No. 11-3119

IN THE

UNITED STATES COURT OF APPEALS

FOR THE EIGHTH CIRCUIT

In re MICHAEL JAMES FISETTE,
Debtor.

JASMINE Z. KELLER,
Trustee-Appellant
— v. —
MICHAEL JAMES FISETTE,
Debtor-Appellee

ON APPEAL FROM THE UNITED STATES BANKRUPTCY APPELLATE PANEL
FOR THE EIGHTH CIRCUIT
No. 11-6012

BRIEF OF APPELLEE

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SUMMARY OF THE CASE

Michael Fisette filed a chapter 13 plan which proposed to avoid or "strip" two wholly unsecured junior mortgages from his homestead real estate. The bankruptcy court denied confirmation. The Bankruptcy Appellate Panel reversed, holding (1) that such liens are avoidable notwithstanding 11 U.S.C. § 1322(b)(2), and (2) that such liens are avoidable in a chapter 13 case where the debtor is not eligible for a discharge. The trustee appeals to this court. Oral argument of 20 minutes is requested.

JURISDICTIONAL STATEMENT

The bankruptcy court had jurisdiction under 28 U.S.C. §§ 157(a) and (b), and 1334(a), to issue its order dated December 9, 2010, denying confirmation of Michael Fisette's originally filed chapter 13 plan, and to issue its order dated February 10, 2011, confirming Mr. Fisette's modified chapter 13 plan over Mr. Fisette's objection. Mr. Fisette appealed the confirmation order of the bankruptcy court dated February 10, 2011. That order was a final order. *In re Zahn*, 526 F.3d 1140 (8th Cir. 2008). Mr. Fisette filed a timely Notice of Appeal on February 21, 2011, under 28 U.S.C. sections 158(a) and (c)(2) and Rule 8002, Federal Rules of Bankruptcy Procedure. The Bankruptcy Appellate Panel for the Eighth Circuit (BAP) had appellate jurisdiction under 28 U.S.C. sections 158(a)(1) and (b). The BAP issued its opinion on August 29, 2011, reversing the decision of the bankruptcy court. The Trustee filed a timely Notice of Appeal on September 21, 2011. This Court has jurisdiction of this appeal pursuant to 28 U.S.C. § 158(d)(1).

STATEMENT OF ISSUES

I. Whether a chapter 13 debtor may modify, or avoid, a junior mortgage on the debtor's principal residence where the junior mortgagee does not have a secured claim as defined by the Bankruptcy Court and the Supreme Court in *Nobelman v. American Sav. Bank*, 508 U.S. 324 (1993).

Nobelman v. American Sav. Bank, 508 U.S. 324 (1993).

In re Lane, 280 F.3d 663 (6th Cir. 2002).

In re Zimmer, 313 F.3d 1220 (9th Cir. 2002).

In re Pond, 252 F.3d 122 (2d Cir. 2001).

II. Whether a chapter 13 debtor may modify a junior mortgage creditor's claim by avoiding its lien even if no discharge is available to the debtor.

In re Fair, 450 B.R. 853 (E.D. Wis. 2011).

In re Jennings, 454 B.R. 252 (Bankr. N.D. Ga. 2011).

In re Okosisi, 451 B.R. 90, 93 (Bankr. D. Nev. 2011).

In re Gloster, -- B.R. --, 2011 WL 5114833 (Bankr. D.N.J. 2011).

The Trustee identifies a third issue on appeal relating to the treatment of the junior mortgage creditors' claims. Debtor believes that this issue is not ripe for review based on the revised opinion issued by the BAP on November 14, 2011. Addendum A. In its original opinion, the Eighth Circuit Bankruptcy Appellate Panel directed the Debtor to submit an amended "plan to provide for proper treatment of the junior lienholders' claims as unsecured nonpriority claims." *See* BAP Op. at 15-16. On November 14, 2011, the BAP issued a revised opinion that removed the language from the opinion that specified any particular treatment of the junior creditors' claims.

STANDARD OF REVIEW

In an appeal from the Bankruptcy Appellate Panel, this Court independently reviews the bankruptcy court's decision, applying the same standard of review as the BAP. *In re Lasowski*, 575 F.3d 815, 818 (8th Cir. 2009), *citing Eilbert v. Pelican*, 162 F.3d 523, 525 (8th Cir. 1998). As the relevant facts in this case are undisputed, this Court reviews the bankruptcy court's conclusions of law *de novo*. *Benn v. Cole*, 491 F.3d 811, 813 (8th Cir. 2007).

STATEMENT OF FACTS AND PROCEEDINGS BELOW

Mr. Fisette filed a voluntary chapter 13 case on April 1, 2010. [R.10][1] Mr. Fisette's originally filed chapter 13 plan proposed payments of $300.00 for 54 months. [R.19]. Debtor's plan notes that the fair market value of the debtor's homestead is $145,000. [R.20]. The homestead was encumbered by three mortgages. The first mortgage, held by BAC Home Loans Serv., LP, had an outstanding balance of approximately $176,312.00 at the time of the Debtor's bankruptcy filing. [R.20]. The plan proposed to cure a small default on the first mortgage and to make future payments on the first mortgage directly to BAC Home Loan Serv., LP. [R.19]. Because the outstanding balance on the first mortgage far exceeded the value of the Debtor's homestead, Debtor's plan also proposed to modify (*i.e.*, avoid) both the

[1] R.__ citations are to the Appellant's (Joint) Appendix filed with the Court on November 9, 2011.

second mortgage held by Principal Bank and the third mortgage held by BAC Home Loan Serv., LP. [R.20-21].

Neither Principal Bank nor BAC Home Loan Serv., LP, objected to the treatment of their claims in Debtor's original plan, which proposed the avoidance of their liens. [R.11-13, showing no objections to confirmation]. The Chapter 13 Trustee (Trustee) also did not object to confirmation of the Debtor's original plan. [R.11-13, same].

