Journal of Law and Policy

Volume 22
Issue 1
SYMPOSIUM:
The Impact of Cognitive Bias on Persuasion and Writing Strategies

Article 8

2014

Why Not Strip To Save Your Home? Prohibition On Chapter 7 Strip Off Makes No Cents for Debtors or Creditors

Brendan Buschman

WHY NOT STRIP TO SAVE YOUR HOME? PROHIBITION ON CHAPTER 7 STRIP OFF MAKES NO CENTS FOR DEBTORS OR CREDITORS

*Brendan Buschman**

INTRODUCTION

A 2012 bankruptcy decision by the United States Court of Appeals for the Eleventh Circuit, *In re McNeal*,[1] may have the answer to the current wave of homes in foreclosure. As of December 2012, "[a]pproximately 1.2 million [American] homes were in the national foreclosure inventory."[2] A home is in the foreclosure inventory if it is "in any stage of the foreclosure process."[3] Although the 2012 inventory numbers show a decline of 19.5 percent from 2011,[4] the 2012 foreclosure statistics are still much higher than foreclosure statistics from 2000 to 2006.[5] In fact 56,000 completed foreclosures occurred in December 2012, as

---

* J.D. Candidate, Brooklyn Law School, 2015; M.A.T., Manhattanville College, 2007; B.A., Hunter College, 2004. Many thanks to Jennifer, my beautiful wife and a wonderful mother to our son Gerald. Thanks to the editors and staff of the *Journal of Law & Policy* for all their helpful suggestions. Thanks also to my mother Mary F. Kelly for her constant support. And special thanks to my father, the late Hon. Howard C. Buschman III, who always tried to help the little guy.

[1] *In re* McNeal, 477 F. App'x 562 (11th Cir. 2012).

[2] *CoreLogic Reports 767,000 Completed Foreclosures in 2012*, CORELOGIC (Feb. 1, 2013), http://www.corelogic.com/about-us/news/corelogic-reports-767,000-completed-foreclosures-in-2012.aspx. "CoreLogic (NYSE:CLGX) is a leading property information, analytics and services provider in the United States and Australia. The company's combined data from public, contributory, and proprietary sources includes over 3.3 billion records spanning more than 40 years . . . ." *Id.*

[3] *Id.*

[4] *Id.*

[5] *Id.*

compared to an average of 21,000 completed foreclosures per month from 2000 to 2006.[6]

Many homes in foreclosure are a product of irresponsible borrowing and irresponsible lending.[7] During the real estate boom of the early 2000s, when home values were consistently increasing, many consumers purchased new homes or borrowed against the equity in their homes.[8] Numerous borrowers had poor credit or a history of irresponsible financial decision-making.[9] Lenders sold loans to people whom they knew or suspected had poor credit or financial qualifications.[10] Further, many borrowers falsified their financial qualifications in order to receive loans.[11]

Lenders had an incentive to sell as many mortgages as possible.[12] Wall Street investment firms like Bear Stearns bought these mortgages, pooled them, and sold them to other investors.[13] Thus, lenders were able to pass their liability on the interest to the Wall Street investors. The Wall Street investors then sold those mortgages and passed liability onto the subsequent buyer.[14] Once the borrowers began to default on the loans—loans which most could not afford in the first place—the final owners of the mortgages had a virtually worthless investment.[15]

These defaulted mortgages destroyed the American housing market, which, in turn, devastated the world economy.[16] Wall Street investment firms stopped buying mortgages from lenders, and the mortgage lending market dried up.[17] Home prices declined drastically.[18] Many homeowners saw the value of their homes drop

6 *Id.*
7 *House of Cards* (CNBC television broadcast June 4, 2009).
8 *Id.*
9 *Id.*
10 *Id.*
11 *Id.*
12 *Id.*
13 *Id.*
14 *Id.*
15 *Id.*
16 *Id.*
17 *Id.*
18 *Id.*

below the amount of their first mortgage.[19]

Historically, the federal bankruptcy courts are places for homeowners to seek refuge from foreclosure.[20] The filing of a bankruptcy petition automatically stays any foreclosure action by the lender until the bankruptcy case is either discharged or closed.[21] A stay forces the foreclosing lender to delay any foreclosure sale.[22] A bankruptcy case may also alter the rights of a creditor—foreclosing or not.[23] A homeowner stands much to gain if, during his bankruptcy, he can reduce the amount of money he owes to a party holding a mortgage on his property.

Two ways of reducing the amount of money owed a mortgagee are called *strip down* and *strip off*.[24] The terms are not synonymous, but they both act upon a lien on the debtor's property.[25] In order to procure funds from a lender, a borrower may grant that lender a right to certain property called collateral.[26] That lender then holds a lien on the collateral.[27] If the borrower defaults on his payments to the lender, the lien is the instrument

---

[19] *Id.*

[20] *See* 11 U.S.C. § 362(a) (2012) (staying any debt collection efforts, including foreclosure, upon the filing of a bankruptcy petition).

[21] *Id.*

[22] *See* 3 COLLIER ON BANKRUPTCY ¶ 362.03[3] (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2013), *available at* LexisNexis (noting that the stay acts as an injunction against all "legal proceedings against the debtor that were or could have been commenced prior to the commencement of the bankruptcy case").

[23] *See, e.g.*, 11 U.S.C. § 524(a)(1) (2012) (explaining that a bankruptcy discharge removes personal liability on any judgment obtained against the debtor).

[24] The U.S. Court of Appeals for the Third Circuit was the first federal appellate court to grant strip off to a Chapter 7 debtor in *Gaglia v. First Federal Savings & Loan Ass'n*, 889 F.2d 1304, 1311 (3d Cir. 1989). The Court of Appeals for the Tenth Circuit denied Chapter 7 strip off in *In re Dewsnup*, 908 F.2d 588, 590 (10th Cir. 1990). The Court of Appeals for the Eleventh Circuit was the first federal appellate court to allow a Chapter 7 strip off in *In re Folendore*, 862 F.2d 1537, 1538 (11th Cir. 1989).

[25] *See* Michael Myers, Dewsnup *Strikes Again: Lien-Stripping of Junior Mortgages in Chapter 7 and Chapter 13*, 53 ARIZ. L. REV. 1333, 1335 (2011).

[26] *See* Joann Henderson, *The Gaglia-Lowery Brief: A Quantum Leap from Strip Down to Chapter 7 Cram Down*, 8 BANKR. DEV. J. 131, 135–36 (1991).

[27] *Id.*

that gives the lender rights to collect on the debt.[28] The value of a lien is simply the balance of the loan due the lender.[29] To *strip down* a lien means to reduce the value of the lien to the value of the collateral secured.[30] To *strip off* a lien means to remove the lien entirely from the property the lien secures.[31] In bankruptcy, both of these concepts link inextricably to the value of the collateral and the balance due the lienholder.[32] For example, a homeowner owns a home worth $150,000. Assume a lien encumbers this home; the homeowner gave a lender the lien as consideration for the funds to purchase the home. Assume the balance due the lienholder is $200,000. This means the lien is worth $200,000. A homeowner who wants to *strip down* a lien wants to reduce the value of the lien from $200,000 to $150,000. Suppose the same home has an additional, or junior, mortgage attached to it worth $50,000. The proceeds from a sale of the home satisfy the senior mortgage in full before they satisfy the junior mortgage at all.[33] Thus, on our home worth $150,000, with a senior mortgage worth $200,000, no value attaches to any junior mortgage. A homeowner who tries to *strip off* a lien will ask a bankruptcy court to remove in full the lien attached to this junior mortgage.[34]

Both a strip down and a strip off are favorable to a homeowner and unfavorable to a creditor. Each action asks the bankruptcy court to disrupt valid interests secured in real property. However,

---

[28] *Id.*

[29] *See, e.g.*, Dewsnup v. Timm, 502 U.S. 410, 413 (1992) (describing the lien as worth $120,000, the balance owed the lender when the debtor filed for bankruptcy).

[30] Henderson, *supra* note 26, at 136.

[31] *See* William P. Nacy, Note, *Survival Underwater: Wholly-Unsecured Security Interests in Bankruptcy*, 40 WASHBURN L.J. 87, 94 n.43 (2000) ("To strip off a lien is to avoid the lien in its entirety, such as when there is absolutely no supporting value; i.e. a junior mortgage subordinated to a senior mortgage which, upon foreclosure, yields nothing for distribution to the junior.") (citing *In re* Smith, 247 B.R. 191, 196 (Bankr. W.D. Va. 2000)).

[32] *See* 11 U.S.C. § 506(a)(1) (2012) (splitting the claim of an under-secured lienholder into a secured claim and an unsecured claim based on the value of the collateral).

[33] *See* GRANT S. NELSON & DALE A. WHITMAN, REAL ESTATE FINANCE LAW 819–21 (5th ed. 2007).

[34] *See* Nacy, *supra* note 31, at 94 n.43.

the disruption of property law is something that a bankruptcy court often does in order to advance its policies of (1) a fresh start for the debtor[35] and (2) equality amongst creditors.[36]

In 1992, the United States Supreme Court held in *Dewsnup v. Timm*[37] that an individual debtor in Chapter 7 *could not strip down* a lien attached to his primary residence.[38] The market value of the property covered some portion of the value of the lien.[39] The Bankruptcy Appellate Panel for the Ninth Circuit[40] and two United States Circuit Courts of Appeals[41] have subsequently extended the *Dewsnup* holding to prevent an individual debtor in Chapter 7 bankruptcy from *stripping off* a lien held by a junior mortgagee on the debtor's primary residence. These courts have incorrectly held that a junior lien covered by no value in the collateral, like the $50,000 junior lien in our example above, must remain fully intact on the home of a Chapter 7 debtor.[42]

A prohibition on stripping off all junior liens could have disastrous results for the housing industry and the entire United States economy. Thousands of homeowners have multiple mortgages on their homes, and, as a result of depressed housing prices, many of these homes have at least one valueless junior lien attached to it.[43] To end the housing crisis, homeowners need to be able to remain in their homes, and the amount of homes in

---

35 Henderson, *supra* note 26, at 136.

36 *See* Union Bank v. Wolas, 502 U.S. 151, 161 (1991) (describing equality amongst creditors as "prime bankruptcy policy") (citation omitted).

