, not dismissed so they are not analogous. Also the plain language of §1325(a)(5)(B)(i)(II) appears to state that permanent lien modifications of secured claims are conditioned on plan completion, rather than on discharge. The Court differentiated Jarvis and its progeny by stating that the Jarvis Court's decision to follow the Lilly case was misguided. Lilly determined that a modification could not be binding on a creditor after the case because there was no discharge. However, the Lilly case dealt with holders of secured claims. The holder of a wholly unsecured lien is not the holder of a secured claim. *See In re Zimmer*, 313 F.3d 1220, 1225-26 (9th Cir.2002). Since there is no basis in the code to condition a lien strip on discharge, the Court found that as long as the plan completes, the lien could be stripped.
NOTE: the Court did find that if a Chapter 13 is filed primarily just to avoid a junior mortgage so that it appears to be an attempt to avoid the Supreme Court's decision in *Dewsnup*, the filing would not be considered to be in good faith and would be dismissed.

NOTE: There are several cases where the Court has ruled that Debtor may file the Chapter 13 and seek to have the lien stripped, but the actual allowance of the stripping of the lien has not been ruled on. It is likely that there will be more and more cases concerning this issue in the near future.

HAMP'S NEW RULES

The Home Affordable Modification Program, or HAMP, is the Obama Administration's response to our current residential mortgage crisis. Ideally, the HAMP program would have stabilized the housing market by reducing an eligible borrower's monthly housing payment to 31% of the borrower's gross earnings.

Although the program has been in existence only since March of 2009, its effectiveness has been questioned and criticized publicly, and some would say with good reason. At the end of 2009, only 31,382 of the 728,000 trial modifications made it to a permanent loan modification. The Big Four lenders, Wells Fargo, Citicorp, JP Morgan Chase and Bank of America, had abysmally low trial-to-permanent conversion rates at the end of 2009.

Recently, the Treasury Department revised some of HAMP's guidelines in an effort to better advance the program's objectives. In addition, Treasury introduced the Home Affordable Foreclosure Alternative (HAFA) program, a new initiative aimed at assisting borrowers who are not eligible for a HAMP solution. These developments expand the options available to homeowners and will help borrowers avoid foreclosure. Hopefully, the recent enhancements will make the program more effective and attractive to struggling homeowners.

The recent Treasury changes can be divided into five categories, which will be discussed below. The revisions illustrate a new approach to addressing the needs of homeowners who qualify for HAMP. The Obama Administration seems to be concerned about those in need of bankruptcy protection, out-of-work borrowers, and individuals for whom foreclosure appears inevitable. In addition, the program is focusing on outreach, communication and timeliness. It's possible that these new changes may cause some critics to re-evaluate their conclusions about the program.

New Treasury Regulations Protect Debtors

On June 1, 2010, new Treasury Department directives aimed at improving the HAMP program took effect. Of particular interest is the Administration's attitude towards debtors involved in an active bankruptcy.

For example, the directives contain a "no discrimination" policy as an added safeguard for bankruptcy filers. A debtor who is in an active case is eligible for the HAMP program, provided the debtor or the debtor's attorney requests a modification. Moreover, a debtor cannot be denied a modification simply because the debtor filed for bankruptcy relief while in a trial period. In fact, trial periods can be extended for two months to allow for the debtor to gain the court's approval of the loan modification. The new regulations also protect debtors from some creditor actions during the trial payment period. If a debtor is in a trial modification plan and is current on his reduced monthly payments, a lender cannot object to confirmation, move to dismiss, or move for relief of the automatic stay unless other grounds exist.

The new regulations favor debtors in several other ways. Chapter 7 debtors who exercised the "ride-through" option and did not reaffirm their mortgages are eligible for a HAMP modification. In fact, if the debtor received a discharge, the modification agreement must contain a provision that states the debtor has no personal liability for the loan. This is remarkable news for a Chapter 7 debtor. In addition to converting his mortgage from a recourse loan to a non-recourse loan, a borrower also may benefit from the lower payment the HAMP program can provide.

Arguably, the HAMP application process is simpler for a bankruptcy debtor due to the Treasury Department directives. Provided the schedules are less than 90 days old, debtors can use the schedules and tax returns provided in the bankruptcy case to verify income. Servicers are permitted to use this information to determine HAMP eligibility.

In the future, the directives state that Chapter 13 debtors may not have to endure the three-month trial payment period provided three qualifications are met. First, the debtor cannot be in default on his post-petition mortgage obligation. In addition, his mortgage payments must be more than the proposed modified amount, and lastly, the investor agreement must allow for it. If all three elements are satisfied, the proposed HAMP loan modification can be deemed permanent without the need of a trial period.

Help for the Unemployed Borrower

Due to our economic climate, HAMP needed to address the obvious problem of the unemployed borrower. Considering the alarmingly high unemployment rate, the Obama Administration had to begin rescuing people who no longer have the financial means necessary to sustain their obligations. Thus, the "temporary assistance period" for unemployed mortgagors was born.

For a period of three to six months, an unemployed homeowner's mortgage can be reduced to 31%, or less in some instances, of the household's gross income. During this reprieve, the mortgagor is expected to be searching for employment. If the homeowner finds a job, but is earning less income, he should apply for a permanent modification under traditional HAMP guidelines. Conversely, if the borrower is unable to find a job once the assistance period expires, the borrower may consider one of HAMP's foreclosure alternative programs, which will be discussed in a later section.

Changes in HAMP's Execution and Philosophy

Based on the recent changes to HAMP, the Obama Administration seems committed to improving the level of communication lenders have with eligible borrowers and modification applicants. For example, lenders must make a "reasonable effort" to contact eligible borrowers by mail and phone. In addition, lenders must adopt a more proactive approach for contacting delinquent

borrowers. The program also increases incentive payment to lenders for permanent modifications. As a result, lenders do not have to absorb all of the additional costs associated with the new outreach efforts. It appears that access, communication and early intervention are now guiding principles for HAMP.

The tension between HAMP modifications and foreclosure sales has been alleviated to some degree as well. A mortgage cannot be foreclosed unless the borrower is ineligible for a HAMP modification or outreach efforts have been fruitless. In practice, this fact must be certified in order for a sale to be conducted. Moreover, the foreclosure process must be suspended during the trial modification period, assuming the borrower's income has been verified. As a result of this change, if a borrower is cooperating with his lender, he no longer has to worry about the consequence of foreclosure. Even if the homeowner is not granted a loan modification, foreclosure sales are stayed for thirty days following a non-approval notice. This gives a borrower time to respond to the determination and, perhaps, find another solution.