A confirmation hearing was held on December 9, 2010. [R.13]. The bankruptcy court expressed its belief the Debtor was not permitted to strip a wholly unsecured second or third mortgage secured by a lien on the debtor's homestead. [Transcript, Dec. 9, 2010 at 6]. The court also expressed skepticism that it was appropriate for a chapter 13 plan to strip junior mortgages where the debtor was not eligible for a discharge in the chapter 13 case. [*Id.* at 10-12]. Although the bankruptcy court's Order dated December 9, 2010, does not specify the reasons for denial of confirmation, the transcript of the proceedings from December 9, 2010, makes clear that the reasons for the denial of confirmation for were twofold: first, the court held that avoidance of any junior mortgage was not allowed in Minnesota, and second, the court held that a junior mortgage could not be avoided unless a discharge was available to the debtor. [*Id.* at 6, 10-12].

Mr. Fisette timely filed a Notice of Appeal, on December 22, 2010, and a Motion for Leave to Appeal, on December 22, 2010. [R.14]. This motion for leave to appeal was denied without hearing. [R.15, 41].

On January 4, 2011, Mr. Fisette filed a modified chapter 13 plan dated January 4, 2011. [R.15, 43.] The amended plan is identical to the originally proposed plan except that it removes the language seeking to avoid the second and third mortgage creditor's liens. [R.43-44]. On January 31, 2011, the Debtor filed an objection to his amended plan. [R.15, 48] In this objection, Mr. Fisette explained that due to the bankruptcy court's denial of confirmation of his original lien stripping chapter 13 plan, and due to the action of the Bankruptcy Appellate Panel in refusing to consider his appeal from that order, he felt he had no choice but to propose a modified chapter 13 plan which did not propose to modify either the second or third mortgages. [R.48]; *see In re Zahn*, 526 F.3d 1140 (8th Cir. 2008). The bankruptcy court confirmed the amended plan over the Debtor's objection. [R.15].

Because the debtor was aggrieved by the order confirming the modified chapter 13 plan, as the plan contains no provision modifying the second or third mortgage, the debtor timely filed a Notice of Appeal to this court on February 21, 2011. [R.16]; *see In re Zahn*, 526 F.3d 1140 (8th Cir. 2008).

The BAP issued its opinion on August 29, 2011, reversing the decision of the bankruptcy court. The Trustee filed a timely Notice of Appeal on September 21, 2011.

SUMMARY OF ARGUMENT

Affirmance of the Bankruptcy Appellate Panel's (BAP) decision is mandated by the Supreme Court's decision in *Nobelman v. American Sav. Bank*, 508 U.S. 324, 113 S.Ct. 2106 (1993), and the plain language of the Bankruptcy Code. Furthermore, the BAP decision comports with the overwhelming weight of authority. Six Circuit Courts of Appeal (Second, Third, Fifth, Sixth, Ninth and Eleventh) have directly addressed this question, and all six have ruled that a completely unsecured second mortgage may be modified in a chapter 13 plan. *In re Zimmer*, 313 F.3d 1220 (9th Cir. 2002); *In re Lane*, 280 F.3d 663 (6th Cir. 2002); *In re Pond*, 252 F.3d 122 (2d Cir. 2001); *In re Tanner*, 217 F.3d 1357 (11th Cir. 2000); *In re Bartee*, 212 F.3d 277 (5th Cir. 2000); *In re McDonald*, 205 F.3d 606 (3d Cir. 2000). The Fourth Circuit has reached the same result in three recent unpublished decisions. *Widewaters Village Comm. Assoc. v. Haywood,* 2011 WL 4793210 (4th Cir. Oct. 11, 2011) (per curium) (unpublished), *aff'g In re Haywood*, 2008 WL 5146637 (Bankr. E.D.N.C. Dec. 5, 2008); *First Mariner Bank v. Johnson*, 407 Fed. Appx. 713 (4th Cir. 2011) (per curium) (unpublished), *aff'g In re Johnson*, 411 B.R. 211 (D. Md. 2009); *Suntrust Bank v. Millard*, 404 Fed. Appx. 804 2010 WL 5158561 (4th Cir. Dec. 15, 2010) (per curium) (unpublished), *aff'g In re Millard*, 414 B.R. 73 (D. Md. 2009). In addition to the BAP below, the Bankruptcy Appellate Panels in the First and Tenth Circuits have adopted this majority view. *In re Griffey*, 335 B.R. 166 (B.A.P. 10th Cir. 2005); *In re Mann*, 249 B.R. 831 (B.A.P. 1st Cir. 2000).

In *Nobelman*, the Supreme Court found that the Code provisions relevant to this matter, sections 506(a) and § 1322(b)(2), are not in conflict. In determining whether a home mortgage claim is entitled to protection from modification under section 1322(b)(2), a court must first look to section 506(a) for a determination of the claim's secured and unsecured components. If the lien is supported by at least some value, the lien holder is the "holder of a secured claim" under the Bankruptcy Code, and its claim may be entitled to protection under section 1322(b)(2). On the other hand, if the lien has no true economic value based on the underlying collateral, and is therefore totally unsecured, then the exception does not come into play and the claim may be modified under section 1322(b)(2). This reading of the statute gives effect to both subsections.

Additionally, nothing in the Code prevents Debtor, who is ineligible for a discharge, from enjoying all the rights of a chapter 13 debtor, including the right to modify claims. In 2005, Congress limited the availability of a discharge for chapter 13 debtors who had obtained a discharge in a chapter 7 case filed within the previous four years. 11 U.S.C. § 1328(f). This limitation, however, does not preclude debtors from filing a chapter 13, does not prevent the use of the automatic stay, does not eliminate the ability of debtors to cure and maintain long-term debts or to pay unsecured creditors through their chapter 13 plan, and it does not limit debtors' ability to modify secured claims.