37 Dewsnup v. Timm, 502 U.S. 410 (1992).

38 *Id.* at 417.

39 *Id.*

40 The Bankruptcy Appellate Panel for the Ninth Circuit denied avoidance of a junior lien in *In re Laskin*, 222 B.R. 872 (B.A.P. 9th Cir. 1998).

41 The Court of Appeals for the Fourth Circuit denied avoidance of a junior lien in *Ryan v. Homecomings Financial Network (In re Ryan)*, 253 F.3d 778 (4th Cir. 2001), and the Court of Appeals for the Sixth Circuit denied avoidance of a junior lien in *Talbert v. City Mortgage Services (In re Talbert)*, 344 F.3d 555 (6th Cir. 2003).

42 *See, e.g.*, *In re Ryan*, 253 F.3d at 783.

43 *See* Myers, *supra* note 25, at 1335 ("Th[e] steep drop in home values [since 2007] left many homeowners stuck with homes that have depreciated in value so much that their value does not even cover the debt they owe on principal mortgages, much less junior mortgages.").

foreclosure needs to decrease.[44] A prohibition on stripping off all junior liens could cause homeowners to abandon their homes, drastically increasing the number of foreclosures.

In May 2012, the Court of Appeals for the Eleventh Circuit in *In re McNeal* correctly held that a Chapter 7 debtor *may strip off* a valueless, junior lien on his primary residence.[45] The court held that the *Dewsnup* prohibition of stripping down a lien does not compel a prohibition on stripping off a valueless, junior lien.[46] The *McNeal* court reached the correct conclusion because a Chapter 7 debtor needs the freedom to strip off a worthless junior lien on his primary residence in order to retain his home. The freedom to strip off this worthless junior lien is a necessary policy: homeowners get a fresh economic start, and lienholders do not suffer economically because the lien being stripped off is already worthless.[47] Further, the debtor's dire need for a fresh start from bankruptcy outweighs the lienholder's interest in potential future equity in the home.

Part I of this note introduces consumer bankruptcy and the relationship of mortgagor and mortgagee that consumer bankruptcy necessarily alters. Part II traces the history of strip down in Chapter 7 consumer bankruptcy, with particular attention paid to *Dewsnup v. Timm*. Part III distinguishes strip off from strip down and advocates for permitting strip off in Chapter 7. Part IV argues that the policy reasons that make strip off permissible in Chapter 13 bankruptcies should apply to Chapter 7 bankruptcies.

---

[44] Congress has clearly noticed the need to reduce the number of homes in foreclosure. To that end, Congress passed the Housing and Economic Recovery Act of 2008, Pub. L. No. 110–289, 122 Stat. 2654 (2008). *See also* R. Travis Santos, Comment, *The Legal Way to Defeat Optimus Sub-Prime*, 25 EMORY BANKR. DEV. J. 285, 287 (2008).

[45] *In re McNeal*, 477 F. App'x 562, 564–65 (11th Cir. 2012).

[46] *Id.*

[47] *See id.* (noting that *Dewsnup* did not abrogate an Eleventh Circuit precedent case, *Folendore v. U.S. Small Bus. Admin. (*In re *Folendore)*, 862 F.2d 1537, 1540 (11th Cir. 1989)). The *Folendore* court allowed strip off because it would help a debtor and not harm an unsecured lienholder. 862 F.2d at 1540.

I. INTRODUCTION TO CONSUMER BANKRUPTCY

A. Chapter 7 and Chapter 13: The Consumer Chapters

The Bankruptcy Code is a federal statute that allows both businesses and individual consumers to reorganize or liquidate under the protection of the federal judicial system.[48] Congress has amended the Code many times since its first drafting in 1978; the most notable amendments were made in 1986, 1994, and 2005.[49] Each federal district has a bankruptcy court, and each federal district court refers its bankruptcy cases to these courts.[50] Each district court hears appeals of the decisions of its bankruptcy court.[51] A consumer bankruptcy case either liquidates the assets of the debtor in satisfaction of his debts[52] or adjusts the debtor's debts so that he may retain his assets and pay off his debts over time.[53]

The two most common types of bankruptcy for consumers are Chapter 7 and Chapter 13.[54] Chapter 7 is called the chapter for "Liquidation."[55] Chapter 13 is called the chapter for "Adjustment of Debts of an Individual With Regular Income,"[56] also known as reorganization.[57] Chapter 13 enables the debtor to pay off creditors from the debtor's future earnings.[58] Chapter 7, on the other hand, requires a trustee in bankruptcy to pay off creditors from the

---

[48] *See* 11 U.S.C. §§ 101–1532 (2012).

[49] ELIZABETH WARREN & JAY LAWRENCE WESTBROOK, THE LAW OF DEBTORS & CREDITORS 104–06 (6th ed. 2009).

[50] Section 157(a) does not require district courts to refer cases to its bankruptcy courts, but all district courts do so. *See* 28 U.S.C. § 157(a) (2012); *see also* 2 COLLIER, *supra* note 22, ¶ 3.02.

[51] WARREN & WESTBROOK, *supra* note 49, at 107.

[52] *See* 6 COLLIER, *supra* note 22, ¶ 700.01.

[53] *See* 8 COLLIER, *supra* note 22, ¶ 1300.01.

[54] *See* 11 U.S.C. § 109 (2012) (clarifying who may be a debtor and in which bankruptcy chapter a debtor may file).

[55] *Id.* §§ 701–84.

[56] *Id.* §§ 1301–30.

[57] *See* 8 COLLIER, *supra* note 22, ¶ 1300.01 (noting that a Chapter 13 bankruptcy is not called a reorganization, but it "is in fact quite similar" to a Chapter 11 reorganization).

[58] *See id.*; *see also* 11 U.S.C. § 109(e) (making regular income a requirement for filing a Chapter 13 case).

debtor's present accumulated assets after liquidation.[59] A successful Chapter 13 case will usually last three to five years,[60] whereas a typical Chapter 7 case lasts about three months.[61] The Chapter 13 debtor submits to the bankruptcy court a plan as to how he will pay his creditors out of his future income.[62] Every Chapter 13 plan requires the debtor to make monthly payments for a minimum of three years and a maximum of five years.[63] The Chapter 13 debtor receives his discharge only upon completion of all plan payments,[64] but there is little required of the Chapter 7 debtor during the bankruptcy in order to get his discharge.[65]

B. The Debtor's Affairs Pre-Bankruptcy

In order to understand how bankruptcy alters the relationships of a debtor to his creditors, we must look at the debtor's financial relationships before the bankruptcy proceeding begins. Assume a homeowner owns one home, which he lives in as his primary residence, and has other debts owed to credit card companies. In order to purchase the home, this hypothetical homeowner borrowed $200,000 from a lender. In exchange, the homeowner executed a promissory note to repay the $200,000 and granted a

---

[59] 6 COLLIER, *supra* note 22, ¶ 704.02[1].

[60] *See* 11 U.S.C. § 1325(b)(4) (2012) (defining the "applicable commitment period" for a debtor paying disposable income as at least 3 but no more than 5 years). This time period generally applies to a debtor with unsecured creditors not being paid in full under the debtor's plan. *See* 8 COLLIER, *supra* note 22, ¶ 1300.01 (noting that an unsecured creditor whose claim is not paid in full under a debtor's plan can object to plan confirmation to force the debtor to pay his disposable income).

[61] *See Liquidation Under the Bankruptcy Code*: *The Chapter 7 Discharge*, U.S. COURTS, http://www.uscourts.gov/FederalCourts/Bankruptcy/BankruptcyBasics/Chapter7.aspx (last visited Sept. 28, 2013) (noting that a Chapter 7 case is typically discharged within "60 to 90 days after the date first set for the meeting of creditors" prescribed by 11 U.S.C. § 341 (2012)).

[62] 11 U.S.C. §§ 1321, 1322(a).

[63] *Id.* § 1325(b)(4).

[64] *Id.* § 1328(a).

[65] *Id.* § 727 (requiring the debtor to complete a course on personal financial management before the court may issue him a discharge).

security interest in his home to the lender.[66] This security interest gave the lender a lien on the property, and it is this lien that enables the lender to foreclose on the home if the homeowner defaults on his monthly mortgage payments.[67] Assuming there were no previous liens when the homeowner purchased his house, this lender got the first, or senior, security interest in the property.[68] This lien survives until the borrower pays in full the balance on the promissory note.[69]

Let's also assume that sometime after the purchase, the value of the home increased to $250,000. The homeowner wanted to pay off credit card debt or put an addition onto the home, so the homeowner took out a home equity loan.[70] A lender lent the homeowner $50,000 and, in exchange, received a lien with a right to foreclose on the property if the homeowner defaults on the monthly payments.[71] This lien also survives until the balance of the note is paid in full,[72] but this lien is considered junior to the previous senior lien that was used to purchase the home.[73] Thus, the junior lienholder can only receive proceeds from a sale of the home after the senior lienholder is satisfied in full.[74]

This same homeowner also has three credit cards. These credit card companies will charge interest and fees on late payments, but, unlike the lienholders, they do not have a security interest in any

---

[66] *See* 12 KARL B. HOLTZSCHUE, PURCHASE AND SALE OF REAL PROPERTY § 36.01 (2009), *available at* LexisNexis (introducing the process of a homebuyer granting a security interest to an entity which lends the money for the home purchase).

[67] *See id*. § 36.07[1][c] ("An action to foreclose must be predicated upon a failure of the mortgagor . . . to perform the agreement for which the mortgage was given as security.").

[68] *See* NELSON & WHITMAN, *supra* note 33, at 819–21.

[69] *See* 12 HOLTZSCHUE, *supra* note 66, at § 36.06[2][b].