These changes reflect a commitment to making HAMP a success and an appreciation for the real concerns facing many homeowners. The new regulations embody compassion, professionalism and fairness. As long as all parties cooperate in this process, HAMP is built for success.

Mortgage Principal Reductions

HAMP has added an essential component that addresses the "underwater" residence. Homeowners across the nation have seen home values decline, and as a result, Americans are paying for homes that are worth far less than the loans we are repaying. HAMP has answered this concern by providing incentives for principal reductions.

Eligible borrowers can benefit from a reduction in their mortgage's principal if the mortgage exceeds 115% of the home's value. Servicers must perform a cost/benefit evaluation to determine if a mortgage write down is appropriate.

Lenders must compare the income it stands to earn under the proposed modification against the income it would earn if the home were foreclosed. If the proposed modification is financial more beneficial to the lender, then the servicer may extend the option to the borrower.

Ultimately, the principal is written down until the monthly housing payment is 31% of the borrower's gross income. If the borrower remains current for three years, the full amount of the reduction is forgiven. The HAMP program also offers incentives to lenders for the full or partial removal of subordinate liens.

Home Affordable Foreclosure Alternative

One of the policies behind HAMP was to keep homeowners from losing their residences to foreclosure. Realistically, it may not be possible for all borrowers to remain in their homes. Accordingly, the Obama Administration created the Home Affordable Foreclosure Alternative (HAFA) Program for those individuals who have run out of options.

This program is scheduled to terminate on December 31, 2012, and is a perfect complement to HAMP because it gives options to a borrower who may not be suitable for a HAMP solution.[1] HAFA requires lenders to consider non-traditional methods for disposing of property. The Obama Administration's focus has always been to avoid the lengthy and costly foreclosure process, and HAFA urges the use of short sales and deeds in lieu of foreclosure as a last resort of eligible borrowers. Under HAFA, the borrower is released from future liability, and no cash contributions, deficiency judgments or promissory notes are permitted. HAFA also offers relocation assistance for a borrower who completes one of the foreclosure alternatives.

A borrower is eligible for HAFA if one of the following qualifications is present: 1) the homeowner is ineligible for a trial period plan; 2) the borrower cannot complete a trial period plan; 3) the borrower has missed two consecutive

[1] HAMP is scheduled to terminate on December 31, 2012 as well.

payments during a permanent modification, or 4) the borrower requests a short sale or deed in lieu. If the homeowner is HAFA-eligible, the lender has thirty days to evaluate the borrower's circumstances. Servicers must create guidelines for determining whether a borrower will be permitted to short sale his home. Servicers can consider market conditions, borrower's cooperation, the decline of the home's value, and the like.

If the lender agrees to permit a short sale, the lender will send the mortgagor a Short Sale Agreement. This agreement lists the lender's approved sales price, the promise to release the borrower if the home is sold, and the amount of the mortgage payment the borrower must pay while the home is being marketed. The agreement also discloses information about post-closing relocation assistance and assures borrowers that the home will not be foreclosed if the homeowner remains in compliance with the agreement. If a lender consents to a deed in lieu of foreclosure, then it will provide a HAFA deed in lieu agreement.

Borrowers have two weeks to accept a servicer's offer to permit a short sale or to accept a deed in lieu of foreclosure. The borrower then has four months to sell his home, but that time period can be extended to twelve months if all parties agree. Once the borrower's offer has been accepted, the borrower must give the lender the contract, the prospective buyer's pre-approval letter, and information on subordinate liens.[2] The servicer must approve or deny the sales offer within ten business days. If the offer is denied, the lender must give an explanation. This gives the borrower an opportunity to address the servicer's concerns or perhaps negotiate with the servicer.

If the borrower is able to dispose of his home, the HAFA program helps him move to more affordable housing. Relocation payments have doubled to $3,000 for a borrower who successfully navigates this process.

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[2] Short sales and deeds in lieu can often be complicated by the existence of junior liens. HAFA addresses this problem by giving incentives for subordinate mortgagees who agree to release a borrower.

HAFA makes short sales and deeds in lieu more accessible. These once elusive options prevent foreclosures and save time and money. It's refreshing that borrowers who cannot afford to keep their homes now have alternatives available to them and can avoid the foreclosure experience.

CONCLUSION

HAMP and HAFA are our government's attempt at stabilizing the housing market. Although it may not be a perfect program, the information contained in this article can assist our clientele in saving their homes, and perhaps, avoiding bankruptcy. While attorneys may have personal feelings about the effectiveness of the program, practitioners have a duty to educate clients and counsel them on its advantages. Moreover, HAMP and HAFA will never appear attractive to the public if eligible borrowers never try to take advantage of its solutions. Bankruptcy professionals must discuss all bankruptcy and non-bankruptcy solutions to your clients. HAMP and HAFA must be considered as viable options of which you and your client should be aware.

Authored by:
Keisha Hooks, Esq.

Issues in the Recovery of Bankruptcy Fees and Costs

I. Recoverability Under the Contract

The first issue in determining whether fees and costs are recoverable is to look at the underlying note and mortgage. Under both Illinois and bankruptcy law, attorneys' fees and costs are only recoverable if provided for in the note and mortgage.

A. Illinois Mortgage Foreclosure Law Fees/Cost Provision
735 ILCS 5/15-1510

Attorney's Fees and Costs by Written Agreement. Attorneys' fees and other costs incurred in connection with the preparation, filing or prosecution of the foreclosure suit shall be recoverable in a foreclosure only to the extent specifically set forth in the mortgage or other written agreement between the mortgagor and the mortgagee or as otherwise provided in this Article.

Courts have repeatedly disallowed fees and costs where the written instrument did not expressly provide for the payment of attorneys' fees and costs.

See for example:

In re Gainous, 2009 WL 1607730 (Bankr. S.D.Tex. June 8, 2009); fees not allowed when deeds of trust or notes did not authorize fees.

In re Rangel, 408 B.R. 650, 676-77 (Bankr.S.D.Tex. May 29, 2009); Mortgage lender's right to collect fees and costs is controlled by loan documents and state law and must satisfy the procedural requirements in Bankruptcy Rule 2016.

Wells Fargo Bank, N.A. v. Gilbreath, 2010 WL 582572 (S.D. Tex. Feb. 12, 2010); remand necessary to determine whether, under the Deed of Trust, Wells Fargo was entitled to recover escrow charges and attorney fees as part of its proof of claim.

