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LIEN-STRIPPING IN THE ABSENCE OF A DISCHARGE: BANKRUPTCY'S ANSWER TO THE DESTRUCTION CAUSED BY EXCESSIVE HOME EQUITY EXTRACTION

GREGORY J. GUEST*

I. INTRODUCTION: THE FOUNDATIONS OF A MORTGAGE CRISIS

There is still a tremendous amount of capacity for refinancing and an enormous amount of home equity available to be tapped People will have more spending power either from the cash taken out or from reduced mortgage payments, which will increase their discretionary spending capabilities.¹

But your home equity isn't free money that is just lying around, waiting for you to "tap" it. . . . In reality, your home equity is more like the "equity" in your grandmother's jewelry. . . . You realize it has some value, let's say \$1000 on the open market. But there is only one way you can have \$1000: Sell the jewelry. Sell it or keep it, but "tapping" is just a fiction.²

* JD, The John Marshall Law School, 2013; BA in Philosophy of Law, Lewis University, 2009. This Comment is dedicated to my wife, Elizabeth Guest, for all of the prayers, love, and encouragement throughout my time in law school. I also extend gratitude to my family for their support and to THE JOHN MARSHALL LAW REVIEW Editorial Board for its assistance in preparing this Comment for publication.

1. *Minutes of the Federal Open Market Committee Meeting on June 24-25, 2003*, BD. OF GOVERNORS OF THE FED. RES. SYS. 117 (June 24-25, 2003), <http://www.federalreserve.gov/monetarypolicy/files/FOMC20030625meeting.pdf>.

2. ELIZABETH WARREN & AMELIA WARREN TYAGI, ALL YOUR WORTH: THE ULTIMATE LIFETIME MONEY PLAN 151 (2006). Since the publishing of this work, Professor Warren served as the Chairman of the TARP Congressional Oversight Panel. Jody Kantor, *Behind Consumer Agency Idea, a Tireless Advocate*, N.Y. TIMES (Mar. 24, 2010), <http://www.nytimes.com/2010/03/25/business/25warren.html?pagewanted=1>. She was also a catalyst for the advent of the Consumer Financial Protection Bureau. Melanie Trottman, *Wall Street Critic Inspired New Consumer-Protection Agency*, WALL ST. J. (June 20, 2009), <http://online.wsj.com/article/SB124545888032233137.html>. Prof. Warren eventually served as a Special Advisor to the Secretary of the Treasury on the Bureau until August 2011. *Treasury Department Announces Plans for Leadership Transition at the Consumer Financial Protection Bureau*, CONSUMER FIN PROTECTION BUREAU (July 26, 2011), <http://www.consumerfinance.gov/pressrelease/treasury-department-announces-plans-for-leadership-transition-at-the-consumer-financial->

In September 2005, Alan Greenspan, then Chairman of the Federal Reserve Board, stated that homeowners had little to worry about regarding a potential drop in the housing market as long as they had sufficient value built up in their homes, referring to this value as an “equity cushion.”³ Unfortunately, some members of the financial sector began promoting and encouraging homeowners to extract the value from this equity cushion by taking out multiple mortgages and home equity lines of credit to often finance mere personal spending and other investments unrelated to the home.⁴ Chairman Greenspan and his colleague, James Kennedy, later attested to the fact that this practice of extracting the equity of one’s home accounted for eighty percent of the rise in mortgage debt between 1990 and 2007.⁵ In 2008, a heavy price was paid when this spending binge gave way to buy-outs, bailouts, and

protection-bureau/.

3. *Remarks by Chairman Alan Greenspan*, BD. OF GOVERNORS OF THE FED. RES. SYS. (Sept. 26, 2005), <http://www.federalreserve.gov/boarddocs/speeches/2005/200509262/default.htm>. San Francisco Federal Reserve Governor Susan Schmidt Bies was also known to refer to a cushion of equity in the same year, stating that most homeowners have more than enough value in their homes even considering a potential drop in the market. *Remarks by Governor Susan Schmidt Bies*, BD. OF GOVERNORS OF THE FED. RES. SYS. (Oct. 12, 2005), <http://www.federalreserve.gov/boarddocs/speeches/2005/200510122/default.htm>; see also, *Remarks by Governor Susan Schmidt Bies*, BD. OF GOVERNORS OF THE FED. RES. SYS. (Apr. 18, 2005), <http://www.federalreserve.gov/boarddocs/speeches/2005/20050418/default.htm> (admitting just six months prior that some Americans would be considerably less able to deal with the “shocks” that come with the rise and fall of the market as a result of the lack of equity in their homes, but attributing this to lower income and fewer financial assets).