[70] *See, e.g.*, *In re* Bartee, 212 F.3d 277, 293 (5th Cir. 2000) (noting that home equity loans are generally used for personal spending).

[71] *See* 12 HOLTZSCHUE, *supra* note 66, § 36.07[1][c] ("An action to foreclose must be predicated upon a failure of the mortgagor . . . to perform the agreement for which the mortgage was given as security.").

[72] *See id.* § 36.06[2][b].

[73] *See* NELSON & WHITMAN, *supra* note 33, at 819–21.

[74] *Id.*

property of the homeowner.[75] If the homeowner defaults on any of the monthly payments, these credit card companies do not have the recourse to begin an action to seize any specific property of the homeowner.[76]

In this scenario, the homeowner had previously met all his monthly payment obligations. However, perhaps he then lost his job and could not find another one quickly. Or he might habitually spend irresponsibly. Or perhaps he could never afford to sustain monthly payments on the mortgage a lender sold him. For whatever the reason, the homeowner defaults on his monthly obligations. Most people who end up in bankruptcy will have defaulted on all of their obligations.[77] In the hypothetical here, the homeowner does not pay the senior lender on his home, the junior lender on his home, or the three credit card companies.

Each lender with a security interest begins a foreclosure proceeding once the homeowner defaults.[78] Those creditors without security interests, like the credit card companies, begin to make phone calls and deliver letters to the debtor's home.[79] The debtor can end the harassing debt collection efforts and stay any initiated foreclosure proceeding by filing a bankruptcy petition.[80] Filing a bankruptcy petition begins the debtor's bankruptcy case.[81] Once the debtor receives a discharge of debts in bankruptcy,[82] the

---

[75] *See, e.g.*, WARREN & WESTBROOK, *supra* note 49, at 223 (giving an example of a typical consumer credit card agreement).

[76] *See id.* (giving an example of a typical consumer credit card agreement); *see also id.* at 38–44 (noting the rights of secured creditors against their collateral).

[77] *See id.* at 113 (noting that most consumer debtors would need to devote years of annual income to paying off their debts, without having any funds available to live on).

[78] *See* 12 HOLTZSCHUE, *supra* note 66, § 36.07[1][c] ("An action to foreclose must be predicated upon a failure of the mortgagor . . . to perform the agreement for which the mortgage was given as security.").

[79] *See* WARREN & WESTBROOK, *supra* note 49, at 138 (noting the debtor's need for "breathing room" from debt collection attempts).

[80] Filing a petition automatically stays debt collection attempts. *See* 11 U.S.C. § 362(a) (2012).

[81] *Id.* § 301.

[82] A bankruptcy discharge removes personal liability on all discharged debts. 6 COLLIER, *supra* note 22, ¶ 700.05.

debtor has a fresh economic start.[83]

C. Secured and Unsecured Claims

The filing of the bankruptcy petition commences the debtor's case[84] and establishes an estate[85] of the debtor's property.[86] The debtor lists his creditors on the bankruptcy petition, and, after those creditors receive notice of the bankruptcy, the creditors submit claims with the amount the debtor owes.[87]

The creditor's claims will either be secured or unsecured.[88] The classification of claims depends on the nature of the claim held by the creditor. In our example from above, the homeowner in default on three credit cards has three unsecured creditors. These credit card companies each hold an unsecured claim in the debtor's bankruptcy because none of them acquired a security interest in property of the debtor. However, the senior lienholder who is owed $200,000 does have a secured claim. This claim is secured because the lienholder acquired a security interest in the debtor's home. But the Code ties the value of the lienholder's interest into the determination of a claim's status.[89] Section 506(a)(1) states that:

> An allowed claim of a creditor secured by a lien on property in which the estate has an interest . . . *is a secured claim to the extent of the value* of such creditor's interest in such property . . . *and is an unsecured claim to the extent that the value* of such creditor's interest . . . is less than the amount of

---

[83] "The whole point of bankruptcy is to provide a debtor with a fresh start." Folendore v. U.S. Small Bus. Admin. (*In re* Folendore), 862 F.2d 1537, 1540 (11th Cir. 1989).

[84] 11 U.S.C. § 301.

[85] *Id.* § 541(a)(1) defines the bankruptcy estate as "all legal or equitable interests of the debtor in property as of the commencement of the case."

[86] *Id.* § 541(a).

[87] *See* 4 COLLIER, *supra* note 22, ¶ 502.01 (stating that one of the ways that a claim is allowed is when "proof of a claim is filed or deemed filed and no party objects").

[88] 11 U.S.C. § 506.

[89] *Id.* § 506(a)(1).

such allowed claim.[90]

Courts have agreed that the market value of real property determines the value of the creditor's interest in that property.[91] Thus, a lender with a security interest in real property has a secured claim *only up to the value of the collateral*.[92] Any portion of the lender's claim that exceeds the value of the collateral becomes an *unsecured claim* in bankruptcy.[93] Assume that the home of our Chapter 7 debtor has a real market value of $150,000. The balance on the mortgage to the senior lienholder is $200,000. Therefore, under section 506(a), this senior lienholder has a secured claim worth $150,000 and an unsecured claim worth $50,000. The next section will reveal how the determination of a claim as secured or unsecured can dramatically impact the amount of payment a creditor receives.

II. STRIP DOWN IN CHAPTER 7

A. Payout to Creditors and Discharge

Once a Chapter 7 case begins, "[a] [t]rustee in [b]ankruptcy . . . is appointed to gather all of the debtor's property, to sell it, and to distribute the proceeds to creditors."[94] In our example, and in virtually all Chapter 7 cases, the trustee will not be able to gather and sell enough property to satisfy in full the claims of all

---

[90] *Id.* (alteration in original).

[91] *See, e.g.*, Gaglia v. First Fed. Savs. & Loan Ass'n, 889 F.2d 1304, 1308 (3d Cir. 1989). Section 506(a)(2) dictates using replacement value for personal property for an individual debtor in Chapter 7 or Chapter 13, but it does not dictate that replacement value be used for a Chapter 7 debtor's real property. *See* 11 U.S.C. § 506(a)(2) (2012). The Code still remains ambiguous as to which exact market value is used for a Chapter 7 debtor's real property. *See* 4 COLLIER, *supra* note 22, ¶ 506.03[6].

[92] *See, e.g.*, Gaglia v. First Fed. Savs. & Loan Ass'n, 889 F.2d 1304, 1308 (3d Cir. 1989) (noting that the under-secured lien is, under section 506(a), a secured claim up to the value of the collateral and an unsecured claim in the amount that exceeds the value of the collateral).

[93] *See, e.g.*, *id.* (noting that the under-secured lien is, under section 506(a), a secured claim up to the value of the collateral and an unsecured claim in the amount that exceeds the value of the collateral).

[94] WARREN & WESTBROOK, *supra* note 49, at 141.

creditors.[95] In fact, general unsecured creditors will often receive nothing in Chapter 7 individual bankruptcies.[96] Here, the debtor's home is worth $150,000 and two mortgages—–whose aggregate value is $250,000—–encumber the home. The trustee will not look to market and sell this home.[97] This is because the secured creditors must be satisfied before any sale proceeds can be used to satisfy the unsecured creditors, and selling the home at market value will not even satisfy the senior lienholder.[98] And if the senior lienholder is not satisfied in full, the unsecured creditors will get nothing from the sale of the house.[99] Thus, the trustee will not sell the home.[100]

Even if our debtor's home is not sold, the Chapter 7 debtor will receive a discharge of his debts within a few months of filing.[101] Discharge eliminates from the debtor all personal liability for secured and unsecured debts.[102] The removal of personal liability means that no creditor—secured or unsecured—can sue the debtor

---

[95] *See* 4 COLLIER, *supra* note 22, ¶ 507.02 ("Many bankruptcy cases do not generate sufficient proceeds to pay in full all claims entitled to payment in the case.").

[96] Section 726 governs the distribution of a Chapter 7 estate. *See* 11 U.S.C. § 726. Section 726 distributes first to priority claims, as defined by section 507, in full before the general unsecured creditors receive any distribution from the estate. *Id.* § 726(a)(6). At the very bottom of the distribution ladder is the debtor. *Id.* For the types of claims given priority, see *id.* § 507.

[97] Section 554(a) allows the trustee to "abandon any property of the estate that is burdensome to the estate or that is of inconsequential value and benefit to the estate." *Id.* § 554(a).

[98] *See* WARREN & WESTBROOK, *supra* note 49, at 113 (noting that "mortgages and security interests" on the homes of many debtors disable his ability to pay creditors from the home's sale).

[99] *See id.* at 141.

[100] Section 554(a) allows the trustee to "abandon any property of the estate that is burdensome to the estate or that is of inconsequential value and benefit to the estate." 11 U.S.C. § 554(a).

[101] *See Liquidation Under the Bankruptcy Code*, *supra* note 61.

[102] *See* 4 COLLIER, *supra* note 22, ¶ 524.02[1] (noting that "any judgment on a discharged debt is void" because the discharge has removed the debtor's personal liability). Section 524(a)(2) bars creditors from any actions to collect on a debt incurred before the debtor filed his prepetition. *See* 11 U.S.C. § 524(a)(2).

for the debt.[103] Note that unsecured creditors—like the three credit card companies whom our debtor owes—had acquired only personal liability against our debtor. For these creditors, bankruptcy discharge erases any ability to recover on a debt.[104] However, secured creditors acquired not just *in personam* rights against the debtor, but also *in rem* rights against collateral when the debtor was in default.[105] For these creditors, the *in personam* rights are extinguished but the *in rem* rights in the property itself remain, even after the discharge.[106] Thus, after the bankruptcy, the secured creditor may still enforce its rights "against the collateral . . . even though the debtor cannot be sued for any deficiency."[107] A secured creditor may enforce these *in rem* rights once the bankruptcy case closes, which lifts the stay on debt collection efforts.[108]

A secured creditor asserts its rights over real property through foreclosure.[109] Foreclosure is a legal action.[110] The foreclosing lienholder files a complaint in state court, usually in the

---

[103] *See* 6 COLLIER, *supra* note 22, ¶ 700.05.