In re Tabares, 2008 WL 5539808 (Bankr.D. Kan. December 15, 2008); mortgage agreement and note did not "unambiguously provide for the payment of attorney fees incurred by bank in responding to this bankruptcy proceeding."

B. Authorization for Fees and Costs in Bankruptcy Code

Authored by: Faiq Mihlar, Heavner, Scott, Beyers & Mihlar, LLC
B.J. Maley, Codilis & Associates

A. Anti-Modification Provisions of Chapter 13

1. 11 USC §1322(b)(2) prevents the modification of a creditors rights under a residential mortgage through Chapter 13 Plan except that a pre-petition arrears can be cured over time while current payments are maintained pursuant to 11 USC §1322 (b)(5).

2. One of the protected rights under §1322(b)(2) is the right to recover advances, such as fees and costs, if provided for under the note and mortgage.

B. Fees and Costs under11 USC 506(b)

1. To the extent that an allowed secured claim is secured by property the value of which, after any recovery under subsection (c) of this section, is greater than the amount of such claim, there shall be allowed to the holder of such claim, interest on such claim, and any reasonable fees, costs, or charges *provided for under the agreement* or State statute under which such claim arose.

II. Standards for Recoverability Under the Contract

Contracts (and applicable case law) generally require that fees must be "reasonable" in order to be added to the indebtedness.

See for example:

In re Nixon, 2009 WL 1845229 (E.D.Pa. June 25, 2009); although the mortgage allowed for recovery of fees and expenses for bankruptcy proceedings, unreasonable portion of fees was disallowed under §502(b)

In re Acevedo Davilla, 2009 WL 249833 (Bankr. D.P.R. Feb. 2, 2009); itemized fee application of oversecured creditor was sufficient to establish that requested fees were reasonable

In re Nixon, 400 B.R. 27 (Bankr. E.D.Pa. 2008); oversecured creditor is entitled to attorney fees but amount was reduced because some services were not "reasonable" as they were excessive, redundant, and vaguely described

III. Court Approval in General

Consumer attorneys have challenged the passing on of fees/costs pursuant to a note and mortgage without first obtaining court approval. Illinois courts have

found that where the contract provides for such fees and costs, prior court approval is not required.

See for example:

Porter v. Fairbanks Capital Corp., 2003 WL 21210115 at *7 (N.D. Ill. May 21, 2003)

James v. Olympus Servicing, L.P., 2002 WL 31307540, at *3-4 (N.D. Ill. Oct. 9, 2002)

Whaley v. Shapiro & Kreisman, LLC, 2003 WL 22232911 (N.D. Ill. Sept. 16, 2003)

IV. Recovery of Post Petition Bankruptcy Fees and Costs

Assuming that recovery of fees and costs is otherwise allowable under the note and mortgage, several other issues regarding the recovery of post-petition fees and costs during and/or after a bankruptcy proceeding have arisen in litigation over the years. Unfortunately for mortgage servicers who deal with loans nationally, there has been a wide divergence of views among the bankruptcy courts throughout the country.

A. Recovery or Post-Petition, Pre-Confirmation Fees

The first "big" litigation over these issues arose in the southeastern United States, where class actions were brought against national mortgage servicers for inclusion of bankruptcy fees and costs (usually for preparation and filing of proofs of claim) in the claim itself. This appropriateness of this practice continues to be an issue in many jurisdictions.

1) Some courts have held that inclusion of these fees/costs in the proof of claim, without first obtaining court approval, is a violation of FRBP 2016 as they represent professional compensation to be paid from the bankruptcy estate.

See for example:

Tate v. NationsBanc Mortg. Corp. (In re Tate), 253 B.R. 653, 668 (Bankr. W.D.N.C. 2000)

2) Other courts have found that the fees **should** be included in the proof of claim and that failure to disclose these fees in the claim is sanctionable.

See for example:

Slick v. Norwest Mortg. Inc. (In re Slick), 280 B.R. 722 (S.D. Ala. 2002)

Harris v. First Union Mortg. Corp. (In re Harris), 281 B.R. 327 Bankr. S.D. Ala. 2002)

3) Some courts have found BOTH that these fees must be disclosed in the proof of claim and that they cannot be included in the claim without prior court approval.

See for example:

Jones v. Wells Fargo Home Mortg. (In re Jones), 366 B.R. 584, 594 (Bankr. E.D. La. 2007)

4) At least one court has held that notwithstanding the protections afforded a homestead mortgage under 11 USC §1322(b)(2), post-petition pre-confirmation fees and costs cannot be recovered unless there is equity in the property. (Relying on 11 USC §506(b) secured claim provisions.)

See for example:

Sanchez v. Ameriquest Mortg. Co. (In re Sanchez), 372 B.R. 289 (Bankr. S.D. Tex. 2007)

Padilla v. Wells Fargo Home Mortg., Inc. (In re Padilla), 379 B.R. 643 (Bankr. S.D. Tex. 2007)

5) Treatment of Post-Petition, Pre-Confirmation Fees in the Northern District of Illinois

The model Chapter 13 plan for the Northern District of Illinois provides guidance as to how to claim fees and costs incurred post-petition as a result of the bankruptcy filing. Section, B, 2(c) provides: "Costs of collection, including attorneys' fees, incurred by the holder after the filing of this bankruptcy case and before the final payment of the cure amount specified in Paragraph 5 of Section E may be added to the cure amount pursuant to order of the court on motion of the holder. Otherwise, any such costs of collection shall be claimed pursuant to subparagraph (b) above."

6) Treatment of Post-Petition, Pre-Confirmation Fees in the Central District of Illinois

There is no guidance for claiming fees and costs in the Central District of Illinois. Without additional guidance from this district, attorneys should adhere to FRBP 2016.

7) Treatment of Post-Petition, Pre-Confirmation Fees in the Southern District of Illinois

Under the current version of the plan, which took effect in January 2008, provisions of the plan specifically prohibit adding any fees/costs to the indebtedness without court approval.

Plan Paragraph 4: Real Estate – Curing Default and Maintaining Payments provides that "All fee and/or charges incurred by the creditor prior to the date of the entry of the discharge which are assessed to the debtor either before or after discharge, must be approved by the Court."

The plan does not specify the manner of obtaining court approval. Some courts require 2016 motions, some permit motions to approve costs of collection, others approve fees in conjunction with resolution of contested matters such as motions for relief or objections to confirmation.

