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Is *Dewsnup* Unravelling Due to Lien-Stripping Cases under § 1322(b)(2)?

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The law of lien-stripping in consumer bankruptcy cases continues to evolve in two opposite directions. The anti-lien-stripping precedent of *Dewsnup v. Timm*,[1] a chapter 7 case, is frequently disregarded in chapter 13 cases notwithstanding the specific directive of § 1322(b)(2), which states that a mortgage secured by a debtor's home cannot be modified. This evolution continues even though chapter 7 and 13 cases are interpreting the same statute applicable in both chapters: § 506. This has created a crescendo of confusion as to fundamental bankruptcy concepts.

Two recent chapter 13 decisions exemplify the disagreement as to the application of § 506(a) in stripping off wholly underwater residential mortgage liens. *In re Larson*,[2] a chapter 13 case, allowed the stripping off of a wholly underwater lien, stating that "the proper starting point for analysis on whether a lien may be stripped off is section 506(a)."[3] *Larson* and similar chapter 13 lien-stripping cases do not follow the precedent established by *Dewsnup v. Timm*.[4] However, *Burkhart v. Community Bank of Tri-County*[5] stated that a wholly underwater lien could *not* be stripped off solely through § 506(a), reasoning that § 506(d) would therefore be rendered "mere surplusage"[6] and cited *Dewsnup* in support of its conclusion.

These decisions highlight the current disagreement between the *Dewsnup* line of cases prohibiting the use of § 506(a) in chapter 7 to strip down or strip off liens, and the *Nobelman v. American Sav. Bank*[7] line of cases (like *Larson*) allowing chapter 13 debtors to use the valuation mechanism of § 506(a) to strip off wholly underwater liens, notwithstanding the anti-modification provisions of § 1322(b)(2).

Dewsnup and *Caulkett*

The starting point is *Dewsnup*, which generally stands for the proposition that a chapter 7 debtor cannot use § 506(d) to avoid or "strip" the portion of a secured creditor's allowed claim that exceeds the value of the collateral given to secure the claim. *Dewsnup* rejected the argument that an allowed claim is only a secured claim "to the extent of the value of such creditor's interest"[8] in the collateral under § 506(a), thereby rejecting the request to "void a lien on the property pursuant to § 506(d) to the extent [that] the claim is no longer secured and thus is not 'an allowed secured claim.'"[9]

Instead, the *Dewsnup* Court found ambiguity in the text of § 506 and interpreted the phrase "allowed secured claim" of § 506(d) separately from the phrases "allowed claim" and "secured claim" in § 506(a).[10] If a claim were both "allowed" under § 502 and "secured" by collateral — in the sense that property of the estate had been pledged to secure the debt underlying the claim, regardless of value — it was an "allowed secured claim" and was therefore not subject to being voided under § 506(d).[11]

The late Justice Antonin Scalia dissented, reading § 506(d) "naturally and in accordance with other provisions of the statute" and concluding that a lien was automatically avoided "to the extent [that] the claim it secures is not both an 'allowed claim' and a 'secured claim' under the [Bankruptcy] Code."[12] The following passage from Justice Scalia's dissent predicts the post-*Dewsnup* criticism:

> When § 506(d) refers to an "allowed secured claim," it can only be referring to that allowed "secured claim" so carefully described two brief subsections earlier.
>
> The phrase obviously bears the meaning set forth in § 506(a) when it is used in the subsections of § 506 other than § 506(d) — for example, in § 506(b), which addresses "allowed secured claim[s]" that are oversecured. Indeed, as respondents apparently concede ... even when the phrase appears outside of § 506, it invariably means what § 506(a) describes: the portion of a creditor's allowed claim that is secured after the calculations required by that provision have been performed.[13]