[104] WARREN & WESTBROOK, *supra* note 49, at 229–30. If a debtor is only personally liable to a creditor, as is the case in a credit card relationship, removal of personal liability removes any way for the creditor to collect on the debt. *See id.* at 223.

[105] *See* 12 HOLTZSCHUE, *supra* note 66, § 36.07[1][a] (noting that a court has *in rem* jurisdiction over land within its jurisdiction because of the creditor's *in rem* rights); *see also id*. § 36.07 (pointing out that a lienholder has a deficiency judgment against the debtor for the amount to which the unpaid balance due the lienholder exceeds the price of the collateral at the foreclosure sale).

[106] *See* 4 COLLIER, *supra* note 22, ¶ 524.02[1] (relying on the U.S. Supreme Court's holding in *Johnson v. Home State Bank*, 501 U.S. 78, 82–83 (1991), when claiming that "the right to foreclose on a lien survives or passes through bankruptcy unaffected by the discharge"). For a scathing criticism of protecting a secured creditor's *in rem* rights in bankruptcy, see Margaret Howard, *Secured Claims in Bankruptcy: An Essay on Missing the Point*, 23 CAP. U. L. REV. 313, 322 (1994) [hereinafter Howard, *Secured Claims*] (arguing that the secured creditor in bankruptcy is entitled to the value of its collateral and nothing more).

[107] WARREN & WESTBROOK, *supra* note 49, at 262.

[108] 4 COLLIER, *supra* note 22, ¶ 524.02[1].

[109] 12 HOLTZSCHUE, *supra* note 66, § 36.07.

[110] *Id.* § 36.07[1][a].

jurisdiction of the property's location.[111] The lienholder will then schedule a foreclosure sale of the property.[112] Usually, the only party to bid on the property at this sale will be the lienholder itself.[113] The price fetched at a foreclosure sale may be below the market value of the home.[114] In the case of our debtor, this means that the home with a market value of $150,000 may sell for less at the foreclosure sale. Thus, if the senior lienholder forecloses on that property, the lender sustains a loss of at least $50,000.

A foreclosing lienholder usually can obtain a judgment against the homeowner for the difference between the balance due the lienholder and the amount of the foreclosure sale price.[115] However, after a bankruptcy discharge, the lienholder cannot obtain this judgment against the debtor because the discharge has removed the debtor's personal liability on the debt.[116]

B. Reaffirmation as an Alternative to Discharge

Often, a debtor does not receive discharge of all of his debts.[117] The Code has provisions to prevent certain debts from being discharged. The list of nondischargeable debts includes federal student loans,[118] any debt incurred through fraud by the debtor,[119] and debts owed to the government,[120]among others.[121] Also, a debtor may decide to reaffirm a debt to a creditor instead of receiving discharge of the debt.[122]

---

[111] *Id.*

[112] *Id.* § 36.07.

[113] *Id.*

[114] *See id.* § 36.07[4][b] (noting that sometimes the price at a foreclosure sale does not "fairly recognize the value of that real estate").

[115] *Id*. § 36.07.

[116] WARREN & WESTBROOK, *supra* note 49, at 262–63.

[117] *See* 11 U.S.C. § 523 (2012) (listing nineteen exceptions to discharge); *see also id.* § 524(c) (describing the process of reaffirmation agreements).

[118] *Id.* § 523(a)(8).

[119] *Id.* § 523(a)(2).

[120] *Id.* § 523(a).

[121] *See id.* § 523(a) (listing many other nondischargeable debts).

[122] *See* 4 COLLIER, *supra* note 22, ¶ 524.04 (explaining the procedures for reaffirming either secured or unsecured debts).

To understand the reasons behind reaffirmation of debt, we must remember that sometimes it is advantageous for both a debtor and creditor to continue their relationship.[123] In our example above, the debtor may wish to reaffirm the debt to the credit card companies or the lienholders. The debtor may wish to do so because he has a particular interest in continuing to borrow from a certain credit card company. More likely, our debtor will wish to reach a reaffirmation agreement with the lienholders on his home. Reaffirmation is the only way to prevent post-bankruptcy actions by the lienholders to repossess the property.[124] This is because reaffirmation is the only way to prevent discharge of the debts to the lienholders,[125] which leaves a secured creditor's *in rem* rights intact. Thus reaffirmation is a powerful motivator for homeowners eager to keep their homes.

Reaffirmation of debt is a voluntary agreement between a debtor and a creditor.[126] Reaffirmation creates a new agreement[127] and execution of the reaffirmation agreement waives the terms of the previous agreement.[128] However, the bankruptcy court and the debtor's counsel heavily scrutinize reaffirmation agreements.[129] The court will only approve a reaffirmation agreement if it finds

---

[123] *See* WARREN & WESTBROOK, *supra* note 49, at 270 (noting that sometimes a creditor will offer "future credit" to a debtor in exchange for a reaffirmation agreement). A debtor may need this credit because he is "low on assets." *Id.* at 259.

[124] That a "bankruptcy discharge [does] not prevent enforcement of valid liens" has been the rule since *Long v. Bullard*, 117 U.S. 617 (1886). 4 COLLIER, *supra* note 22, ¶ 524.02[2][d]. This rule is not absolute, however. The Code provides many ways for the lien of a secured creditor to be avoided during the bankruptcy. *Id. Long* stands for the protection of all valid liens *remaining* after the bankruptcy case closes. *See* Howard, *Secured Claims*, *supra* note 106, at 322 ("To cite *Long* for the proposition that "liens pass through bankruptcy" is simply wrong. [*Long*], more accurately, stands for the proposition that liens pass through bankruptcy when they are not dealt with during the case.").

[125] *See* 4 COLLIER, *supra* note 22, ¶ 524.04 (describing a reaffirmation agreement as a "binding agreement reaffirming a debt that would otherwise be discharged").

[126] *Id.* ¶ 524.04[1].

[127] *See* WARREN & WESTBROOK, *supra* note 49, at 261–62.

[128] *See id.*

[129] *See* 11 U.S.C. § 524(c) (2012).

that the agreement does not place an "undue hardship" on the debtor's fresh start.[130] The debtor and creditor must agree to the reaffirmation agreement before the debtor receives his discharge.[131]

The debtor in our example wishes to retain his home. In order to reaffirm the debt, he and the senior lienholder will negotiate in order to come up with a new loan agreement. The lienholder incurs a loss if it accepts a reaffirmation agreement that pays anything less than $200,000, but this loss will be less than the loss of foreclosing on the home. The debtor will agree to reaffirm a debt he thinks he can pay because reaffirmation enables him to remain in his home.

C. Section 506(d) and Strip Down

A discharge is perhaps the most powerful tool available to provide the debtor with a fresh start. But the debtor may avail himself of other tools before he receives the discharge. One of these tools is in the bifurcation provision of section 506(a)(1) mentioned above, which splits the claim of an under-secured creditor into a secured claim and an unsecured claim, as determined by the market value of the collateral.[132] Another provision designed to help the debtor is section 506(d), which states that: "To the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void . . . ."[133] We have already noted that our senior lienholder holds a lien against the debtor's home, and that this lienholder has a secured claim in the amount of $150,000 and an unsecured claim in the amount of $50,000. Section 506(d) seems to void a lien attached to any unsecured claim. Does section 506(d) enable our homeowner to void the portion of the lien attached to the $50,000 unsecured claim? Voiding the portion of the lien attached to the lienholder's unsecured claim would have the effect of reducing the

---

[130] *See id.* § 524(c)(3)(B).

[131] *See* 4 COLLIER, *supra* note 22, ¶ 524.04[1] ("To be enforceable, a reaffirmation must be made before the granting of a discharge.").

[132] 11 U.S.C. § 506(a)(1).

[133] *Id.* § 506(d).

value of the lien from $200,000 to $150,000. If allowed, this would be a *strip down*.

In 1989, the Third Circuit, in *Gaglia v. First Federal Savings and Loan Ass'n*, held that the combination of section 506(a)(1) and section 506(d) enabled strip down of an under-secured lien.[134] In that case the debtors sought to keep their home, which had a market value of $34,000.[135] A senior mortgage on the property had a value of $28,873.50. Unlike our example, where the senior mortgage is under-secured, the debtors' senior mortgage was over-secured because the value of the home exceeded the balance due. A junior mortgage on the property had "an outstanding balance of more than $200,000."[136] The debtors wanted to avoid any portion of the junior lien secured to their home which exceeded the home's value.[137] The debtors hoped to reduce the under-secured junior lien from over $200,000 to $5,126.50, the amount of the junior lien covered by the home's market value.[138] The debtors wanted to reaffirm the debt on that reduced amount and, thus, keep their home.[139]

The Court of Appeals for the Third Circuit allowed the strip down as the result of bifurcation by section 506(a)(1) and the lien-avoidance of section 506(d).[140] The court held that the plain language of section 506(d), which voids a lien "[t]o the extent that a lien secures a claim against the debtor that is not an allowed secured claim,"[141] voids *all* liens attached to an unsecured claim.[142]

---

[134] The court held that the unsecured portion of the under-secured claim was an unsecured claim and, thus, voided by 11 U.S.C. § 506(d). *See* Gaglia v. First Fed. Savs. & Loan Ass'n, 889 F.2d 1304, 1307–08 (3d. Cir. 1989).

[135] *Id.*

[136] *Id.* at 1305. The debtors had taken out a small business loan and granted the lender this large junior lien on their home as security. *Id.*

[137] *Id.*

[138] *Id.*

[139] *Id.* at 1308 ("While the [lienholder] is no worse off than if the property were sold, the Gaglias may realize significant benefits from lien avoidance. They may be better able to negotiate a repayment schedule with the [lienholder] for the reduced amount of the secured claim. Thus, they have an increased chance to retain their homestead.").

[140] *Id.* at 1308–09.