The availability of a discharge under section 1328(f) is not relevant to whether the debtor may modify creditors' claims in chapter 13. The only limitation on debtors' ability to modify the rights of mortgage creditors in chapter 13 remains the anti-modification provision of section 1322(b)(2).

ARGUMENT

I. The right to modify secured claims in chapter 13 is universally accepted, and that right, combined with claim bifurcation, permits debtors to modify liens that are not supported by any value in the collateral.

Since the Bankruptcy Code was enacted in 1978, debtors' ability to modify creditors' rights in chapter 13 has been explicit and broad. The plain language of section 1322(b)(2) permits a chapter 13 plan to "modify the rights of holders of secured claims…or holders of unsecured claims, or leave unaffected the rights of holders of any class of claims." In creating this section of the Code, Congress made a definitive and significant departure from the former chapter XIII of the Bankruptcy Act of 1898, which gave debtors no effective way for dealing with secured creditors.[2]

The ability to modify creditors' rights in chapter 13 is constrained by a limited exception for claims only secured by a security interest in real property that is the debtor's principal residence. 11 U.S.C. § 1322(b)(2). This special protection for

[2] Under chapter XIII of the Bankruptcy Act of 1898, a repayment plan could not be approved unless every secured creditor that would receive payments in the plan consented to it. *See* Bankruptcy Act of 1898, §§ 651–52, 11 U.S.C. §§ 1051–52 (1976).

residential mortgages applies only if the creditor has an "allowed secured claim" as determined by section 506(a). *See Nobelman v. American Sav. Bank*, 508 U.S. 324 (1993). The rights protected by the anti-modification provision of section 1322(b)(2) include the "right to repayment of the principal in monthly installments over a fixed term at specified adjustable rates of interest, the right to retain the lien until the debt is paid off, the right to accelerate the loan upon default and to proceed against [debtor's] residence by foreclosure and public sale, and the right to bring an action to recover any deficiency remaining after foreclosure." *Nobelman*, 508 U.S. at 329. Conversely, absent special protection, section 1322(b)(2) permits a debtor to modify any of the listed rights. Thus, chapter 13 explicitly allows debtors to modify the rights of junior mortgage holders, including avoiding the lien attached to the collateral, if the anti-modification provision of section 1322(b)(2) does not apply.

II. The Debtor's ability to strip off a wholly unsecured lien is supported by the plain language of the Bankruptcy Code, the Supreme Court's decision in the *Nobelman* case, and the overwhelming weight of relevant case law.

Every appellate court to decide this issue has adopted the Debtor's position and rejected the Trustee's position. Six Circuit Courts of Appeals (Second, Third, Fifth, Sixth, Ninth and Eleventh) have directly addressed the question presented in this case, and all six have ruled that a completely unsecured junior mortgage may be modified in a chapter 13 plan. *In re Zimmer*, 313 F.3d 1220 (9th Cir. 2002); *In re Lane*, 280 F.3d 663 (6th Cir. 2002); *In re Pond*, 252 F.3d 122 (2d Cir. 2001); *In re Tanner*, 217

F.3d 1357 (11th Cir. 2000); *In re Bartee*, 212 F.3d 277 (5th Cir. 2000); *In re McDonald*, 205 F.3d 606 (3d Cir. 2000). The Fourth Circuit has reached the same result in three recent unpublished decisions. *Widewaters Village Comm. Assoc. v. Haywood,* 2011 WL 4793210 (4th Cir. 2011) (per curium) (unpublished), *aff'g In re Haywood*, 2008 WL 5146637 (Bankr. E.D.N.C. Dec. 5, 2008); *First Mariner Bank v. Johnson*, 407 Fed. Appx. 713 (4th Cir. 2011) (per curium) (unpublished), *aff'g In re Johnson*, 411 B.R. 211 (D. Md. 2009); *Suntrust Bank v. Millard*, 404 Fed. Appx. 804 2010 WL 5158561 (4th Cir. 2010) (per curium) (unpublished), *aff'g In re Millard*, 414 B.R. 73 (D. Md. 2009). In addition, the Bankruptcy Appellate Panels in the First and Tenth Circuits have adopted this majority view. *In re Griffey*, 335 B.R. 166 (B.A.P. 10th Cir. 2005); *In re Mann*, 249 B.R. 831 (B.A.P. 1st Cir. 2000). Though this Court has not decided the issue, bankruptcy courts from every district in the Eighth Circuit, except in the District of Minnesota, have adopted the majority position. *See, e.g., In re Reed*, 2011 WL 1045070 (Bankr. D.S.D. Mar. 16, 2011); *In re Krapfl*, 2010 WL 4338475 (Bankr. N.D. Iowa Oct. 27, 2010); *Black v. Conseco Financial Servicing Corp.*, 260 B.R. 134 (Bankr. E.D. Ark. 2001); *In re McCarron*, 242 B.R. 479 (Bankr. W.D. Mo. 2000); *In re Sanders*, 202 B.R. 479 (Bankr. D. Neb. 1996); *In re Mitchell*, 177 B.R. 900 (Bankr. E.D. Mo. 1994).

Despite this weight of authority, bankruptcy courts in the District of Minnesota have repeatedly held that wholly unsecured junior mortgages may not be modified. *See, e.g., In re Loban*, 2010 WL 1292787 (Bankr. D. Minn. Apr. 2, 2010); *In re Hughes*,

402 B.R. 325 (Bankr. D. Minn. 2009); *In re Mattson*, 210 B.R. 157 (Bankr. D. Minn. 1997).

In this case, despite the lack of objection by either the creditors or the trustee, the bankruptcy court relied on the jurisprudence of the district to deny confirmation of the Debtor's plan, which included a provision to modify the wholly unsecured second and third mortgages. [Transcript Dec. 9, 2010 at 12].