1 *Dewsnup v. Timm*, 502 U.S. 410 (1992).
2 *Larson v. Nationstar Mortg. LLC (In re Larson)*, 544 B.R. 883 (Bankr. W.D. Wis. 2016).
3 *Id.* at 885.
4 *Dewsnup v. Timm*, 502 U.S. 410 (1992). (prohibiting stripping of underwater lien)
5 *Burkhart v. Cmty. Bank of Tri-County*, 2016 U.S. Dist. LEXIS 97803, *1 (D. Md. July 26, 2016).
6 *Id.* at *18.
7 *Nobelman v. Am. Sav. Bank*, 508 U.S. 324 (1993).
8 *Dewsnup*, 502 U.S. at 413.
9 *Id.* at 414-15 (citing 11 U.S.C § 506(a) and (d) (2016)).
10 *Id.* at 416-17.
11 *Id.*
12 *Id.* at 420.
13 *Id.* at 421. *See also* Symposium, "Consumer Bankruptcy Panel: Strip Off in Chapter 7: The Limits of *Dewsnup*," 30 *Emory Bankr. Dev. J.* 291 (2014), looking to the "hanging paragraph" following § 1325(a)(9) that excludes the valuation mechanism in § 506 in certain purchase-money lien cases under § 1325(a)(5) to illustrate "the centrality of § 506(a)(1) in defining what it means to be secured," and for "[c]ongressional reaffirmation that an allowed secured claim as used throughout the [Bankruptcy] Code derives fundamentally from the meaning assigned in § 506(a)(1), *Dewsnup* notwithstanding, unless that provision is made inoperative by Congress."

The U.S. Supreme Court lien-stripping case of *Bank of America v. Caulkett*[14] left *Dewsnup* intact in a 9-0 decision. In *Caulkett*, the Court rejected the debtors' attempt to draw a distinction between partially and wholly underwater liens, noting that the definition given to the phrase "allowed secured claim" in § 506(d) by *Dewsnup* was not susceptible to this distinction.[15] The Court reaffirmed the *Dewsnup* logic that had been so heavily criticized in Justice Scalia's dissent and the commentary that followed, while also perhaps implicitly criticizing the *Dewsnup* precedent by noting that the debtors had not specifically asked the Court to overrule *Dewsnup*.[16]

Notably, *Caulkett* also distinguished *Nobelman*, the chapter 13 case that gave rise to stripping off wholly underwater junior mortgages (discussed *infra*.). The Court stated that the meaning of "secured claim" in § 506(d) was not at issue in *Caulkett* and explained that *Nobelman* instead addressed the "interaction between the meaning of ... 'secured claim' in § 506(a) and an entirely separate provision, § 1322(b)(2)."[17] The Court further reasoned that *Nobelman* did not alter the *Dewsnup* Court's refusal to apply the § 506(a) "secured claim" definition to § 506(d).[18]

Nobelman and Chapter 13 Lien-Stripping

Much was written after *Caulkett* about the future of *Dewsnup*, with commentators wondering whether the *Dewsnup* precedent would finally unravel for the benefit of chapter 7 debtors looking to strip off secured claims under § 506(d). However, *Dewsnup*'s definition of "allowed secured claim" under § 506(d) appears to be under more fire from the trend of chapter 13 cases allowing debtors to strip off wholly underwater liens notwithstanding the anti-modification provisions of § 1322(b)(2). The key difference for lien-stripping in chapter 13 cases (as opposed to chapter 7 cases) is the "anti-modification" provision of § 1322(b)(2), which provides that a debtor may modify the rights of a holder of a secured claim, but only if the claim is not "a claim secured only by a security interest in real property that is the debtor's principal residence."[19]

Seventeen months after *Dewsnup*, the Supreme Court opened the door to lien strip-offs in chapter 13 cases in *Nobelman*.[20] Although the Court protected the junior mortgage lender in *Nobelman* (because its lien was partially secured by value in the debtor's residence) and held that an undersecured lien against a debtor's residence could not be bifurcated under § 506(a), the Court stated:

> Petitioners were correct in looking to § 506(a) for a judicial valuation of the collateral to determine the status of the bank's secured claim. It was permissible for petitioners to seek a valuation in proposing their Chapter 13 plan, since § 506(a) states that "such value shall be determined ... in conjunction with any hearing ... on a plan affecting such creditor's interest."[21]

This rationale provided an avenue for chapter 13 debtors to strip off wholly underwater liens under § 506(a), notwithstanding § 1322(b)(2)'s anti-modification provisions.[22]

It is difficult to understand how the mortgagee protection of § 1322(b)(2) is now actually less protective than a chapter 7 case given the majority view of allowing strip-offs in chapter 13.

