

CONSUMER SESSION

Gypsy Rose Lee or Playboy Centerfold? The Art of Valuation for Strip-Downs and Strip-Offs

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The Art of Valuation for Strip-Downs and Strip-Offs

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The Art of Valuation for Strip-Downs and Strip-Offs

I. **The Legal Tools for Valuation**

A. **Relevant Code Provisions Which Valuation is Relevant**

- § 527 Obligation of Attorney to Disclose Replacement Value of Assets after Reasonable Inquiry
- § 522(a)(2) Use of Bankruptcy Exemptions
- § 522(f) Avoiding Judicial Liens
- § 506 Value of a Secured Creditor's Collateral to Determine Extent of Secured vs. Unsecured Claim (e.g. valuation, cramdown and lienstripping)
- § 722 Debtor's Redemption Rights
- § 362(d) Value of a Secured Creditor's Collateral to Determine Whether Such Creditor Can Obtain Relief From Stay
- § 547 and § 548 Valuation and the Solvency of the Debtor in Preference and Fraudulent Transfer Actions (i.e. Transfers made for less than reasonably equivalent value)
- § 1325 Cram-Down in the Confirmation of a Chapter 13 Plan; Best Interests of Creditors Test

B. **The Rules for valuation**

1. Bankruptcy Rules
2. Federal Rules of Evidence
3. any state law rules applicable

C. **What property gets valued in a bankruptcy case, and why**

II. **Importance of Valuation**

- A. Amount of claim / Bifurcation: Secured vs. Unsecured (dischargeable)
 - Creditor argues high value vs. Debtor argues low value
- B. Lifting of Automatic Stay for Lack of Adequate Protection
 - Creditor argues low value vs. Debtor argues high value
- C. Availability of Lienstrip of Second Mortgage: *See In re McNeal*
 - Determining if second mortgage is completely under water
 - See First Mariner Bank v. Johnson, 411 B.R. 221 (D. Md. 2009) (Court reasoned that 1322(b)(2) anti-modification provision is inapplicable to wholly unsecured liens, which were not “secured claims” within the meaning of the code. Such liens are usually second mortgages and thus permitting them to be stripped-off would not create an absurd result)

III. **The Art of advising the Debtor regarding valuations**

A. **Real Estate Valuation**

- 1. Homestead for junior lien stripping – Chapter 13 (strip off)
 - a. Can the debtor afford the home without the second mortgage?
 - I. Maintenance/repair/taxes required in addition to the first mortgage.
 - ii. Strip only effective if client completes the plan
 - b. Is the home actually worth keeping?
 - I. Could the debtor choose 7 rather than 13 if home is surrendered?
 - ii. What are the possible advantages of a strategic surrender?
 - iii. How far upside down with the first mortgage?
 - c. What will be the effect of stripping the second mortgage?
 - I. Will an increase in unsecured debt adversely affect the debtor?
 - aa. 100% plans
 - bb. Jurisdictional debt limits
 - ii. Will a reduction in secured debt adversely affect the debtor?
 - aa. Means test
 - bb. Budget
 - d. Would a settlement with the second mortgage holder be more beneficial?
- 2. Non-homestead for stripping or cramming
 - A. Strip offs - All of the considerations above
 - b. Strip downs

- I. Will the debtor be able to pay the entire stripped down mortgage in 60 months?
- ii. Will it be worth keeping the property?
- iii. Is the property necessary for reorganization?
- iv. Is a strip down worth it taking into account the trustee fees?

B. Vehicle Valuation

1. Personal use vehicle
 - a. 910 day vehicle
 - I. Would a valuation significantly reduce the principle and interest as to make it worth the hassle of having the vehicle be part of the case?
 - ii. Will the trustee fee make reduce the advantage of valuing?
 - iii. Is it worth the risk of repossession if the case fails?
 - b. Non-910 vehicle
 - I. Will changing the repayment terms to 60 months benefit?
 - ii. Will reducing the interest rate but adding the trustee fee benefit?
2. Non-personal use vehicle – basically the same as above

IV. **The Art of advising the Creditor regarding valuations**

V. **The Art of negotiation** - resolving valuation disputes prior to litigation

VI. **Appraisers and Appraisals**

- A. What to look for when you select an appraiser
 1. experience in the field
 2. testified in Court
 3. appears credible
- B. Preparing the Appraiser
 1. make sure the appraiser knows from the outset that may be called to testify in Court
 2. advise appraiser of the **date of valuation** to be used

3. advise appraiser of the legal standard the Court will utilize
4. give specific instructions to the appraiser so that he will be an effective witness if called to testify. For example, a car appraiser should:

- look at the car
- take pictures
- confirm the mileage and optional equipment
- start the car
- ask the debtor about any issues related to the car
- identify comparable sales
- identify automotive guides or published resources
- request documentation of any recent damage or repairs