8) Other Potential Issues

a. Mischaracterization/Misrepresentation

1) The official proof of claim form requires that the creditor designate which portion of the total claim is the "Amount of Arrearage and other charges as of time case filed included in secured claim."

2) If fees and costs incurred post-petition are included in the arrearage claim, they clearly do not fit this description as they are incurred after the time the case is filed.

3) If this were construed to be an intentional mischaracterization of the nature of these fees/costs there could be severe consequences to the person filing the claim under Rule 9011.

b. Misapplication under 11 USC §524(i)

If the plan requires the creditor to apply payments received through the trustee only towards amounts due pre-petition and creditor includes post-petition fees/costs in its arrearage claim, application of trustee disbursements to its claim could arguable be a violation of 11 USC §524(i) .

V. Recovery of Post Confirmation Bankruptcy Fees and Costs

A. Courts often distinguish post-petition pre-confirmation advances and post-petition, post-confirmation advances. The distinction usually revolves around the theory that post-petition pre-confirmation advances could be provided for in the plan at confirmation while post-confirmation advances could not.

B. Courts have been especially concerned with post-confirmation advances as debtors successfully completing Chapter 13 sometimes find themselves surprised to discover that they are still in default.

The purpose of a bankruptcy case is to allow a debtor to get out of financial trouble. At discharge, a debtor ought to be able to expect he or she has brought his or her secured debts current and wiped out all unsecured debts not paid through a plan.

C. There appears to be a dispute among the courts as to what is required in order for post-confirmation fees to be recoverable against the debtor. Some cases indicate that as long as the fees/costs are disclosed, they are allowable if otherwise allowable under state law. Some cases indicate if the case reaches discharge, the court must actually approve the fees and costs in order for them to be allowable.

1) Disclosure

a. For most courts, the threshold requirement is that the fees/costs be disclosed in some fashion. This puts the debtor on notice that the fees and costs are being assessed and give the debtor the opportunity to determine how they will be dealt with.

Post confirmation, debtors have at least three options regarding the payment of accruing post confirmation charges. The charges can be paid through a modified plan, deferred until completion of the case, or voluntarily paid outside of the plan. However, in order for a debtor to exercise his choice, the post confirmation fees and charges must be disclosed.

Authored by: Faiq Mihlar, Heavner, Scott, Beyers & Mihlar, LLC
B.J. Maley, Codilis & Associates

See for example:

Jones v. Wells Fargo Home Mortg. (In re Jones), 366 B.R. 584, 596 (Bankr. E.D. La. 2007)

Padilla v. Wells Fargo Home Mortg., Inc. (In re Padilla), 379 B.R. 643 (Bankr. S.D. Tex. 2007)

c. Since state law does not require court approval of fees/costs in order for such fees to be added to the loan, disclosure also allows the borrower an opportunity to see a determination by the court (if so desired) that the charges are reasonable.

2) Court Approval

Some courts seem to indicate that mere disclosure is not enough, but that such fees and costs actually require court approval.

a. Northern District of Illinois

In the Northern District of Illinois a mechanism has been built into the Chapter 13 plan for approval of any post-petition "costs of collection" or other amounts accruing post-petition. Motions for Cost of Collections can be filed, noticed and set for hearing. The form Chapter 13 plan provides, in 2(c): "Costs of collection, including attorneys' fees, incurred by the holder after the filing of this bankruptcy case and before the final payment of the cure amount specified in Paragraph 5 of Section E may be added to the cure amount pursuant to order of the court on motion of the holder. Otherwise, any such costs of collection shall be claimed pursuant to subparagraph (b) above."

Subparagraph (b) referenced above, provides that once the arrearage claim has been paid in full, the creditor is given an opportunity to file notice of any outstanding payment obligations.

b. Central District of Illinois

The Central District of Illinois does not have a model plan, nor does this district have other guidance for claiming creditor's attorney's fees and costs. Without additional guidance, attorneys must rely on FRBP 2016.

c. Southern District of Illinois

The language of the current model plan in the Southern District of Illinois requires court approval for all pre-discharge fees/costs. The plan does not specify the method for obtaining court approval.

Stripping Off Junior Mortgages in Chapter 13 Reorganizations

by Berton J. Maley

I. Introduction: Historical Protection for Residential Mortgages

Special protections have been built into the bankruptcy code to protect residential mortgages. In Chapter 13 cases, the most notable of these provisions can be found in 11 USC 1322(b)(2) and (b)(5).

These provisions read together protect residential mortgage holders from the modification of their rights under the note and mortgage in a Chapter 13 plan except to the extent that an arrearage can be cured over a reasonable time while the debtor maintains current payments.

> 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, or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims**;
>
> (5) notwithstanding paragraph (2) of this subsection, provide for the curing of any default within a reasonable time and maintenance of payments while the case is pending on any unsecured claim or secured claim on which the last payment is due after the date on which the final payment under the plan is due;

The protections afforded the residential mortgage holder are discussed at length by the U.S. Supreme Court in *Nobelman v. American Sav. Bank*, 508 U.S. 324 (U.S. 1993).

These protections have been somewhat whittled down in the 16 years since *Nobelman* was decided. Some exceptions have been created by statute, and some distinctions crafted by persuasive attorneys and adopted by courts. This article will focus on strip offs of wholly unsecured junior mortgages. Other possible issues in determining whether or not a loan falls under the protection of 11 USC 1322(b)(2) may include mortgages with "additional security" (assignments of rents, fixtures, etc.), mortgages that mature prior to the completion of the Chapter 13 plan, impact of a prior Chapter 7 discharge; but these issues will not be discussed here.

II. Secured and Undersecured versus Wholly Unsecured

Determination of secured status is governed at 11 USC 506 which provides that a 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 a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property".

> Section 506(a) can lead to three possible valuation alternatives. If the secured claim is less than the value of the underlying collateral, the claim is fully secured. If the secured claim partially exceeds the value of the underlying collateral, the claim is bifurcated into secured and unsecured components, a process sometimes referred to as a "stripdown" of the creditor's claim. See *Dewsnup v. Timm*, 502 U.S. 410, 412, 112 S. Ct. 773, 775, 116 L. Ed. 2d 903 (1992). Finally, if the secured claim completely exceeds the value of the underlying collateral, the claim is asserted to entirely "strip off," leaving the creditor wholly unsecured.
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> *Barnes v. American Gen. Fin. (In re Barnes)*, 207 B.R. 588, 590 (Bankr. N.D. Ill. 1997)

The Supreme Court made is clear that the anti-modification provisions of 11 USC 1322(b)(2) protected residential mortgages, even if the mortgage in question was undersecured, and that the claims of mortgage lenders secured by the debtor's principle residence could not be reduced to the value of the residence.