[141] *Id.* at 1306 (quoting 11 U.S.C. § 506(d) (1985)).

[142] *Id.* (construing 11 U.S.C. § 506(d) (1985)).

Additionally, under section 506(a)(1), the unsecured portion of the debt became an unsecured claim. Therefore, section 506(d) voided the lien attached to that claim since that lien was now unsecured.[143] The court also reasoned that a strip down in this instance would not harm the under-secured lienholder.[144] If there were no strip down and the lien remained intact, the debtor would not be able to reaffirm the debt, and the under-secured lienholder would have the right to foreclose on its $200,000 lien after the bankruptcy.[145] However, a liquidation sale on that lien would only bring the lienholder $5,126.50 if the property sold at market value, which is the same amount the under-secured lienholder would receive after the strip down.[146] Thus, the court reasoned that stripping down a lien to the value of the collateral would enable the debtors to keep their home and would not harm the under-secured lienholder.[147]

D. Dewsnup v. Timm

The United States Supreme Court "stunned the bankruptcy community"[148] when, in 1992, it abrogated *Gaglia* and prohibited strip down of an under-secured lien in *Dewsnup v. Timm*.[149] In *Dewsnup*, the debtors filed a Chapter 7 petition in the Bankruptcy Court, District of Utah, in 1984.[150] The debtors owned two parcels of Utah farmland secured by a lien worth $120,000[151] but defaulted on their mortgage payments in 1979.[152] In 1987, the debtors filed an adversary proceeding[153] seeking to reduce the value of the lien

---

143 *Id.*

144 *See id.* at 1308 (pointing out that allowing a strip down "place[s] [the lender] in the same position as if the property had been liquidated").

145 *Id.*

146 *Id.*

147 *Id.*

148 David Gray Carlson, *Bifurcation of Undersecured Claims in Bankruptcy*, 70 AM. BANKR. L.J. 1, 13 (1996).

149 Dewsnup v. Timm, 502 U.S. 410, 419–20 (1992).

150 *Id.* at 413.

151 *Id.* at 410.

152 *Id.* at 412.

153 There are many types of adversary proceedings in a bankruptcy case. One type is "a proceeding to determine the validity, priority, or extent of a lien .

attaching to the two parcels of farmland.[154] The bankruptcy court determined that the fair market value of the debtors' home was $39,000.[155] Thus, the debtors sought to reduce the value of the lien to $39,000 and then redeem[156] the property by paying the creditor $39,000.[157] The debtors made the same argument that had succeeded in *Gaglia*: section 506(a)(1) bifurcated the lienholder's claim into a secured claim and an unsecured claim, and section 506(d) voided the lien attached to the unsecured claim.[158]

The bankruptcy court denied the debtors' request for relief.[159] The court assumed that the trustee had abandoned the property[160] and concluded that section 506(d)'s avoidance power did not apply because abandoned property is not "an allowed, secured claim."[161] The bankruptcy court also reasoned that use of section 506(d) to avoid the unsecured portion of a mortgage would be "unfair and inequitable."[162] The court insisted upon examining section 506(d) in light of the entire Bankruptcy Code and not in isolation.[163] The district court affirmed without a supporting opinion.[164]

The Court of Appeals for the Tenth Circuit also affirmed the bankruptcy court's decision.[165] The court stated that the

. . ." FED. R. BANKR. PRO. 7001(2).

154 *In re* Dewsnup, 87 B.R. 676, 677 (Bankr. D. Utah 1988).

155 *Id.*

156 Redeeming real property is no longer an option for a Chapter 7 debtor. *See* 11 U.S.C. § 722 (2012) (restricting the right of redemption to personal property). Now a Chapter 7 debtor would have to reaffirm the debt in order to retain his home. *See id.* § 524(c); *see also* 4 COLLIER, *supra* note 22, ¶ 524.04.

157 *In re Dewsnup*, 87 B.R. at 677.

158 *Id.*

159 *Id.* at 683.

160 The term "abandoned property" has nothing to do with whether the debtor lives on the property. Abandoned property is property that the Chapter 7 trustee has chosen not to seize and sell to benefit the estate. 11 U.S.C. § 554. Here, the property was abandoned because the mortgage was under-secured and a sale of the property would not benefit the estate. *In re* Dewsnup, 908 F.2d 588, 589 (10th Cir. 1990); *see also In re Dewsnup*, 87 B.R. at 683.

161 *In re Dewsnup*, 87 B.R. at 683.

162 *Id.* at 680.

163 *Id.* at 682.

164 *In re Dewsnup*, 908 F.2d at 589.

165 *Id.* at 590.

bankruptcy estate had no interest in abandoned property; therefore, section 506(a) did not apply and the lienholder's claim could not be severed into a secured portion and an unsecured portion.[166] And if section 506(a) did not apply, the lienholder held only a secured claim, and section 506(d) could not act to void any portion of a secured claim.[167] The court sided with bankruptcy courts that had denied strip down and concluded that strip down "inequitably give[s] debtors in a Chapter 7 liquidation more than they would receive in the reorganization chapters."[168] The court recognized that its decision directly conflicted with the decision of the Court of Appeals for the Third Circuit in *Gaglia*.[169]

The Supreme Court granted *certiorari* because of the circuit split between the Court of Appeals for the Third Circuit in *Gaglia* and the Court of Appeals for the Tenth Circuit in *Dewsnup*.[170] To the debtors' argument that section 506(d) voided the unsecured claim created by section 506(a)(1), the lienholder responded that section 506(d), which voids a lien attached to an "allowed secured claim," does not void *all* liens attached to unsecured claims.[171] Under the lienholder's interpretation, section 506(d) only voids the

---

166 *Id.* at 589.

167 *Id.*

168 *Id.* Although not titled as such, Chapter 13 is the consumer reorganization section. Congress created Chapter 13 in order to provide consumer debtors with regular income the ability to pay off their debts over time in exchange for more easily retaining their assets. *See* 8 COLLIER, *supra* note 22, ¶ 1300.02. At the time the Court of Appeals for the Tenth Circuit issued this opinion, the Ninth and Third Circuit courts had allowed strip downs in Chapter 13 cases. *See* Wilson v. Commonwealth Mortg. Corp., 895 F.2d 123, 124 (3d Cir. 1990) (holding "(1) that the unsecured portion of the Commonwealth's claim may be modified and (2) that Commonwealth's claim was secured by personal property as well as by the debtor's residence and, therefore, the anti-modification provision of section 1322 does not apply."); *In re* Hougland, 886 F.2d 1182, 1185 (9th Cir. 1989) ("The secured portion has special protection when residential real estate lending is involved. The unsecured portion does not.").

169 *In re Dewsnup*, 908 F.2d at 589.

170 Dewsnup v. Timm, 502 U.S. 410, 414 (1992). The Tenth Circuit and the Third Circuit were the only two federal appellate courts to directly address the issue of strip down in Chapter 7. *In re Dewsnup*, 908 F.2d at 589.

171 *Dewsnup*, 502 U.S. at 415.

liens on claims *that are not both allowed and secured*.[172] Both the secured and unsecured claims of this lienholder were clearly allowed.[173] Thus, the lender reasoned, the lien-voiding provision of section 506(d) did not apply.[174] Further, the lender stressed that "pre-Code bankruptcy law preserved liens" like this one.[175]

In a 6-2[176] decision, the Court found for the lender.[177] The Court found ambiguity in the statutory interplay of sections 506(a) and 506(d).[178] The Court agreed with the lender's argument that "liens [generally] pass through bankruptcy unaffected."[179] Further, the Court noted that Congress would have made clear any desire to depart from this rule if Congress intended such a result from the combination of sections 506(a) and 506(d).[180] The Court stated that the entirety of the lien should "stay[] with the real property until

---

172 *Id.*

173 *See id.* Section 502 deals with the claims allowance process. 11 U.S.C. § 502 (2012). The Code defines "claim" as "right to payment." *Id.* § 101(5)(A). For the secured creditor in *Dewsnup*, no issue existed as to the lender's right to payment. *See Dewsnup*, 502 U.S. at 415.

174 *Dewsnup*, 502 U.S. at 415.

175 *Id.* at 416. This quote refers, *inter alia*, to the rule in *Long v. Bullard*, 117 U.S. 617, 621 (1886), protecting the rights of secured creditors to enforce their lien after the bankruptcy case closes. *See also* 4 COLLIER, *supra* note 22, ¶ 524.02[2][d] ("The bankruptcy discharge will not prevent enforcement of valid liens.").

176 Justice Thomas did not participate in the decision. *See Dewsnup*, 502 U.S. at 410.

177 *Id.* at 417.

178 *Id.* The Court noted that liens attached to claims that were not allowed were voided by 11 U.S.C. § 506(d). *Id.* at 415–16. Such a conclusion, however, makes section 506(d) superfluous because "we do not need [section] 506(d) to tell us that a lien is dead if it secures a claim disallowed under [section] 502(b)." Carlson, *supra* note 148, at 5.

179 *Dewsnup*, 502 U.S. at 417. This statement by the Court ignores the powers of the Code which can affect liens in many ways. *See* 11 U.S.C. § 544(a) (the so-called strong arm clause that avoids unperfected security interests); *id.* § 1325(a)(5)(B) (the cramdown provision that allows a Chapter 13 debtor to strip down the value of a lien to the value of the collateral securing it); *see also* Howard, *Secured Claims*, *supra* note 106, at 322. *But see* 11 U.S.C. § 1322(b)(2) (excepts a home mortgage from cramdown).