- C. recourse where debtor makes it difficult for appraiser to inspect the collateral
- D. what happens when only one party obtains an appraisal

VII. **Litigating valuation disputes in Court**

A. Witnesses

1. expert testimony
2. lay witness testimony (e.g. the debtor)

B. Witness and exhibit lists

1. requirements by Court's Trial Order or Local Rule
2. consequence of not filing list

C. Appraisals

VIII. **Trial Tips from the perspective of the Court**

A. What to do and, what NOT to do

B. Objections to evidence and testimony

1. what can/will the Judge do when a lawyer cannot seem to get their document or testimony into evidence

IX. **Legal issues related to valuation disputes**

A. The date of valuation - date of filing, date of hearing, or some other date

B. The standard of valuation

1. Replacement Cost

§ 506 – Defining replacement value, Codifying *Rash*

“If the debtor is an individual in a case under chapter 7 or 13, such value with respect to personal property securing an allowed claim shall be determined based on the replacement value of such property as of the date of the filing of the petition without deduction for costs of sale or marketing. With respect to property acquired for personal, family, or household purposes, replacement value shall mean the price a retail merchant would charge for property of that kind considering the age and condition of the property at the time value is determined.”

2. Fair Market Value

§ 522(a)(2) Exemptions – "value means fair market value"

Knowledgeable buyer and reasonable period of exposure to market – *In re Todd*, 194 B.R. 893 (Bankr. D. Mont. 1996). *A Look at Disparate Approaches to Valuation Under Section 506 and Its Relationship to Section 1325*, by Stacy L. Molison (2007)

a. Need uniformity yet concept of valuation remains fluid

(I) Argues that BAPCPA § 506(a)(2) is still problematic (not uniform) because:

(a) Determining “retail value” in industries that do not publish industry books (such as Kelley Blue Book) is a case by case inquiry.

(b) Makes no determination on how to value assets that are used both personally and professionally.

© Courts are using at least three different approaches to determine replacement value

- Retail value less necessary deductions resulting from the condition of the specific vehicle being valued;
- Retail value minus some fixed percentage; or
- The average between retail value and trade-in value.

3. NADA, Kelly Blue Book, Carmax appraisals, etc.

4. Court chooses its own standard, or a hybrid of others

C. **Lien-stripping in Chapter 7 cases** - 11th Circuit *McNeal* case and the questionable survival of *Dewsnup*

1. *Dewsnup*: A Chapter 7 debtor could not “strip down” a partially secured lien under § 506(d).

2. Several courts have determined that *Dewsnup* precludes a Chapter 7 debtor from “stripping off” a wholly unsecured junior lien.

a. *Ryan v. Homecomings Fin.*, 253 F.3d 778 (4th Cir. 2001)

b. *Talbert v. City Mortg. Serv.*, 344 F.3d 555 (6th Cir. 2003)

c. *Laskin v. First Nat’l Bank of Keystone*, 222 B.R. 872 (BAP. 9th Cir. 1998)

3. The 11th Circuit interpretation of *Dewsnup*: *In re McNeal*

The issue in *In re McNeal* was whether a chapter 7 debtor could strip off a wholly unsecured second priority mortgage lien under §§ 506(a) and 506(d). The 11th Circuit stated that *Dewsnup*, unlike the case at hand, addressed stripping down a partially secured claim and was therefore not on point. Rather, *Folendore v. United States Small Bus. Admin.*, 862 F.2d 1537 (11th Cir. 1989), which held that a wholly unsecured claim is voidable under 506(d), is the controlling precedent.

4. Reaction to *In re McNeal*

a. under *In re McNeal*, a Debtor cannot reduce the principal owed to a Creditor, but Debtor can completely eliminate it.

b. this could be very helpful to many Debtors who meet all of the criteria for a Chapter 7, but find themselves in a Chapter 13 for no other reason than to file a Motion to Avoid a Lien.

D. **910 day vehicles** - any arguments left for debtors in the 11th Cir.

E. **Valuing TBE or jointly owned property** - where only a single debtor has filed

X. **Misc. Issues and Thoughts**

A. Do I even need to file a Motion to Value? Can I value collateral in the Plan? See In re Bennett, 466 B.R. 422 (Bkrty. S.D. Ohio 2012)(Chapter 13 debtor brought adversary proceeding seeking to strip off junior mortgagee's lien on theory that value of real property that secured mortgagee's claim had already been determined, through plan confirmation process, as being less than senior mortgage debt. The Court held that provisions added to Chapter 13 form plan by the debtor were sufficient to put a sophisticated creditor like junior mortgagee on notice that confirmation hearing would serve as a valuation hearing for lien-stripping purposes).

f/dennis/ABI/ABI 2013 Paskay Outline of presentation.1-30-13