> In other words, to give effect to § 506(a)'s valuation and bifurcation of secured claims through a Chapter 13 plan in the manner petitioners propose would require a modification of the rights of the holder of the security interest. Section 1322(b)(2) prohibits such a modification where, as here, the lender's claim is secured only by a lien on the debtor's principal residence.
>
> *Nobelman v. American Sav. Bank*, 508 U.S. 324, 332 (U.S. 1993)

Another question remained, however. If a residential mortgage loan is wholly unsecured, does the protection of §1322(b)(2) still apply?

Example:

Assume that the debtor's residence is worth $150,000.00. The first mortgage on the debtor's residence has a current pay off amount of $152,300.00. The second mortgage has a payoff of about $32,000. The first mortgage is undersecured because the value of the property only secured $150,000.00 of its $152,300.00 claim. Under §506, the second mortgage is wholly unsecured because the first mortgage has left no value to secure the junior mortgage's claim.

A great number of cases on this issue were litigated with the majority of courts holding that a wholly unsecured mortgage was not protected by §1322(b)(2) and such a claim could be treated as unsecured in a Chapter 13 reorganization. No less than six circuit courts ruled that such claims were modifiable.

> Since *Nobelman*, the issue of whether Section 1322(b)(2) precludes strip-off has been decided by a large number of courts. The Seventh Circuit has not yet decided the issue but each of the six Courts of Appeal that have, has held that a wholly unsecured mortgage may be stripped off in Chapter 13 notwithstanding Section 1322(b)(2) and *Nobelman*. *In re Pond*, 252 F.3d 122 (2nd Cir. 2001); *In re McDonald*, 205 F.3d 606 (3rd Cir. 2000), cert. denied, 531 U.S. 822, 121 S.Ct. 66, 148 L.Ed.2d 31 (2000); *In re Bartee*, 212 F.3d 277 (5th Cir. 2000); *In re Lane*, 280 F.3d 663 (6th Cir. 2002); *In re Zimmer*, 313 F.3d 1220 (9th Cir. 2002); *In re Tanner*, 217 F.3d 1357 (11th Cir. 2000).
>
> *In re King*, 290 B.R. 641, 646 (Bankr. C.D. Ill. 2003) [Judge Perkins]

Several Illinois Judges followed suit including: Northern District Court Judge Darrah [see, *In re Holloway*, 2001 U.S. Dist. LEXIS 16898, 2001 WL 1249053 (N.D.Ill., 2001)], Northern District Bankruptcy Judge Squires [see, *Waters v. Money Store (in Re Waters)*, 276 B.R. 879, 882 (Bankr. N.D. Ill. 2002)]; Central District Bankruptcy Judges Perkins [see, *King*, cited above], Fines (while sitting in the Southern District) [see, *Havel v. Household Mortg. Servs. (In re Havel)*, 2002 Bankr. LEXIS 1004 (Bankr. S.D. Ill. Aug. 15, 2002)]and Gorman [see, In *re Jarvis*, 390 B.R. 600 (Bankr. C.D. Ill. 2008)]

One Northern District Bankruptcy Judge, Judge Schmetterer, published an opinion taking the minority view that Section 1322(b)(2) protected even wholly unsecured mortgages:

> Generally, the debtor will file in Chapter 13 in order to save some property. The tradeoff is that to save such property the debtor must pay for it by paying mortgages as well as Plan payments out of future income. Until Congress chooses to limit § 1322(b)(2) in some way, all mortgagees holding security interests in a debtor's principal residence receive protection against any modification of their rights, and may receive increased economic protection of their interest from growing real estate value over the three to five year life of the Plan. Should that value rise, the creditor stands to benefit thereby, and the debtor may not capture such increase in value through a § 506(a) stripoff.
>
> *Barnes v. American Gen. Fin. (In re Barnes)*, 207 B.R. 588, 594 (Bankr. N.D. Ill. 1997)

Judge Schmetterer's opinion has apparently changed since then. In a subsequent opinion, he considers the issue of "whether a debtor may strip off a junior mortgage that is allegedly wholly

unsecured through a Chapter 13 Plan, rather than through an adversary proceeding". *In re Forrest*, 410 B.R. 816, 818 (Bankr. N.D. Ill. 2009). Nowhere in the *Forrest* opinion does Judge Schmetterer mention his prior opinion in *Barnes*, and implicit in the *Forrest* opinion appears to be the assumption that the lien of a wholly unsecured mortgage can be stripped off if the correct procedure is followed.

III. Procedure for Stripping Off a Wholly Unsecured Junior Mortgage

Assuming that the majority of courts are correct and a wholly unsecured residential mortgage can be stripped off in a Chapter 13, the next question to arise is what procedure must be followed in order to strip off that lien. The simplest, most cost effective way for a debtor to accomplish this task would be to provide for the strip off in his or her Chapter 13 Plan and simply accomplish this as part of the regular plan confirmation process. In the Northern District of Illinois, where a court mandated form plan ("the Model Plan") must be used, the provisions regarding a strip off would be added to section "G" of the plan [see, Local Rule 3015-1]. Many argue, however, that the Bankruptcy Code and Rules require an adversary proceeding in order for such relief to be granted.

The Federal Rules of Bankruptcy Procedure identify certain types of matters which constitute adversary proceedings in bankruptcy cases. Among these matters are proceedings "to determine the validity, priority, or extent of a lien or other interest in property" Fed. R. Bankr. P. 7001(2). Adversary proceedings are separate civil proceedings and afford more procedural protections to the parties than typical contested matters handled by motion or objection which do not require separate complaint, service of summons, etc. *Ill. Dep't of Revenue v. Ayre (In re Ayre)*, 360 B.R. 880, 885 (C.D. Ill. 2007).

There is a split of authority as to whether or not an adversary proceeding is required in order to strip off wholly unsecured junior mortgage liens.