In determining whether the anti-modification provision of section 1322(b)(2) applies, all appellate courts and bankruptcy courts, except the bankruptcy courts of Minnesota, properly began their analyses with the application of section 506(a). The Supreme Court in *Nobelman* makes clear that section 506(a) is essential to the preliminary determination of whether the anti-modification protections should be invoked at all.

The general rule set forth in section 1322(b)(2) is that a debtor's chapter 13 plan may "modify the rights of a holder of a secured claim." This general rule permitting modification of the rights of a holder of a secured claim is followed by a limited exception for secured claim holders whose claims are "secured only by a security interest in real property that is the debtor's principal residence." 11 U.S.C. § 1322(b)(2). Based on the plain language of the statute, the narrowly drawn language that follows the general rule and contains the anti-modification provision can apply only to a holder of a "secured claim." Thus, before reaching the question of whether the claim is "secured only by a security interest in real property that is the debtor's

principal residence," the creditor must hold a secured claim. *In re Zimmer*, 313 F.3d at 1226-27. It is this initial determination that requires the application of section 506(a).

Section 506(a) is designed to deal with the situation, not uncommon in bankruptcy, where lien amounts exceed the current value of the property. In relevant part, section 506(a) provides:

> (a) 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 the estate'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 such allowed claim.

11 U.S.C. § 506(a). "[T]his section separates an undersecured creditor's claim into two parts—he has a secured claim to the extent of the value of his collateral; he has an unsecured claim for the balance of his claim." H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 356 (1977) (section 506 effectively "abolishes the use of the terms 'secured creditor' and 'unsecured creditor' and substitutes in their places the terms 'secured claim' and 'unsecured claim.'").

The Supreme Court has repeatedly explained that, in bankruptcy reorganizations under chapters 11 and 13, section 506 "governs the definition and treatment of secured claims" and that for bankruptcy purposes "a claim is secured only to the extent of the value of the property on which the lien is fixed." *United States v. Ron Pair Enter., Inc.*, 489 U.S. 235, 241 (1989) (chapter 11). Thus, *Nobelman* recognized the need to turn to section 506(a) first to determine whether the creditor has a secured claim:

> 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 '[s]uch value shall be determined…in conjunction with any hearing…on a plan affecting such creditor's interest. But even if we accept petitioners' valuation, the bank is still the 'holder' of a 'secured claim,' because petitioners' home retains $23,500 of value as collateral.

Nobelman, 508 U.S. at 328-29.

Nobelman correctly states that after conducting a section 506(a) valuation, a partially secured claim will be divided into its secured and unsecured claim components. *Nobelman*, 508 U.S. at 329 ("The portion of the bank's claim that exceeds $23,500 is an 'unsecured claim componen[t]' under § 506(a), *United States v. Ron Pair Enterprises, Inc.* 489 U.S. 235, 239 n.3, 109 S.Ct. 1026, 1030 n.3, 103 L.Ed.2d 290 (1989)"). The BAP correctly understood that a claim having no secured component cannot be a secured claim entitled to the protection of the anti-modification provision. *See In re Zimmer*, 313 F.3d at 1227 (improper to jump forward to the last step in analysis—determining what is entitled to protection from modification—without considering whether the creditor even qualifies for such protection in the first place); 8-1322 Collier on Bankruptcy ¶ 1322.06[1][a][i]. As a matter of common sense, a lien that attaches to nothing provides no security to the lien holder.

The position of the Trustee and its Amici completely dismisses the role of section 506(a). Creditor argues that the "rights" of a home mortgage creditor

contained in the mortgage instruments must be unequivocally enforced; that the mere existence of a lien controls rather than the creditor's status as a "holder of a secured claim" under the Bankruptcy Code. *See Hughes*, 402 B.R. at 326. This position, however, cannot be reconciled with the *Nobelman* directive that courts are "correct in looking to § 506(a) for judicial valuation" of the collateral. *Nobelman*, 508 U.S. at 328-29. If the "rights" of a home mortgage holder are protected in all circumstances, as the Trustee would have it, then what purpose would such a valuation serve? "[T]he § 506(a) analysis approved of by the court would superfluous if any claim secured by a lien on the debtor's principal residence were protected by the anti-modification provision. In other words, there would be no need for a § 506(a) analysis if fully secured, partially secured, and totally unsecured home mortgage lienholders all received the protection of the anti-modification provision." *Sanders*, 202 B.R. at 990, *citing In re Williams*, 161 B.R. 27, 29-30 (Bankr. E.D. Ky. 1993). For the statement in *Nobelman* to have any meaning at all, it must follow that a section 506(a) valuation to determine whether a claim is at least partially secured is a necessary prerequisite before turning to section 1322(b)(2). *See In re McDonald*, 205 F.3d at 611.

The BAP correctly noted that *Nobelman* did not examine the rights protected by section 1322(b)(2) until after it established that the creditor held a secured claim. BAP Op. at 9. To the extent "rights" are to be protected under section 1322(b)(2), they must attach to a lien having at least some minimum economic value. *See In re Lane*, 280 F.3d at 664. Here there is no question that the second and third mortgages are

liens to which not a penny can attach. Accordingly, under *Nobelman*, the second and third mortgage creditors do not have "secured claims," and they are not protected by the anti-modification provision of section 1322(b)(2).

III. Debtors may file a chapter 13 even if no discharge is available to them.

When it enacted BAPCPA in 2005, Congress limited the availability of a discharge for chapter 13 debtors who had obtained a discharge in a chapter 7 case filed within the previous four years. 11 U.S.C. § 1328(f)(1). However, Congress did not preclude debtors from filing a chapter 13 even when no discharge would be available to them, nor did Congress alter the other benefits of chapter 13, such as the automatic stay and the ability to cure and maintain long-term debts. *See Bateman, et al. v. Branigan*, 515 F.3d 272, 281 (4th Cir. 2008) (section 1328(f)(1) is not an eligibility provision); *In re Jennings*, 454 B.R. 252 (Bankr. N.D. Ga. 2011) (Congress was deliberate in only prohibiting discharge in a subsequent chapter 13 case).