In re Larson

The possibility for chapter 13 debtors to completely strip off value-unsupported junior liens secured by their principal residence by using the valuation mechanism of § 506(a) to establish that there is no equity supporting the lien goes back at least to the Third Circuit's *McDonald* case, and many lower courts have followed.[23] One recent example is *In re Larson*.[24]

Relying on *Nobelman* and noting that a "narrow application of [*Dewsnup*'s] effect is warranted," the bankruptcy court identified § 506(a) as "the proper starting point for analysis on whether a lien may be stripped off" and examined whether there was any value securing the claim at issue.[25] The mortgagee holding the junior mortgage against the debtor's residence conceded that there was no value securing the claim, so the debtors successfully stripped off the wholly unsecured mortgage lien.[26] The bankruptcy court looked outside of the Seventh Circuit for guidance (including to *McDonald*) and concluded that a "wholly unsecured creditor does not hold a claim secured by a debtor's residence, so the anti-modification provisions [of § 1322(b)(2)] do not apply."[27]

The *Nobelman* line of cases (including *McDonald*, *Larson* and many others)[28] contradict *Dewsnup* by ignoring § 506(d) and the *Dewsnup* definition of "allowed secured claim," focusing instead on the value of the collateral under § 506(a) and determining whether the junior lienholder has "a claim secured ... by" instead of an "allowed secured claim" under § 506(d) (because under it, *Dewsnup* would be violated). The following passage from the penultimate paragraph of the *Dewsnup* decision is noteworthy in the context of these chapter 13 strip-off cases:

> to attribute to Congress the intention to grant a debtor the broad new remedy against allowed claims to the

14 *Bank of Am. NA v. Caulkett*, 135 S. Ct. 1995 (U.S. 2015).
15 *Id.* at 1999-2000.
16 *Id.* at 1999-2001.
17 *Id.* at 2000.
18 *Id.*
19 11 U.S.C. § 1322(c)(2) (2016).
20 *Nobelman*, 508 U.S. at 324.
21 *Id.* at 329-30.

22 *See, e.g., McDonald v. Master Fin. Inc. (In re McDonald)*, 205 F.3d 606, 611-12 (3d Cir. 2000):
> Perhaps the clearest explanation of how the [Nobelman] Court's discussion of [§§ 506(a) and 1322(b)(2)] can be reconciled is to point out that while the antimodification clause uses ... "claim" rather than "secured claim" and therefore applies to both the secured and unsecured part of a mortgage, the antimodification clause still states that the claim must be "secured only by a security interest in ... the debtor's principal residence." 11 U.S.C. § 1322(b)(2). If a mortgage holder's claim is wholly-unsecured, then after the valuation that Justice [Clarence] Thomas said that debtors could seek under § 506(a), the bank is not ... a holder of a claim secured by the debtor's residence. The bank simply has an unsecured claim and the antimodification clause does not apply.

23 Symposium, *supra* n.13; *see also In re McDonald*, 205 F.3d at 610-12.
24 *In re Larson*, 544 B.R. at 883.
25 *Id.* at 884-85.
26 *Id.* at 885.
27 *Id.*
28 *See, e.g., In re Larson*, 544 B.R. at 885.