180 *Dewsnup*, 502 U.S. at 420.

the foreclosure,"[181] because the mortgagor and the mortgagee had agreed to just that.[182] In addition, the Court reasoned that a reduction of the value of the lien based on a judicial valuation of the home's market value at the time of the filing of the petition would act to "freeze" the value of the lien so as to deprive the lienholder of any post-petition increase in home value.[183] The Court stated that a strip down of the lien would impermissibly endow the debtor with a "windfall" of any post-bankruptcy increase in the home's value.[184] Finally, the Court expressed that its holding was limited to these facts.[185]

Dissenting Justice Scalia argued that the plain language of sections 506(a)(1) and 506(d) should allow the debtors to strip down the value of the mortgage on their home.[186] Justice Scalia urged that the term "allowed claim" in section 506(a)(1) clearly had the same meaning as the term "allowed secured claim" in section 506(d).[187] With these two provisions referring to the same type of claim, section 506(d) should void a lien attached to any claim identified by section 506(a) as allowed, but not secured.[188] Justice Souter joined the dissent.[189]

As stated in Justice Scalia's dissent, the *Dewsnup* opinion struggled with the language of sections 506(a) and 506(d).[190] How could one phrase, "allowed secured claim" mean something different in section 506(a) from what it meant in section 506(d)?[191]

---

181 *Id.* at 417.

182 *Id.* at 417–18.

183 *Id.* at 417.

184 *Id.*

185 *Id.* at 416–17.

186 *Id*. at 420–23 (Scalia, J., dissenting).

187 *Id.* at 421–22. As one commentator puts it, the majority's reading means that "the phrase 'allowed secured claim' in [section] 506(d) means the pre-bifurcation claim of an undersecured party, even while the same phrase means the post-bifurcation claim when used in [section] 506(a)." Carlson, *supra* note 148, at 13, 1.

188 *Dewsnup*, 502 U.S. at 420–21 (Scalia, J., dissenting).

189 *Id.* at 420.

190 Carlson, *supra* note 148, at 13–14.

191 *Id.*

The bankruptcy world was "stunned."[192]

III. STRIP OFF DIFFERS FROM STRIP DOWN

A. The Unsecured Lienholder Has Nothing to Gain

Under *Dewsnup*, which is still good law, the debtor in our example cannot strip down the senior lien on his home from $200,000 to $150,000, the home's market value. But what is unclear is how, if at all, this prohibition of strip down affects *strip off* of the junior lienholder.

The position of the senior lienholder—both before and after a debtor's bankruptcy—differs from that of the junior lienholder. When the junior lienholder acquired its lien on the home of our debtor, the market value of the home was $250,000. The debtor borrowed the $50,000 in order to have more cash to spend as he saw fit. Whether the debtor wanted to make a renovation to the home or pay off other credit card debt, the home equity lender was satisfied that the junior lien on the debtor's home provided the lender with sufficient security to cover the risk of default. The junior lienholder knew of the presence of the senior lien at the time the lender sold the home equity loan because it was a matter of public record.[193] It was a matter of public record because the senior lienholder had perfected its security interest by filing its lien with a public office.[194] Thus, the junior lien acquired "the property subject to prior encumbrances."[195]

Foreclosure differs greatly for a junior lienholder because of the senior lienholder's right to foreclose. Foreclosure by a senior lienholder generally extinguishes the lien of the junior lienholder.[196] The proceeds of the senior lienholder's foreclosure sale are distributed in priority order; the senior lienholder is satisfied in full before the junior lienholder receives any sale

---

[192] *Id.* at 13.

[193] *See* NELSON & WHITMAN, *supra* note 33, at 819 ("A junior mortgagee's security is the property subject to prior encumbrances.").

[194] *See* 12 HOLTZSCHUE, *supra* note 66, § 41.01 (describing the process of recording a security interest).

[195] NELSON & WHITMAN, *supra* note 33, at 819.

[196] *Id.* at 819–21.

proceeds.[197] In the case of our debtor, a foreclosure sale by the senior lienholder will return proceeds of at most $150,000, the market value of the home. These proceeds will go entirely to the senior lienholder, and the junior lienholder will lose its lien and get nothing in return.[198]

The presence of the senior lien also influences the decision to foreclose by the junior lienholder. If a junior lienholder forecloses on its lien and a senior lienholder does not foreclose, the junior lienholder sells at the foreclosure sale its subordinate position to the senior lien.[199] In the case of our debtor, the foreclosing junior lienholder would sell a $50,000 lien, in subordinated position to a $200,000 lien on a home worth $150,000. Clearly, this junior lien would not be an attractive purchase. The foreclosing junior lienholder would lose its lien for nothing. Thus, the unsecured junior lienholder receives no return on its lien in a foreclosure sale whether the sale is done by the senior lienholder or the junior lienholder.[200]

In 2012, the Court of Appeals for the Eleventh Circuit in *In re McNeal* granted strip off to a debtor in a similar position to our debtor.[201] There, the market value of the debtor's home was $141,416.[202] The home was subject to a senior lien worth $176,413 and a junior lien worth $44,444.[203] As in the case of our debtor, the market price of the home left the junior lien with no value in the collateral.[204] The court relied on its reasoning from a pre-*Dewsnup* Court of Appeals for the Eleventh Circuit case,[205] *Folendore v.*

---

197 *See id.* (describing the economically and legally advantageous position of the senior lienholder over the junior lienholder).

198 *See id.* at 821 (a senior lienholder has priority over proceeds in a foreclosure sale).

199 *Id.* at 819.

200 *See id.* at 819–21.

201 *See In re* McNeal, F. App'x 562, 563 (11th Cir. 2012) (noting that the debtor's home was encumbered by an under-secured lien and an unsecured lien).

202 *Id.*

203 *Id.*

204 *See id.* (noting that the debtor's home was encumbered by an under-secured lien and an unsecured lien).

205 *Id*. at 564–65.

United States Small Bus. Admin.[206]

In 1989, the *Folendore* court granted a strip off for two reasons. First, the junior lienholder would get nothing from either its own foreclosure sale or the sale of the senior lienholder.[207] Second, strip off would help provide the debtor with a fresh start, which is "the whole point of bankruptcy."[208] The junior lienholder in *Folendore* was in the same position as the junior lienholder in *McNeal* and the junior lienholder in our example: the aggregate value of senior liens exceeded the market value of the home.[209]

The Court of Appeals for the Eleventh Circuit reached the correct decision in *Folendore* and *McNeal*. The unsecured junior lien will not bring a return in a foreclosure sale, and the removal of the unsecured lien will enhance the debtor's fresh start. At the very least, the absence of the lien means the debtor will have one less debt to reaffirm on his home.

B. Post-Bankruptcy Increase in the Home's Value

The Court of Appeals for the Eleventh Circuit's decision in *Folendore* examines a post-bankruptcy foreclosure sale using the market value of the debtor's home during bankruptcy.[210] The bankruptcy's market value of the property is the appropriate measure of the impact of foreclosure on the junior lienholder if the market value remains the same. If the foreclosure sale by either the senior or junior lienholder closely follows the bankruptcy, the home will most likely have the same market value. But what if the foreclosure sale happens long enough after the bankruptcy that the property's value increases enough that the junior lienholder gets some value for its lien?

The possibility of a post-bankruptcy increase in the home's value situation concerned the *Dewsnup* Court.[211] The Court stated

---

[206] *In re* Folendore, 862 F.2d 1537 (11th Cir. 1989).

[207] *See id.* at 1540.

[208] *Id.*

[209] *Id.* at 1538.

[210] *See id.* at 1540 (noting the power of the senior lienholder to "foreclose and annihilate" the junior lien because no value in the home covered the junior lien).

[211] Dewsnup v. Timm, 502 U.S. 410, 417–18 (1992).

that a strip down based on the market value at the time of the bankruptcy impermissibly acted to "freeze" the value of the collateral.[212] In other words, stripping down a lien to the market value would prevent the under-secured creditor from securing any future increase in the property value.[213] In the case of our debtor, if he could strip down the senior lien to $150,000, the senior lienholder would hold a lien valued at $150,000. If the value of the home increased post-bankruptcy to $175,000, the senior lienholder would not get any of the new value of the home. Thus, the Court found it unfair to deprive the under-secured lienholder of its chance at this increase in the home's value by stripping down its lien.[214]

In 1998, the Bankruptcy Appellate Panel for the Ninth Circuit held in *In re Laskin* that a Chapter 7 strip off was impermissible because a strip off would deprive a junior lienholder of an increase in the value of the collateral.[215] In so holding, the court extended the *Dewsnup* prohibition of *strip down*, which affects an *under-secured* creditor,[216] to prohibit *strip off*, which affects an *unsecured* creditor.[217] In 2001, the Court of Appeals for the Fourth Circuit in *Ryan v. Homecomings Financial Network*,[218] denied Chapter 7 strip off for the same reasons as those relied on in *In re Laskin*.[219] In 2003, the Court of Appeals for the Sixth Circuit in *In re Talbert* also denied Chapter 7 strip off in order to protect the possibility of future value for the unsecured lienholder.[220]

---

212 *Id.* at 417.

213 *Id.*

214 *Id.* at 417–18.

215 *In re* Laskin, 22 B.R. 872, 876 (B.A.P. 9th Cir. 1998).

216 *Id.* at 874.

217 *Id.* at 876.

218 Ryan v. Homecomings Fin. Network (*In re* Ryan), 253 F.3d 778 (4th Cir. 2001).

219 *See id.* at 783 (summarizing the case law that holds that protecting the lienholder's interest post-bankruptcy applies to a strip off situation).

220 *See* Talbert v. City Mortg. Servs. (*In re* Talbert), 344 F.3d 555, 560 (6th Cir. 2003) ("The Supreme Court's reasoning for not permitting 'strip downs' in the Chapter 7 context applies with equal validity to a debtor's attempt to effectuate a Chapter 7 'strip off.'") (citing *In re Ryan*, 253 F.3d at 782); *see also id.* at 561–62 ("Section 506 was intended to facilitate valuation and disposition of property in the reorganization chapters of the Code, not to confer an

The decisions of the *Laskin*, *Ryan*, and *Talbert* courts treat the under-secured lienholder's chance at future value as equal to the unsecured lienholder's chance, but as a practical matter they are not equal. Consider the case of our debtor. The under-secured lienholder is owed $200,000. The home is worth $150,000. The junior unsecured lienholder is owed $50,000. In order for the *under-secured* lien to increase in value, the home must only go up by $1! An increase of $5,000 in the home's value would be significant to the under-secured creditor. But look at the *unsecured* junior lienholder. In order for this lien to have any value, the home's value must increase by $50,001, beyond the full value of the under-secured lienholder. Thus, as a practical matter, the right of the unsecured lienholder to future value in the home is not equivalent to that of the senior lienholder. Therefore, courts should recognize the economic inequality to post-bankruptcy increase in the home's value between the unsecured lienholder and the under-secured lienholder.