Section 109 of the Code sets forth the eligibility requirements for bankruptcy. In 2005, Congress added new language to this section requiring pre- and post-petition credit counseling for consumer debtors. Other than this addition, the eligibility requirements for chapter 13, which are in section 109(e), were not changed at all. Only an individual with regular income that owes, on the date of the filing of the petition, noncontingent, liquidated, unsecured debts of less than $360,475 and noncontingent, liquidated secured debtors of less than $1,081,400, may be a debtor

under chapter 13. 11 U.S.C. § 109(e). This section places no filing restrictions on someone with a previous chapter 7 or chapter 13 discharge. By comparing sections 1328(f) and 109(e), it is apparent that Congress only restricts a subsequent filer's eligibility for a discharge, not his or her eligibility to file. This makes sense because of the benefits that subsequent filings have to both creditors and debtors, even if a discharge is unavailable. For example, creditors will receive an orderly and appropriate payment of their claims, instead of having to engage in a "race to the courthouse" to obtain judgments or collect on garnishments, mortgagees will not have to incur out-of-pocket expenses of a foreclosure because property can be sold by the trustee through the bankruptcy, debtors receive the benefit of the automatic stay throughout the course of their case, and debtors can cure long-term debts and provide for repayment of otherwise nondischargeable debts such as domestic support obligations and student loan debt. *See Bateman*, 515 F.3d at 283 (chapter 13 debtor ineligible for a discharge may file a chapter 13 case and utilize the tools in chapter 13 to cure mortgage, deal with other secured debts, or simply pay debt under a plan with the protection of the automatic stay.) For these reasons, there as been little disagreement, and the Trustee does not now argue, that debtors who are ineligible for a discharge may still file a chapter 13.

IV. In a chapter 13 case, Debtor may modify mortgage creditor's claim by avoiding the lien even if no discharge is available to him.

The benefits of chapter 13 remain the same even when the debtor may be ineligible for a discharge. This principle, which applies to the automatic stay and the curing of long-term debts, is equally applicable to the debtors' ability to modify liens under section 1322(b)(2). *See In re Gloster,* 2011 WL 5114833, at *5 (Bankr. D.N.J. Oct. 13, 2011)(BAPCPA made no changes to section 506 and 1322, which form the basis of debtors' right to modify wholly unsecured junior liens); *see also In re Fair*, 450 B.R. 853 (E.D. Wis. 2011); *In re Okosisi,* 451 B.R. 90, 93 (Bankr. D. Nev. 2011); *In re Davis*, 447 B.R. 738, 745 (Bankr. D. Md. 2011).

The only limitation on the Debtor's ability to modify the rights of mortgage creditors in chapter 13 is the anti-modification provision of section 1322(b)(2). Nothing in the Code prevents Debtor, who is ineligible for a discharge, from enjoying all the rights of a chapter 13 debtor, including the right to modify claims. *See Davis,* 447 B.R. at 745; *In re Frazier,* 448 B.R. 803 (Bankr. E.D. Cal. 2011); *In re Hill*, 440 B.R. 176 (Bankr. S.D. Cal. 2010). Rather, the right to strip off a wholly unsecured junior lien is conditioned on the debtor's obtaining confirmation of, and performing under, a chapter 13 plan that meets all the statutory requirements. *See Gloster*, 2011 WL 5114833, at *5.

The availability of a discharge under section 1328(f) is not relevant to whether the debtor may modify creditors' claims in chapter 13. The bankruptcy discharge only

eliminates the debtor's personal liability for a discharged debt. 11 U.S.C. § 524(a). It prevents creditors from beginning or continuing actions against the debtor to collect the amount owed to it by the debtor prior to bankruptcy. The discharge has no effect on liens one way or another. *See Johnson v. Home State Bank*, 501 U.S. 78, 87, 111 S.Ct. 2150, 115 L.Ed.2d 66 (1991). Because the discharge only affects personal liability and has no effect on liens, it can not be a precondition for modifying liens if a chapter 13 debtor has satisfied all statutory requirements for plan confirmation and successfully performs that plan. *See Jennings*, 454 B.R. at 255 ("Plan completion voids the lien. Discharge cannot be the legal mechanism that voids the lien.").

V. The reasoning of *Dewsnup*—involving lien stripping in a chapter 7 case—is not applicable in chapter 13.

Courts have consistently held that *Dewsnup v. Timm*, 502 U.S. 410, 112 S.Ct. 773, 116 L.Ed.2d 903 (1992), is not applicable in the reorganization chapters—chapters 11, 12 and 13. *Nobelman*, which was decided after *Dewsnup*, and its progeny never consider *Dewsnup* as a barrier to stripping off wholly unsecured junior mortgages in chapter 13. *See, e.g., In re Zimmer*, 313 F.3d 1220 (9th Cir. 2002); *In re Lane*, 280 F.3d 663 (6th Cir. 2002); *In re Tanner*, 217 F.3d 1357 (11th Cir. 2000). As noted by the Ninth Circuit in *In re Enewally*, 368 F.3d 1165, 1170 (9th Cir. 2004):

> The rationales advanced in the *Dewsnup* opinion for prohibiting lien stripping in Chapter 7 bankruptcies, however, have little relevance in the context of rehabilitative bankruptcy proceedings under Chapter 11, 12, and 13, where lien stripping is expressly and broadly permitted, subject to very minor

> qualifications. The legislative history makes clear that lien stripping is permitted in the reorganization chapters.

