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—
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> (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**;
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> (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.
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> *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).
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> *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.
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> *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).
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> *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.
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> *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."
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> *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.
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> *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.
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> *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.
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> *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.
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> *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.
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> *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.
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> "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.
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> *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.
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> *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)).
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> "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."
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> *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.