> There is a split of authority on how a chapter 13 debtor can deal with a lien on property which has no value to support it. Some say that the lien can be stripped through confirmation of the chapter 13 plan. See e.g., *In re King*, 290 B.R. 641 (Bankr. C.D. Ill. 2003); *In re Hill*, 304 B.R. 800, 805 (Bankr. S.D. Ohio 2003); *In re Wolf*, 162 B.R. 98, 106 (Bankr. D. N.J. 1993); *In re Beard*, 112 B.R. 951, 955-56 (Bankr. N.D. Ind. 1990). See also, *In re Black*, 2002 Bankr. LEXIS 1752, 2002 WL 31719957 (Bankr. N.D. Ind.). Others say an adversary proceeding is required. See e.g., *In re Pierce*, 282 B.R. 26, 28 (Bankr. D. Utah 2002); *In re Kressler*, 252 B.R. 632, 634-35 (Bankr. E.D. Pa. 2000).
>
> *In re Grupp*, 2009 Bankr. LEXIS 1401 (Bankr. N.D. Ind. Apr. 6, 2009)

Illinois bankruptcy judges have taken both sides of the issue in published opinions, most notably Chief Judge Perkins in the Central District [*In re King*, 290 B.R. 641 (Bankr. C.D. Ill. 2003)] and Judge Schmetterer in the Northern District [*In re Forrest*, 410 B.R. 816, 818 (Bankr. N.D. Ill. 2009)].

In *King*, a Chapter 13 plan was confirmed which provided for voiding of a junior mortgage as wholly unsecured. Post confirmation, Bank One filed a motion for relief from the automatic stay. Bank One argued that the plan provision was not enough to void its lien, and that since their lien was valid and not provided for in the plan, they were entitled to relief from the automatic stay. Judge Perkins opined that the plan did not determine "validity, priority, or extent of a lien" which would require an adversary proceeding, but instead provided for a valuation and determination of secured claim under 11 USC 506 which could be handled by contested matter. Judge Perkins further held that since plan included specific terms and the creditor was given adequate notice of these terms and reasonable time to respond, the creditor was bound by the confirmed plan. Citing his own prior opinion in *Zimmerman* (a case which dealt with the lien on a vacuum cleaner), the court found that:

> a creditor's lien may be avoided through confirmation of a Chapter 13 plan where the basis is lack of collateral value and where the plan properly "provides for" the creditor through language sufficiently specific to put the affected creditor on notice that its lien will be lost if an objection to the plan is not made. The burden is squarely on the shoulders of the debtor, as the drafter of the plan, to ensure that the language of the plan provides adequate notice of the debtor's intentions and the basis for the proposed lien avoidance.
>
> *In re King*, 290 B.R. 641, 650 (Bankr. C.D. Ill. 2003) citing, *In re Zimmerman*, 276 B.R. 598, 604 (Bankr. C.D. Ill. 2001).

The court found that Bank One's mortgage was "properly voided" at confirmation and was properly treated as unsecured. Bank One's motion for relief was denied.

In the *Forrest* case, Judge Schmetterer took the opposite position, criticizing Perkins' opinion in *King*. While acknowledging that a claim could be "valued" without an adversary proceeding, Judge Schmetterer found that a plan which voided a lien as wholly unsecured had the same effect as a declaration that a lien is void in an adversary proceeding. Thus an adversary was required under both Fed. R. Bankr. P. 7001(2) and 2001(9). *Forrest*, at 818.

In *Forrest*, Litton Loan Servicing objected to a plan which provided that due to a "lack of equity" their junior lien was stripped off and their claim would be paid as unsecured. Although not raised in their original objection, Litton's attorneys raised the oral objection that an adversary proceeding was required to strip off its lien. The court agreed citing a Seventh Circuit's opinion which prevents discharging of a student loan through a plan provision.

> As Seventh Circuit Panel observed in preventing a student loan from being discharged by a similar tactic in *In re Hanson*, 397 F.3d 482, 484 (2005), "Apparently the hope is that an unsuspecting bankruptcy court will confirm the plan and that the lender will not recognize the ... ploy in time to object to confirmation or to file an appeal."
>
> *In re Forrest*, 410 B.R. 816, 818 (Bankr. N.D. Ill. 2009)

Judge Schmetterer went on to conclude that not only did the plan provision fail for lack of compliance with Bankruptcy Rules, but also on constitutional grounds for depriving the lender of its property rights without due process of law in violation of the Fifth Amendment.

> Because the Bankruptcy Code and Bankruptcy Rules require an adversary proceeding for this relief, Constitutional due process entitles Litton Loan Servicing to the heightened notice through service of summons and complaint in an adversary proceeding. Therefore, Forrest may not constitutionally strip off Litton Loan Servicing's second mortgage through the Plan and must file an adversary proceeding.
>
> *In re Forrest*, 410 B.R. 816, 820 (Bankr. N.D. Ill. 2009)

Judge Schmetterer's opinion relies heavily throughout on the Seventh Circuit decision in *Hanson*, a student loan case. It is interesting to note that the United States Supreme Court recently heard the appeal in a similar Ninth Circuit case, *Espinosa v. United Student Aid Funds, Inc.*, 545 F.3d 1113 (9th Cir. Ariz. 2008),. [Opinion amended by *Espinosa v. United Student Aid Funds, Inc.*, 553 F.3d 1193 (9th Cir. Ariz. 2008).] One of issues in *Espinosa* is whether the practice of discharging student loans through the Chapter 13 plan confirmation process rather than by adversary proceeding is acceptable. It was thought by many that that while not directly dealing with mortgage loans, the Supreme Court's decision in this case could have a huge impact on the similar issue with respect to mortgage liens. The Supreme Court's decision while finding that confirmed plan in Espinosa was binding, did not approve the method by which the discharge was entered.

> Given the Code's clear and self-executing requirement for an undue hardship determination, the Bankruptcy Court's failure to find undue hardship before confirming Espinosa's plan was a legal error. See Part III, infra. But the order remains enforceable and binding on United because United had notice of the error and failed to object or timely appeal.
>
> *United Student Aid Funds, Inc. v. Espinosa*, 176 L. Ed. 2d 158, 172 (U.S. 2010)

Thus the Supreme Court's decision overruled *Hanson* only to the extent that it held that the court's error in confirming a plan without an adversary made the order void. It did not uphold the practice of making these determinations through the plan confirmation process. Logically, if the objection had been raised to the plan confirmation, the court would have to deny confirmation under *Espinosa*.

Judge Barbosa was recently presented with a case in which a a debtor attempted to lien strip both a second and third mortgage by motion. The second mortgage holder objected, and the third mortgage holder did nothing. The court ruled denied the motion as to the second mortgage holder on procedural grounds based on their objection, but granted the motion as the third mortgage holder which did not object even though receiving notice. The Judge relied in part on his interpretation of *Espinosa*.