The Trustee and courts relying on *Dewsnup* in the chapter 13 context fail to consider the limited nature of the decision and the fundamental historical differences that preclude applying *Dewsnup* in chapter 13 cases. Appellant's Brief at 17; *see In re Fenn*, 428 B.R. 494 (Bankr. N.D. Ill. 2010)(suggesting 506(d) cannot apply in chapter 13 because it does not apply in chapter 7); *In re Gerardin*, 447 B.R. 342 (Bankr. S.D. Fla. 2011)(applying *Dewsnup*). In *Dewsnup*, the majority was reluctant to depart from established pre-Code practice without clearer direction and comment by Congress. 502 U.S. at 419. Prior to *Dewsnup*, for nearly a hundred years, lien stripping in chapter 7 was not permitted. *See In re Gibbons*, 164 B.R. 717, 718 (Bankr. D.N.H. 1993). By contrast, in enacting the Bankruptcy Code, Congress evinced a clear intent to change the way chapter 13 debtors could deal with secured creditors. The historical principles that applied in *Dewsnup* in chapter 7 do not apply in chapter 13.

Furthermore, the holdings of *Dewsnup* and *Nobelman* are not inconsistent. In *Dewsnup*, a chapter 7 debtor sought to avoid the portion of a $120,000 loan that exceeded the $39,000 value of the property. Thus, the debtor sought to "strip down" a partially secured first lien, rather than "strip off" a wholly unsecured junior lien. The Supreme Court rejected debtor's argument and stated that "the words [in 506(d)] should be read term-by-term to refer to any claim that is, first, allowed, and, second, secured." *Dewsnup*, 502 U.S. at 415. In the Supreme Court's view, the existence of

some collateral sufficed to render the lien a secured claim. Thus, the Court concluded that section 506(d) did not permit a chapter 7 debtor to strip down a creditor's lien to the judicially determined value of the underlying collateral. The Supreme Court in *Dewsnup* did not decide whether a completely unsecured lien would be void under section 506(d). Rather, the *Dewsnup* court specifically contemplated a narrow interpretation of its decision. *Id.* at 417 ("We therefore focus upon the case before us and allow other facts to await their legal resolution on another day.").

VI. *Jarvis*, and the cases that follow it, rest on a weak foundation because *Jarvis* misapplies both *King* and *Lilly* in reaching its conclusion that a chapter 13 discharge is necessary to strip a lien.

In re Jarvis, 390 B.R. 600 (Bankr. C.D. Ill. 2008), was the first case to address the issue of lien stripping in a no-discharge chapter 13. Subsequently, several courts have followed *Jarvis* in holding that a discharge is necessary to strip a lien in chapter 13. *See In re Gerardin,* 447 B.R. 342 (Bankr. S.D. Fla. 2011)*; In re Trujillo*, 2010 WL 4669095 (Bankr. M.D. Fla. Nov. 10, 2010); *In re Colbourne*, 2010 WL 4485508 (Bankr. M.D. Fla. Nov. 8, 2010); *In re Mendoza*, 2010 WL 736834 (Bankr. D. Colo. Jan. 21, 2010). However, an analysis of the court decisions underlying *Jarvis* demonstrates that these cases rest on a shaky foundation.

With no direct precedent to work from, the *Jarvis* court relied on *In re King*, 290 B.R. 641, 646 (Bankr. C.D. Ill. 2003), and *In re Lilly*, 378 B.R. 232 (Bankr. C.D. Ill. 2007), to reach its conclusion. *King* is cited for the proposition that lien avoidance is

contingent upon the debtor completing the plan ***and receiving a discharge.*** *Jarvis*, 390 B.R at 604. However, the *Jarvis* court acknowledges that pre-BAPCPA debtors who completed their plans as a matter of course received a general discharge. In other words, the discharge, except in the case of hardship, followed automatically from the completion of the chapter 13 plan. In interpreting *King*, *Jarvis* mistakenly creates two necessary conditions to lien avoidance (plan completion and discharge) when previously the second condition (the discharge) was purely derivative of the first (plan completion). Other pre-BAPCPA cases, not cited by *Jarvis*, simply leave off the derivative condition (discharge) and state that lien avoidance only requires completion of the debtor's chapter 13 plan. *See In re Feher*, 202 B.R. 996 (Bankr. S.D. Ill. 1996)(cram down premised on "debtors' successful completion of their chapter 13 plan payments"); *In re Gibbons*, 164 B.R. 207 (Bankr. D.N.H. 1993) (lien avoidance "contingent on full performance of the plan"). As noted above, the discharge determines only whether any personal liability on a debt is eliminated. 11 U.S.C. 524(a); *see Jennings*, 454 B.R. at 255. It has no effect on liens one way or the other. Thus, *Jarvis* overreaches in concluding that "modification has traditionally only been achieved through a discharge."

Similarly, *Jarvis* relies on *In re Lilly*, 378 B.R. 232 (Bankr. C.D. Ill. 2007), for the proposition that, without a discharge, modifications to a creditor's rights imposed by the plan are not permanent and have no binding effect once the term of the plan ends. As with *King*, the *Jarvis* court acknowledges that *Lilly* is distinguishable because

the decision rests on section 1325(a)(5) which relates to the treatment of allowed secured claims. *Jarvis*, 390 B.R. at 605. The *Jarvis* court correctly recognized that *Lilly* involved a creditor with an allowed secured claim, whereas junior liens unsupported by value in the collateral do not achieve the same status. *Id.* Nevertheless, the *Jarvis* court found persuasive *Lilly*'s analysis of the modification of creditor's rights. *Lilly*'s analysis, in turn, relied on three cases—*Place, Holway, and Ransom*—to support the proposition that modifications to a creditor's rights without a discharge were not permanent. However, as explained below, the cases relied on by *Lilly* do not support that conclusion reached by *Lilly*, and thus *Lilly* provides a weak legal basis for *Jarvis* and its followers.