C. Folendore

In 1989, before *Dewsnup*, *Laskin*, *Ryan*, and *Talbert*, the *Folendore* court refuted the need to protect the post-bankruptcy rights of an unsecured lienholder.[221] The court noted that the junior lienholder wanted to preserve its unsecured lien in the hope that the home's value would eventually increase enough so as to provide the creditor with some equity, or coverage, of this junior lien.[222] The court called this argument of the junior lienholder "self-defeating."[223] The court pointed out that the junior lien remaining on the debtors' property would, ironically, actually *decrease* the likelihood of the creditor reacquiring some equity in the home: the presence of the junior lien would "provide[] incentive for the [debtors] to abandon the property."[224] The court stated that:

---

additional avoiding power on a Chapter 7 debtor.") (citation omitted) (quoting *In re Laskin*, 222 B.R. at 876).

[221] *In re* Folendore, 862 F.2d 1537, 1540 (11th Cir. 1989).

[222] *Id.*

[223] *Id.*

[224] *Id.*

> There is no reason the [debtors] should remain on a piece of property on which the [junior lienholder] can attach any equity [the debtors] manage to generate. [The debtors], and any other post-discharge possessors of real property, would be far better off finding unencumbered property upon which to start their financial life afresh.[225]

Thus, the court reasoned that preserving the unsecured junior lien actually dis-incentivizes a homeowner from keeping his home.[226] The debtor will be financially better off if he abandons the home and buys a new house.[227]

This is sound reasoning. The *Folendore* court understands that the preservation of the unsecured junior lien makes the home a less attractive financial investment for the debtor.[228] The court also understands that the loss incurred by strip off to the junior lienholder is *only the loss of the slim chance at future value*.[229] This slim chance is not worth the damage it can do to the debtor by forcing him out of his home, reasoned the court correctly.[230]

The *Folendore* court did fail to recognize another deleterious effect of the preservation of the junior lien. If the preservation of the junior lien causes the debtor to abandon the home, the debtor will not reaffirm the debt to the senior lienholder. This senior lienholder will then have to foreclose on the abandoned property and sustain a greater loss than it would have in a negotiated reaffirmation agreement. Property law has a priority system for security interests so as to prevent the junior lienholder from harming the senior lienholder.[231] Further, the junior lienholder who keeps his lien under *Laskin*, *Ryan*, and *Talbert* only gets the chance at future attachment to equity in the home.[232] But preserving this

---

[225] *Id.*

[226] *Id.*

[227] *Id.*

[228] *See id.*

[229] *See id.*

[230] *Id.*

[231] *See* NELSON & WHITMAN, *supra* note 33, at 819–20.

[232] Talbert v. City Mortg. Servs. (*In re* Talbert), 344 F.3d 555, 561 (6th Cir. 2003) ("By the time of sale in the future, a piece of real estate may have increased in value to cover a second-mortgage lien not covered by the property's

chance comes at the expense of the present interests of the senior lienholder. It is unfair to preserve the future opportunity of the junior lienholder at the present expense of the more senior lienholder when the senior lienholder has a lot to lose (the debtor abandoning the home and the loss of a foreclosure sale) and the junior lienholder's chance at future equity is so slim.

D. The Debtor Needs a Chance at Future Home Equity

Dewsnup prohibits strip downs because they deprive the under-secured lienholder of potential future home equity.[233] *Laskin*, *Ryan*, and *Talbert* prohibit strip off for the same reason because it deprives the unsecured lienholder of potential future equity.[234] However, the debtor's need for future home equity outweighs the lienholder's right for a chance at future home equity. After all, the goal of a Chapter 7 bankruptcy "is to disencumber the future to provide debtors a fresh start."[235] The debtor should have the opportunity to keep his home after the bankruptcy and, if possible, acquire equity in the home without fearing a junior lienholder who waits to attach to that equity. In the case of our debtor, he should get a real fresh start. He should be able to sell his home if it increases in value and use the equity generated to improve his financial position. This is better policy than denying strip off, which results in either (1) the debtor abandoning his home; or (2) the debtor remaining in his home but losing out on any potential equity he is able to generate.[236]

The courts that prohibit strip offs focus on the rights of an unsecured lienholder as opposed to the value of the lien.[237] After

---

value today.") (citation omitted); *see also* Ryan v. Homecomings Fin. Network (*In re* Ryan), 253 F.3d 778, 783 (4th Cir. 2001); Laskin v. First Nat'l Bank of Keystone (*In re* Laskin), 222 B.R. 872, 876 (B.A.P. 9th Cir. 1998).

[233] Dewsnup v. Timm, 502 U.S. 410, 417 (1992).

[234] *In re Talbert*, 344 F.3d at 561; *see also In re Ryan*, 253 F.3d at 783; *In re Laskin*, 222 B.R. at 876.

[235] Henderson, *supra* note 26, at 136.

[236] *See In re* Folendore, 862 F.2d 1537, 1540 (11th Cir. 1989).

[237] *See In re Talbert*, 344 F.3d at 561; *In re Ryan*, 253 F.3d at 783 (noting that protecting the lienholder's interest in full post-bankruptcy applies to a strip off situation); *In re Laskin*, 222 B.R. at 876.

all, the junior lienholder in our example holds a claim unsecured by value in the home. This claim is, at present, valueless. To prohibit strip off, then, is to change the focus of bankruptcy from providing the debtor a fresh start to protecting the rights and possible future profits of creditors.

A bankruptcy court should evaluate a junior lien in light of the importance of the debtor's fresh start and the bleak outlook of the lienholder's economic position. Viewing a strip off through the economic realities of the parties outweighs viewing the junior lien from the perspective of the lienholder's *in rem* rights. In fact, as Professor Margaret Howard points out in her critique of the *Dewsnup* decision, protection of a creditor's *in rem* rights has not been the focus of bankruptcy since the bankruptcy courts were created in the Bankruptcy Act of 1898.[238] Howard traces the history of pre-Code opinions and criticizes the *Dewsnup* Court for erroneously construing bankruptcy law as a system that protects of the rights of secured creditors.[239] Howard claims that both pre-Code bankruptcy law and "the Code [itself] shift[] focus away from *in rem* rights towards protection of the value of those rights . . . ."[240] To focus on respecting the rights of a secured creditor, without regard to the value of those rights, ignores the fact that "[t]he history of bankruptcy law shows a steady alteration of the rights of secured creditors, undertaken for the purposes of achieving equality of distribution and assuring the debtor a fresh start."[241] Thus, according to Howard, bankruptcy has never served the purpose of sacrificing the debtor's present needs in order to protect the post-petition rights of a secured creditor.[242] Bankruptcy has always served to give the debtor a fresh start and distribute the debtor's assets equitably.[243]

In an article written shortly before *Dewsnup*, Professor Joann Henderson comments on bankruptcy policy and supports Howard's

---

[238] *See* Margaret Howard, *Dewsnupping the Bankruptcy Code*, 1 J. BANKR. L. & PRAC. 513, 526–530 (1992) [hereinafter Howard, *Dewsnupping*].

[239] *Id.*

[240] *Id.* at 528.

[241] *Id.* at 527.

[242] *Id*. at 526–30.

[243] *Id*. at 527.

assertions.[244] Henderson argues that protecting secured creditors' rights to future equity is the business of state law.[245] But bankruptcy necessarily disrupts the rights of creditors in order to provide the debtor with a fresh start.[246] Henderson states that, for example, a bankruptcy discharge serves to disrupt state law property rights.[247] In other words, discharge alters a "nonbankruptcy entitlement."[248] A strip off would be another way to alter a nonbankruptcy entitlement. The junior lienholder would lose its lien and incur a loss, but the debtor would get to keep his home. The history of bankruptcy law has often had to choose the debtor's fresh start over the disturbance of a lienholder's rights,[249] and strip off would simply be another example of that trend.

IV. STRIP OFF IN CHAPTER 13

While Chapter 13 strip offs are not prohibited in any federal circuit, the Supreme Court prohibited Chapter 13 strip downs in *Nobleman v. American Savings Bank* in 1993.[250] Since *Nobleman*, which only concerned strip downs, all Circuit Courts of Appeals and Bankruptcy Appellate Panels that have addressed the issue of strip offs in Chapter 13 filings have allowed them.[251] These circuit

---

[244] *See, e.g.*, Henderson, *supra* note 26, at 155 ("[D]ebtor strip down is an important tool to protect bankruptcy goals and is consistent with other provisions in the Bankruptcy Code.").

[245] *Id.* at 135.

[246] *Id.* at 135–36.

[247] *Id.* at 143.

[248] *Id.*

[249] *See* Howard, *Dewsnupping*, *supra* note 238, at 527 ("The history of bankruptcy law shows a steady alteration of the rights of secured creditors, undertaken for the purposes of achieving equality of distribution and assuring the debtor a fresh start.").

[250] Nobleman v. Am. Savs. Bank, 508 U.S. 324 (1993).

[251] Strip off in Chapter 13 has been allowed in several post-*Nobleman* circuit cases. *See In re* Pond, 252 F.3d 122, 127 (2d Cir. 2001); *In re* McDonald, 205 F.3d 606, 615 (3d Cir. 2000); *In re* Bartee, 212 F.3d 277, 293, 296 (5th Cir. 2000); *In re* Tanner, 217 F.3d 1357, 1359–60 (11th Cir. 2000). Strip off in Chapter 13 has been allowed in post-*Nobleman* Bankruptcy Appellate Panel cases. *See In re* Mann, 249 B.R. 831, 840 (B.A.P. 1st Cir. 2000); *In re* Lam, 211 B.R. 36, 40–41 (B.A.P. 9th Cir. 1997).

court cases reveal strong policy reasons to allow strip off.[252] This policy applies with equal force to strip off in Chapter 7 filings.