> "A creditor can waive the right to an adversary proceeding, see *In re Pence*, 905 F.2d 1107 (7th Cir. 1990), and as the Supreme Court recently held in *United Student Aid Funds, Inc. v. Espinosa*, 130 S. Ct. 1367, 176 L. Ed. 2d 158, 2010 WL 1027825 (2010), a creditor can lose its right to an adversary proceeding by failing to object, at least where it received reasonable or actual notice. *Espinosa* clarified that the Bankruptcy Rules are procedural rules, 176 L. Ed. 2d 158, Id. at 7, and therefore overruled *In re Hanson*, 397 F.3d 482 (7th Cir. 2005), which had held that constitutional due process required compliance with notice provisions in the Rules. But a procedural rule is still a procedural rule, and HSBC has not waived its right and has instead raised an objection. Therefore, the Court will deny the HSBC Motion. If the Debtors wish to strip the HSBC Junior Mortgage and the creditor will not consent to a procedure by motion, then they should do so by means of an adversary proceeding. In contrast, Beneficial has not objected to the motion, despite apparently receiving notice of it, and therefore the Beneficial Motion is granted.
>
> *In re Ginther*, 427 B.R. 450, 456-457 (Bankr. N.D. Ill. 2010)

III. Effective Date of the Lien Strip Off

Assuming that either as part of the plan confirmation process or pursuant to an adversary proceeding, the court has made the determination that the junior mortgage is wholly unsecured and the lien should be avoided, another issue remains. When should the lien be actually stripped off? Does the lien strip off take effect at confirmation/adversary judgment or when the plan completes and the debtor is discharged?

Chief Judge Perkins addresses this issue in the *King* opinion as well:

> this Court also holds that the lien-avoiding effect of the confirmed plan, while established at confirmation, is contingent upon a discharge pursuant to Section 1328. Accord, *In re Stroud*, 219 B.R. 388, 390 (Bankr. M.D. N.C. 1997); *In re Leverett*, 145 B.R. 709, 713 (Bankr. W.D. Okla. 1992). BANK ONE has no duty to release its mortgage until then. If, for any reason, the DEBTORS do not receive a discharge under Section 1328, BANK ONE 'S mortgage lien remains in effect.
>
> *In re King*, 290 B.R. 641, 651 (Bankr. C.D. Ill. 2003)

Central District Bankruptcy Judge Gorman also recently addressed this issue. She found that even if a plan completes, but for some other reason the debtor is not eligible for a discharge, no modification of a creditor's rights including lien avoidance can become permanent. "A no-discharge Chapter 13 case may certainly be utilized to obtain the protections of the automatic stay for the purpose of proposing a plan to make payments on debts. A no-discharge Chapter 13 case may not, however, result in a permanent modification of a creditor's rights" *In re Jarvis*, 390 B.R. 600, 606 (Bankr. C.D. Ill. 2008).

While both King and Jarvis addressed this issue in connection with a lien avoidance that was accomplished through the plan confirmation process, Judge Kelley in the Eastern District of Wisconsin reached the same decision in connection with lien avoidance by adversary proceeding finding that "The only difference between this case and Jarvis is the Debtor's use of an adversary proceeding rather than a plan provision to attempt to avoid the lien. ...avoidance of the lien is contingent upon a Chapter 13 discharge, and the Debtor does not qualify for a Chapter 13 discharge .... The format of this lien avoidance attempt cannot save it from this fatal flaw." *Blosser v. KLC Fin., Inc. (In re Blosser),* 2009 Bankr. LEXIS 1049 (Bankr. E.D. Wis. Apr. 15, 2009).

IV. Effect of Value Changes During the Life of the Plan

Give that the most courts appear to agree that the lien stripping cannot be effective until the Chapter 13 plan has successfully completed, another potential issue arises – what happens if over the course of the plan (often a five year period of time) the value of the property increases and/or the amount of the first lien holder's debt decreases so much that junior mortgage is no longer **wholly** unsecured? It was in part this issue that concerned Judge Schmetterer in the *Barnes* case:

> Should that value rise, the creditor stands to benefit thereby, and the debtor may not capture such increase in value through a § 506(a) stripoff.
>
> *Barnes v. American Gen. Fin. (In re Barnes)*, 207 B.R. 588, 594 (Bankr. N.D. Ill. 1997)

It is entirely possible (though no Judge the author has discussed this issue with agrees) that in the future courts could hold that even if brought by adversary, the cause of action in a Chapter 13 lien stripping is not "ripe" and cannot be adjudicated until the discharge is entered and that the values at the time of discharge are the pertinent values. Similar rulings have been made in conjunction with student loan discharge determinations in Chapter 13 in the past.

> The ripeness doctrine is rooted both in the limits of Article III of the Constitution and "on discretionary reasons of policy." See *Automotive, Petroleum & Allied Indus. Employees Union v. Gelco Corp.*, 758 F.2d 1272, 1275 (8th Cir. 1985). The Constitution charges Article III courts with the resolution of "cases and controversies," precluding them from rendering advisory opinions. *Flast v. Cohen*, 392 U.S. 83, 96-97, 20 L. Ed. 2d 947, 88 S. Ct. 1942 (1968); see U.S. Const. art. III, § 2. In addition to these constitutional concerns, the ripeness doctrine allows the federal courts to avoid wasting scarce judicial resources in attempts to resolve speculative or indeterminate factual issues. See *National Treasury Employees Union v. United States*, 322 U.S. App. D.C. 135, 101 F.3d 1423, 1431 (D.C. Cir. 1996). We find that these concerns justify the district court's decision in this case.
>
> "Undue hardship" is an inherently discretionary determination, and we have held that in applying § 523(a)(8) bankruptcy courts must consider the totality of the circumstances. See *In Re Long*, 322 F.3d 549, 554 (8th Cir. 2003). For the reasons that we have already identified, the factual question is whether there is undue hardship at the time of discharge, not whether there is undue hardship at the time that a § 523(a)(8) proceeding is commenced. As a matter of administrative convenience, of course, it makes sense to commence an adversary petition to determine undue hardship before the actual date of discharge, but such proceedings should take place relatively close to that date so that the court can make its determination in light of the debtor's actual circumstances at the relevant time.
>
> *Bender v. Educ. Credit Mgmt. Corp. (In re Bender),* 368 F.3d 846, 848 (8th Cir. Neb. 2004)