In re Place, 173 B.R. 911 (Bankr. E.D. Ark 1994), deals with lien stripping in a chapter 7 case, not in a chapter 13 case as indicated in the *Lilly* citation to *Place*. *See Lilly*, 378 B.R. at 236. It is inapposite because it is a chapter 7, not a chapter 13, case. The *Place* court found the matter governed by *Dewsnup* and denied the debtor's motion to avoid the lien. *Place*, 173 B.R. at 912. *Place* does not stand for the longstanding principle related to the modification of creditor's rights in chapter 13 that *Lilly* claims and *Jarvis* relies upon. *In re Ransom,* 336 B.R. 790 (B.A.P. 9th Cir. 2005), addresses the ability of a debtor to discharge a student debt in a chapter 13 plan and had nothing to do with liens.[3] Lastly, in *In re Holway*, 237 B.R. 217 (Bankr. M.D. Fla. 1999), the

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[3] Subsequent to *Lilly*, the BAP decision in *Ransom* was vacated in light of the Ninth Circuit's opinion in *Espinosa v. United Student Aid Funds*, 553 F.3d 1193 (9th Cir. 2008), *aff'd*,

debtors received a discharge after converting to chapter 7, but did not complete their plan payments. The *Holway* court states that only debtors who successfully complete their chapter 13 plans enjoy the unique ability to pay their tax liability without the penalties and interest normally associated with tax debt. *Id.* at 219. As in *King*, *Holway* treats the chapter 13 discharge and completion of chapter 13 plan payments as interchangeable concepts. It does not follow from *Holway* that modification of a creditor's rights is necessarily conditioned upon a chapter 13 discharge, as opposed to completion of chapter 13 plan payments.

The majority of cases holding lien avoidance is contingent on eligibility for a discharge rely on *Jarvis*, which in turn relies on *King* and *Lilly*, which rely on *Place*, *Ransom*, and *Holway*. At bottom, the weak foundation upon which this stack of cases is built cannot support a requirement that a chapter 13 discharge is necessary to avoid lien for which is not supported by value in the collateral.

Pre-BAPCPA case law demonstrates that plan completion was the critical condition for lien avoidance, and that reference to the "discharge" was merely an unfortunate shorthand for "plan completion," which before 2005 always resulted in a discharge. Post-BAPCPA, plan completion (or a finding of hardship under 1328(b)) remains necessary, but not in itself sufficient for a discharge. 11 U.S.C. 1328(f). It is

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130 S.Ct 1367 (2010), which held that provisions of the confirmed plan have a preclusive effect and may modify a creditor's rights.

logical error, however, to assume lien avoidance now depends on a discharge rather than plan completion.

VII. Section 1325(a)(5) has no applicability in cases, such as this, where the junior mortgage creditors do not hold an "allowed secured claim" as determined under *Nobelman*.

Section 1325(a)(5) sets forth the criteria for the treatment of allowed secured claims provided for by the plan. A plan is entitled to confirmation if, with respect to each allowed secured claim provided for in the plan, 1) the creditor accepts the plan; 2) the debtor surrenders the collateral; or 3) the debtor treats the claim as provided for in section 1325(a)(5)(B). To confirm a plan over the objection of a ***holder of an allowed secured claim***, the plan must provide that 1) the holder retains the lien until the underlying debt in paid or discharge under section 1328, 2) the debtor must pay present value on the allowed secured claim, and 3) distribution of property under the plan to holders of allowed secured claims must be in equal monthly payments and sufficient to provide adequate protection if the collateral is personal property. 11 U.S.C. 1325(a)(5)(B).

In this case, the junior mortgage creditors are not holders of allowed secured claims, and therefore their claims need not be treated in accordance with section 1325(a)(5)(B). *See In re Okasisi*, 451 B.R. 90, 97 (Bankr. D. Nev. 2011); *Gloster*, 2011 WL 5114833, at *5 (a claim classified as unsecured cannot logically be treated as a secured claim under § 1325). As discussed above, in the reorganization chapters, the Supreme Court has been clear that the application of section 506(a) determines

whether a creditor has an allowed secured or unsecured claim, or both. *See Nobelman*, 508 U.S at 329; *Ron Pair Enter., Inc.*, 489 U.S. at 241. Courts holding otherwise have disregarded more than a decade of consistent jurisprudence in chapter 13 cases. *See, e.g., In re Zimmer*, 313 F.3d 1220 (9th Cir. 2002); *In re Lane*, 280 F.3d 663 (6th Cir. 2002); *In re Bartee*, 212 F.3d 277 (5th Cir. 2000); *In re McDonald*, 205 F.3d 606 (3d Cir. 2000).

For example, in *In re Woolsey*, 2010 WL 4249216 (Bankr. D. Utah Oct. 8, 2010), the court denied confirmation of a plan proposing to strip down a wholly unsecured junior mortgage because the plan did not provide for lien retention until the underlying debt was paid in full or a discharge was granted. *Id.* at •3, *see* 11 U.S.C. § 1325(a)(5)(B). In holding the junior mortgage holder had an "allowed secured claim," the *Woolsey* court never mentions *Nobelman* and its universal application in chapter 13. Instead, without clear explanation, the court relies heavily on *Dewsnup*—the chapter 7 case—even though that case, too, is distinguished because it involved a partially secured claim. *Id.* at *2.