In a Chapter 13 plan, the debtor may "modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence . . . ."[253] In other words, the debtor may strip down liens attached to his property. However, the right to strip down does not apply to all of the debtor's property. The Supreme Court held in *Nobleman* that section 1322(b)(2) prohibited stripping down a lien attached to the debtor's primary residence in Chapter 13.[254] The Court focused on the language in section 1322(b)(2) protecting the "rights" of lienholders and held that strip down of an under-secured lien would impermissibly modify those rights.[255]

Justice Stevens wrote a short concurring opinion in *Nobleman*, which explained the legislative history behind section 1322(b)(2).[256] He noted that the provision intended to offer "favorable treatment to residential mortgagees . . . to encourage the flow of capital into the home lending market."[257] Justice Stevens explained that Congress intended to protect home lenders in Chapter 13 bankruptcy because such protection would enable these lenders to make loans more easily.[258]

Justice Stevens' concurrence and the appellate opinions on Chapter 13 strip off reveal strong policy reasons to allow strip off in Chapter 7. The first appellate court to address Chapter 13 strip off was the Bankruptcy Appellate Panel for the Ninth Circuit in *In re Lam*.[259] In *In re Lam*, the court distinguished strip off from the strip down in *Nobleman*.[260] The court noted that the *Nobleman* prohibition of strip down served to protect the under-secured

---

[252] *See, e.g.*, *In re Bartee*, 212 F.3d at 293.

[253] 11 U.S.C. § 1322(b)(2) (2012).

[254] Nobleman v. Am. Savs. Bank, 508 U.S. 324, 332 (1993).

[255] *Id.* at 331–32.

[256] *Id.* at 332 (Stevens, J., concurring).

[257] *Id.*

[258] *Id.*

[259] *See* Lam v. Investors Thrift (*In re* Lam), 211 B.R. 36, 40–41 (B.A.P. 9th Cir. 1997).

[260] *Id.* at 41 ("The *Nobleman* decision . . . does not apply to holders of totally unsecured claims.").

lienholder, not the unsecured lienholder.[261] The court also described the economically untenable position of the unsecured lienholder:

> An analysis of the state law "rights" afforded a holder of an unsecured "lien", if such a situation exists, indicates these rights are empty rights from a practical, if not, a legal standpoint. A forced sale of the property would not result in any financial return to the lienholder, even if a forced sale could be accomplished where the lien attaches to nothing. Nothing secures the "right" of the lienholder to continue to receive monthly installment payments, to retain the lien until the debt is paid off, or the right to accelerate the loan upon default, if there is no security available to the lienholder to foreclose on in the event the debtor fails to fulfill the contract payment obligations.[262]

Thus, the *Lam* court stripped off the unsecured lien because the lienholder had, at the time of the bankruptcy, no real rights, as a practical matter.[263] The *Folendore* court made the exact same point in the Chapter 7 strip off context.[264] An unsecured lienholder does not have any enforceable rights unless the home increases in value.[265] It is important to note that the *Lam* court, the Bankruptcy Appellate Panel for the Ninth Circuit, subsequently denied Chapter 7 strip off in *Laskin*.[266] The *Laskin* opinion delves into the practical considerations in *Lam* because *Laskin* concludes that *Dewsnup* decided the issue of Chapter 7 strip off.[267] *Dewsnup* does not necessarily prohibit strip off, though, as *Dewsnup* applied to a strip down situation. And the junior lienholder's unfavorable position is the same whether a debtor is in Chapter 13 or Chapter 7. Other Circuit Courts of Appeals have agreed that strip off is permissible

---

[261] *Id.*

[262] *Id.* at 40.

[263] *Id.*

[264] *See In re* Folendore, 862 F.2d 1537, 1540 (11th Cir. 1989).

[265] *Id.*

[266] *See In re* Laskin, 222 B.R. 872 (B.A.P. 9th Cir. 1998).

[267] *See id.* at 876 ("Our holding that a strip off is prohibited in Chapter 7 . . . is consistent . . . with *Dewsnup* . . . .").

in Chapter 13 cases.[268]

The courts' allowance of strip off has given additional weight to the policy concerns mentioned in Justice Stevens' concurrence.[269] Justice Stevens noted that Congress was concerned with giving home purchase lenders "favorable treatment" over home equity lenders.[270] Home purchase lenders lend the money to purchase a home. Home equity lenders lend money for any purpose and take a security interest on a home already owned by the borrower.[271] In our example, the home purchase lender has the senior mortgage of $200,000; its interest was the first on the property. The home equity lender is the junior lienholder. This lender lent our debtor $50,000 and took a security interest in the home subordinate to the senior home purchase lender. The *Lam* court noted that "because second mortgages are not in the business of lending money for home purchases, the same policy reasons for protection of first mortgages under [section] 1322(b)(2) do not exist for second mortgages."[272] The Court of Appeals for the Third Circuit, in *In re McDonald*, identified the purpose of section 1322(b)(2) as promoting home-buying and home-building; homeowners typically do not use second mortgages for those purposes.[273] The Court of Appeals for the Fifth Circuit, in *In re Bartee*, noted that "because secondary lending is targeted primarily at personal spending, allowing wholly undersecured second mortgages under the umbrella of [section 1322(b)(2)] would be unlikely to positively impact home building and buying."[274] The

[268] Pond v. Farm Specialist Realty (*In re* Pond), 252 F.3d 122, 127 (2d Cir. 2001); McDonald v. Master Fin., Inc. (*In re* McDonald), 205 F.3d 606, 615 (3d Cir. 2000); *In re* Bartee, 212 F.3d 277, 296 (5th Cir. 2000); Tanner v. First Plus Fin., Inc. (*In re* Tanner), 217 F.3d 1357, 1359–60 (11th Cir. 2000); *In re* Mann, 249 B.R. 831, 840 (B.A.P. 1st Cir. 2000).

[269] *See, e.g.*, *In re Lam*, 211 B.R. at 41.

[270] *See* Nobleman v. Am. Savs. Bank, 508 U.S. 324, 332 (Stevens, J., concurring).

[271] *See* Nacy, *supra* note 31, at 103 (describing the practices of home equity lenders).

[272] *In re Lam*, 211 B.R. at 41.

[273] *See* McDonald v. Master Fin. Inc. (*In re* McDonald), 205 F.3d 606, 613 (3d Cir. 2000) ("[S]econd mortgages are rarely used to purchase a home.").

[274] *In re Bartee*, 212 F.3d at 293 (citation omitted).

court in *Bartee* also noted that many home equity loans are the result of predatory lending practices that do not deserve protection from strip off.[275] Thus, second-mortgage lenders do not get protection from strip off in Chapter 13 because Congress favored home purchase mortgage lending over home equity lending and because home equity lenders often use predatory lending practices.[276]

These same rationales apply with equal force to a Chapter 7 strip off situation. Homeowners in Chapter 7 took out home equity loans not for home-buying but, rather, personal spending.[277] There is no reason why home equity lenders should have greater protection in Chapter 7 than in Chapter 13. Allowing strip off in Chapter 7 would promote home-buying and home-building, just as Chapter 13 strip off promotes home-buying and home-building. Further, it is in the best financial interest of the senior lienholder if a Chapter 7 debtor is able to retain his home, because then the senior lienholder avoids the loss incurred by the foreclosure sale.[278] Allowing strip off in a Chapter 7 case increases the likelihood that a Chapter 7 debtor retains his home and the senior lienholder avoids that loss.[279] Denial of strip off may actually hurt the senior lienholder since the debtor may choose to abandon his home because the junior lien will encumber it post-bankruptcy.[280]

Also, many of the junior liens currently encumbering homes are the product of predatory or bad lending practices.[281] The home equity lending market was full of irresponsible lending practices in

---

[275] *Id.* (discussing Jane Kaufman Winn, *Lien Stripping After Nobelman*, 27 LOY. L. REV. 541, 584 (1994)).

[276] The Bankruptcy Appellate Panel for the First Circuit affirmed the concerns expressed by the *Lam* court, the *McDonald* court, and the *Bartee* court regarding the policy underlying 11 U.S.C. § 1322(b)(2) (2012). *In re* Mann, 249 B.R. 831, 839–40 (B.A.P. 1st Cir. 2000).

[277] *In re Bartee*, 212 F.3d at 293.

[278] *See, e.g.*, Folendore v. U.S. Small Bus. Admin. (*In re* Folendore) 862 F.2d 1537, 1540 (11th Cir. 1989).

[279] *See, e.g.*, *id.*

[280] *See id.* (noting that denial of strip off gives the debtor incentive to abandon the property, which would force the senior lender to foreclose and incur losses).

[281] *See House of Cards, supra* note 7.

the early 2000s.[282] These shady lending practices contributed to many of the unsecured junior liens currently encumbering American homes.[283] Thus, the reasons to allow strip off in Chapter 13 apply to Chapter 7.

CONCLUSION

Implementing a Chapter 7 strip off provision would help the current housing crisis. A debtor could more easily retain his home because he would have only one lienholder with which to reaffirm debt. Also, the junior lienholder holds a lien that, at the time of the bankruptcy, is worthless. This lien may increase in value, and a strip off eliminates a junior lienholder's chance at that increase, but this chance is slim, and the debtor's need to retain his home outweighs providing a junior lienholder with a slim chance at avoiding a loss. Finally, Chapter 7 debtors should have the same right to strip off that Chapter 13 debtors get, because Chapter 7 strip off would, as it does in Chapter 13, favor home purchase lenders over home equity lenders. Thus, Congress should amend the Bankruptcy Code so that a Chapter 7 debtor may strip off the lien attached to the debtor's home of a junior, unsecured lienholder.

---

282 *Id.*

283 *See id.*