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extent that they become "unsecured" for purposes of § 506(a) without the new remedy's being mentioned somewhere in the Code itself or in the annals of Congress is not plausible ... and is contrary to basic bankruptcy principles.[29]

Burkhart and the "Minority View"

A more recent case runs exactly counter to *Larson*. In *Burkhart*,[30] the court addressed what it deemed a matter of first impression: "whether a Chapter 13 debtor can avoid a completely unsecured junior lien when no proof of claim has been filed."[31] The court held that the debtors could not strip off wholly underwater liens because the junior lien creditor had not filed a proof of claim (nor did the debtor or trustee).[32] In the absence of a filed claim, there was no "allowed claim" under § 506(a)(1) and therefore nothing to value.

Separately from the issue of the absence of a filed claim, the *Burkhart* court tied § 506(d) to the anti-modification restriction in § 1322(b)(2) and relied on *Dewsnup* and *Caulkett* for the proposition that § 506(d) was "the specific provision through which avoidance should occur after valuation under § 506(a)."[33] The court concluded that eliminating § 506(d) from the lien strip-off analysis would render § 506(d) "mere surplusage" and declared that § 506(d), "working in tandem with §§ 506(a) and 1322(b), constitutes the statutory mechanism for stripping off a wholly-unsecured junior lien in a Chapter 13 case."[34]

Therefore, *Burkhart* and *Larson* are directly at odds with each other as to whether § 506(d) applies in chapter 13 lien strip-off cases. *Larson* states that it does not and looks only to valuation under § 506(a) and the *Nobelman* analysis. *Burkhart* states that it does apply, and therefore the *Dewsnup* interpretation of it applies to prohibit the strip-off of liens.

Another recent decision, *In re Etheridge*,[35] identifies the "minority view" that § 1322(b)(2) should be interpreted to emphasize "the existence of the lien, not the value of the collateral, because in the clause prohibiting modification of homestead liens, Congress could have repeated ... 'secured claim' instead of using ... 'a claim secured ... by.'"[36] Relying on *Caulkett*, the bankruptcy court opined that the minority view is correct because its interpretation of the meaning of "secured claim," even though in the context of chapter 7 cases, was consistent with § 1322(b)(2)'s anti-modification provisions.

Conclusion

The fault line separating the anti-lien strip-off chapter 7 cases and the pro-lien strip-off chapter 13 cases has grown considerably more unstable, and judges and practitioners have struggled to rationalize these competing lines of cases.[37] Policy arguments on each side are equally persuasive. On one hand, the "fresh start" policy should enable a debtor to adjust his/her debts (both secured and unsecured) in a chapter 7 case just like in chapter 13.[38] On the other hand, state law property rights are generally protected in bankruptcy and the policy that liens on property pass through bankruptcy unaffected remains a constant refrain.[39]

It is difficult to understand how the mortgagee protection of § 1322(b)(2) is now actually less protective than a chapter 7 case given the majority view of allowing strip-offs in chapter 13. Moreover, it is unclear how such different results for secured creditors emanating from competing interpretations of the same statute (§ 506) in chapter 7 and 13 cases can be sustained. Therefore, a Supreme Court or legislative reconciliation seems necessary. abi

29 *Dewsnup*, 502 U.S. at 420.
30 *Burkhart v. Cmty. Bank of Tri-Cnty.*, 2016 U.S. Dist. LEXIS 97803, *1 (D. Md. July 26, 2016).
31 *Id.* at *9.
32 *Id.* at *25.
33 *Id.* at *16.
34 *Id.* at *19.
35 *Etheridge v. CitiMortgage Inc. (In re Etheridge)*, 546 B.R. 896 (Bankr. S.D. Ga. 2016).
36 *Id.* at 898 (internal citations omitted).
37 *See* Symposium, *supra* n.13; David N. Saponara, "Lien-Stripping in Consumer Bankruptcy: Debtors Cannot Strip Liens Down Partially, But Can They Strip Them Off Entirely? The Answer Should Be No," 21 *Am. Bankr. Inst. L. Rev.* 257 (2013), *available at* abi.org/member-resources/law-review (cataloguing and discussing cases on each side, and reaching different conclusions).
38 Symposium, *supra* n.13.
39 *See, e.g., In re Paijan*, 785 F.3d 1161, 1163 (7th Cir. 2015).