Similarly, in *In re Fenn*, 428 B.R. 494 (Bankr. N.D. Ill. 2010), the court erroneously denied plan confirmation because the debtor's plan did not provide for lien retention as required by section 1325(a)(5)(B) despite the fact that the junior mortgagee did not have an allowed secured claim. Unlike *Woolsey*, the *Fenn* court acknowledges the applicability of *Nobelman*. *Id.* at 503. Despite acknowledgment that *Nobelman* is controlling, the *Fenn* court, nevertheless, finds that confirmation requires

compliance with 1325(a)(5)(B). *See also In re Orkwis,* 457 B.R. 243 (Bankr. E.D.N.Y. 2011); *In re Gerardin*, 447 B.R. 342 (Bankr. S.D. Fla. 2011). ***The court does not explain why a provision concerning allowed secured claims is relevant to a claim that is not an allowed secured claim.***

Contrary to these decisions, other courts, including the BAP below, have correctly found that in chapter 13 the holder of an unsecured junior mortgage does not have an allowed secured claim, and therefore neither the anti-modification provision of 1322(b)(2) or the lien retention provision of 1325(a)(5)(B) apply. *See Okasisi*, 451 B.R. at 97; *Gloster*, 2011 WL 5114833, at *5; *Jennings*, 454 B.R. at 255; *In re Hill,* 440 B.R. 176, 182-83 (Bankr. S.D. Cal. 2010); *In re Jarvis*, 390 B.R at 605 (finding 1325(a)(5) not applicable to unsecured junior mortgagee because mortgagee not holder of an allowed secured claim); *see also Nobelman*, 508 U.S. at 329 (1993).

In *Hill*, the court observed that:

> Because section 1325(a)(5) only applies to holders of secured claims, this Court respectfully disagrees that the statute imposes the condition of discharge to allow a Chapter 20 lien strip. Section 1325(a)(5) has no applicability to unsecured claims, which are separately governed by the confirmation requirements of section 1325(a)(4). Controlling Ninth Circuit precedent treats CIT's claim as an unsecured claim in this Chapter 13 case under section 1322. *Zimmer*, 1313 F.3d at 1226-27. To remain true to the holding of *Zimmer*, 1313 F.3d at 1226-27, CIT's unsecured claim cannot logically be treated differently under section 1325 than it is treated under section 1322.

Hill, 440 B.R at 183. The *Hill* court also noted that because "the Debtor's Chapter 7 simply brought about a change in recourse status, the discharged [mortgage] debt does

not spring back to life in their Chapter 20 case such that any unpaid amount become due upon completion of the Plan."

Based on the foregoing, this Court should affirm the BAP opinion that holds the unavailability of a discharge does not prevent the avoidance, or "stripping," of a wholly unsecured junior mortgage, and that section 1325(a)(5) is inapplicable where the mortgage creditor does not hold an allowed secured claim as determined by the application of section 506(a).

VIII. Allowing debtor to strip off a lien that is secured in name only and that is not supported by any true economic value is not unfair to junior mortgagees.

Courts have repeatedly noted a distinction between the first and second mortgage markets. Starting in the mid-1990's the second mortgage market expanded rapidly as lenders pushed high loan-to-value (LTV) mortgages. In issuing a warning to lenders about the risks involved with such loans in comparison to traditional mortgage loans, the Office of Thrift Supervision described the practice as follows:

> An increasing number of lenders are aggressively marketing home equity and debt consolidation loans, where the loans, combined with any senior mortgages, are near or exceed the value of the security property.…Until recently, the high LTV home mortgage market was dominated by mortgage brokers and other less regulated lenders. Consumer groups and some members of Congress have expressed concern over the growth of these loans, and the mass marketing tactics used by some lenders.

Thrift Bulletin TB 72, Office of Thrift Supervision, Department of the Treasury, August 27, 1998, at 1. Lenders who make such high LTV loans, or no equity loans,

take their illusory security in the debtor's home not for its economic value or the ability to foreclose, but for the threat of foreclosure.

In the early 2000's, lenders aggressively pitched "piggyback" loans to borrowers unable to come up with a larger down payment, or any down payment at all. Piggyback loans feature two mortgages—an 80 percent first mortgage and a second mortgage for 10, 15 or 20 percent of the purchase price. The structure typically combined a traditional fixed-rate or adjustable-rate first mortgage with either a closed-end second lien or a home equity line of credit. The risks of piggyback loans were well known to the second mortgage industry by mid-2005. *See* Broderick Perkins, Piggyback Loan Growth Poses Mortgage System Risk, Realty Times (July 13, 2005), available at http://realtytimes.com/rtpages/20050713_piggyback.htm. ("The potential for risk is that already over-extended home buyers will be left with an upside down mortgage should the bubble burst and price drop.") The additional risks borne by piggyback and other high LTV lenders caused them to charge higher interest rates on these second mortgages. Now that the housing bubble has burst and home values have dropped, creditors can hardly argue that they were not aware of the potential risk that debtors would be left with upside down junior mortgages—risk that they priced into their products

Lastly, debtors do not receive a "windfall" at the expense of high LTV lenders. Markets are uncertain, and it is not certain if, or when, the value of Debtor's property will increase. Secondly, mortgage creditors' right to foreclose will not currently result

in any monetary gain. Bankruptcy is not intended to benefit either the creditor in speculating on a potential increase in property value, or the debtor. However, where the future is uncertain, the lien should be avoided. *In re Cook*, 2010 WL 4687953 (Bankr. E.D. Va. Nov. 10, 2010)(no statutory or case authority stands for the proposition that lien avoidance may be denied solely based on anticipated future increase in the value of the secured creditor's collateral).

Bankruptcy policy should not be used to protect piggyback and high LTV lenders who would not otherwise be protected outside of bankruptcy and who knowingly made riskier loans. Any other result will create a perverse incentive for lenders to make high LTV loans, or mortgages on homes with no equity to which the mortgage will attach, knowing that they will gain an unfair advantage in bankruptcy.

CONCLUSION

For the foregoing reasons, the judgment of the bankruptcy court should be reversed and the opinion of the BAP should be affirmed. The matter should be remanded to the bankruptcy court to allow the debtor to propose an amended plan consistent with this Court's decision.

Respectfully Submitted,

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/s/ Craig W. Andresen

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I hereby certify that on this 8th day of December 2011 pursuant to 8th Cir. R. 25, I caused the foregoing brief to be served electronically on the following through the ECF System:

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