See also:

> The determination of the dischargeability of a Chapter 13 debtor's student loans is not ripe until successful consummation of the chapter 13 plan. See, e.g., *Bender v. Educ. Credit Mgmt Corp. (In re Bender)*, 368 F.3d 846 (8th Cir. 2004) v. Educ. Credit Mgmt Corp. (In re Bender), 368 F.3d 846 (8th Cir. 2004) (finding that a student loan adversary proceeding filed by a Chapter 13 debtor is not yet ripe for adjudication until the bankruptcy discharge is entered or

> imminent -- the majority view); *Pair v. United States DOE* (In re Pair), 269 B.R. 719 (Bankr. N.D. Ala. 2001) (same); *Soler v. United States of America (In re Soler)*, 250 B.R. 694 (Bankr. D. Minn. 2000) (same); *Raisor v. Education Loan ServicingCenter, Inc. (In re Raisor)*, 180 B.R. 163 (Bankr. E.D. Tex. 1995) (same); cf. *Ekenasi v. The Educ. Res. Inst. (In re Ekenasi)*, 325 F.3d 541, 546-47 (4th Cir. 2003) and *In re Strahm*, 327 B.R. 319 (Bankr. S.D. Ohio 2005) (each of which reflect the minority view and fail to analyze or rule upon the jurisdictional nature of the ripeness doctrine, and merely examine non-Article III concepts). This is because until a chapter 13 discharge has occurred or is imminent, there is no case or controversy relating to discharge that a bankruptcy court may decide. The majority view in favor of the ripeness argument is based on jurisdiction, which are crucial concepts in American jurisprudence. Indeed, this Court is busy enough deciding ripe actions and does not need to waste time deciding cases that are not ripe.
>
> *Walton v. Sallie Mae Educ. Credit Fin. Corp. (In re Walton)*, 340 B.R. 892, 894 (Bankr. S.D. Ind. 2006)

If a court finds that the lien stripping orders to cannot take effect until the Chapter 13 has been discharged, then application of the ripeness doctrine is a reasonable extension of that position and prevents either party from deriving a windfall by taking advantage of the fluctuating real estate market.

While the Supreme Court held in *Espinosa* that the court's err in not making a finding of undue hardship in an adversary proceeding was not a jurisdictional error, the court did not address the doctrine of ripeness and indeed no dispute was raised at all until after payments under the confirmed plan had been completed and the debtor had received his discharge. *United Student Aid Funds, Inc. v. Espinosa*, 176 L. Ed. 2d 158, 167 (U.S. 2010). Accordingly, the *Espinosa* decision does not preclude the application of the Ripeness Doctrine.

V. Availability of Lien Stripping Relief to Debtor's Not Eligible for Discharge

One additional obstacle to stripping off a wholly unsecured, junior mortgage lien (whether by adversary or other means) may be in store for debtors who are not eligible for discharge. Court have consistently held that the lien stripping is contingent upon the debtor's receipt of a discharge. [See, *In re King*, 290 B.R. 641, 651 (Bankr. C.D. Ill. 2003) and *In re Jarvis*, 390 B.R. 600, 606 (Bankr. C.D. Ill. 2008) discussed above.]

This issue was recently one of those addressed by Judge Cox in *In re Fenn*, 428 B.R. 494, 2010 Bankr. LEXIS 1512 (Bankr. N.D. Ill. 2010). In *Fenn*, the debtors had previously received a Chapter 7 discharge and were ineligible for a Chapter 13 discharge under 11 U.S.C. § 1328(f) because less than four years had passed. Judge Cox denied confirmation for the Fenn's proposed

plan because it treated the junior mortgage claim as unsecured and did not provide for lien retention.

VI. Effect of Lien Stripping on Chapter 13 Eligibility Requirements

Among the possible downsides to lien stripping could be its effect on debtor eligibility for Chapter 13. 11 USC § 109(e) establishes debt limits for Chapter 13 eligibility. If a large junior lien holder is treated as wholly unsecured, this could potentially affect the debtor's eligibility by raising his unsecured debt above the 109(e) maximum.

Judge Mayer addressed this issue in his recent decision in *In re Bernick*, 2010 Bankr. LEXIS 3106 (Bankr. E.D. Va. Sept. 7, 2010). In that case, the Chapter 13 Trustee brought a motion to dismiss the case based alleging that debtor's unsecured debts were in excess of the amount permitted under 11 USC § 109(e). Judge Mayer agreed finding that even without the filing or adjudication of an adversary, the scheduled unsecured or undersecured portions of "secured" claimant's claims must be considered for eligibility purposes.

> "An adversary proceeding to avoid a lien does not have to be filed or completely adjudicated before the debt is determined to be secured or unsecured for purposes of §109(e). 11 U.S.C. §506(a) ("Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property"); *In re Scov*is, 249 F.3d at 983-84. See also *In re Daniels*, 2010 WL 1416803, * 1 (Bankr.E.D.N.C. 2010) (using the bifurcation process under §506(a) in a hearing on a motion to dismiss for ineligibility under §109(e)).
>
> "Conclusion: For purposes of §109(e), the debtor's wholly unsecured second deed of trust will be treated as an unsecured debt. The trustee's motion to dismiss will be granted unless the debtor moves to convert this case to a case under chapter 11 or, if appropriate, chapter 7."
>
> *In re Bernick*, 2010 Bankr. LEXIS 3106 (Bankr. E.D. Va. Sept. 7, 2010)

VII. Model Plan Provisions

Several jurisdictions have adopted or are considering adopting model plan provisions regarding treatment of wholly unsecured junior mortgage claims. Even in the Northern District of Illinois where there continues to be a split of authority as to whether or not an adversary is required for lien stripping, provisions have been introduced into the model plan which provide for treatment of such claims as unsecured.

Effective October 15, 2010, the court adopted a new model plan which includes the following provision:

3.2. *Other secured claims treated as unsecured.* The following claims are secured by collateral that either has no value or that is fully encumbered by liens with higher priority. No payment will be made on these claims on account of their secured status, but to the extent that the claims are allowed, they will be paid as unsecured claims, pursuant to Paragraphs 6 and 8 of this section.

(a) Creditor: _____ Collateral: _____

(b) Creditor: _____ Collateral: _____

It's interesting to note, that although the model plan provision allows the claims to be paid as unsecured and may arguably have some binding effect as to valuation of the collateral, no provision is made regarding the stripping of the lien.