4. See Ted Rechtshaffen, *Turn ‘Dead’ Money into New Wealth*, GLOBE AND MAIL (Sept. 17, 2010), <http://www.theglobeandmail.com/globe-investor/personal-finance/turn-dead-money-into-new-wealth/article1710487/> (arguing that the value of one’s home is “dead” money unless it is liquefied and utilized for other investments or personal expenses).

5. Alan Greenspan & James Kennedy, *Sources and Uses of Equity Extracted from Homes*, BD. OF GOVERNORS OF THE FED. RES. SYS. 2 (Mar. 2007), <http://www.federalreserve.gov/pubs/feds/2007/200720/200720pap.pdf>. The increase in real estate financing for secondary mortgages and home equity lines of credit notably quadrupled the increase in financing for the purchase of new homes, which constituted twenty percent of the increase in borrowing against one’s home. *Id.* What is also remarkable is that the cash that came out of homes was primarily used to pay down credit card debt, which according to surveys had built up from personal consumption expenditures. *Id.* Approximately \$530 billion were extracted from homes every year between 1991 and 2005. *Id.* at 9. Chairman Greenspan attested several years prior to the “frenetic pace” at which homeowners were extracting equity from their homes. Thomas A. Fogarty & Sue Kirchhoff, *Fed Chief: Home Prices May Vol, USA TODAY* (Mar. 4, 2003), http://www.usatoday.com/money/economy/fed/2003-03-04-gspan-housing_x.htm#.

massive bank failures.⁶

The current American bankruptcy system codified in the Bankruptcy Code (“the Code”) offers an answer to the crisis that developed in part as a result of the detrimental practice of excessive home equity extraction. Bankruptcy law has the potential to provide an efficient solution to the current mortgage foreclosure tragedy, as well as an incentive that will prevent future, similar calamities. Section II of this Comment introduces the concept of lien-stripping and outlines the various provisions of the Code that authorize its practice, even under the so-called “Chapter 20” case. Section III identifies the possible ambiguity within the Code caused by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (“BAPCPA”).⁷ BAPCPA has exposed two opposing schools of thought within the bankruptcy courts regarding the exact requirements to strip junior liens in “Chapter 20.” Section IV examines the advantages of one view as more conducive to the policies underlying bankruptcy, and proposes an amendment to the Code that would clean up the inconsistencies that currently prevent the system from operating at its full potential.

II. LIEN-STRIPPING IN A “CHAPTER 20” BANKRUPTCY

A. *Lien-Stripping: The Power to Modify Creditors’ Rights*

Chapter 7 and Chapter 13 of the Code are the primary avenues of relief for most individual debtors who file bankruptcy. Chapter 7 is for those eligible individuals intending to liquidate their nonexempt assets to satisfy a portion of the allowed claims against their estate. Chapter 13 is for those eligible individuals intending to retain possession of their nonexempt assets, and creates a payment plan for a period of three to five years under which the individual would pay disposable income payments to a trustee.⁸ After liquidation under Chapter 7, or the completion of a

6. See *TIMELINE: U.S. Financial Rescues, Failures in the Last Century*, REUTERS (Sept. 14, 2008), <http://uk.reuters.com/article/2008/09/14/us-lehman-rescues-idUSN1445176620080914> (outlining the various points in American history where financial institutions failed and required assistance from solvent private institutions or the federal government).

7. Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, 11 U.S.C. §§ 101-1329 (2011).

8. *Id.* §§ 109, 701-727, 1301-1330. Chapter 11 is also available to individual debtors whose income exceeds the limitation to qualify for Chapter 7 but lack the “regular income” required to make payments under a Chapter 13 Plan. *Id.* § 109. The Code defines an “individual with regular income” as someone whose income is “sufficiently stable and regular to enable such individual to make payments under a plan under Chapter 13” *Id.* § 101(30). Some courts have defined “sufficiently stable and regular” to exclude potential income to be received by the debtor pending the granting of a

plan under Chapter 13, an individual debtor is ordinarily entitled to a discharge of all eligible debts, which essentially voids all judgments against the debtor for personal liability for prepetition debts.⁹ Regardless of which chapter of the Code the petition is filed under, the general provisions of the Code, as well as those governing case administration, creditors, the debtor, and the estate, are applicable in every bankruptcy case.¹⁰

Chapter 5, in part, covers the rights and responsibilities of creditors as they make claims upon a debtor's estate, after the debtor files a petition.¹¹ Section 506 of the Code is the primary source for determining a creditor's status as secured or unsecured in bankruptcy.¹² It is a foundational concept of bankruptcy law that a secured creditor's claim against the estate is only secured to the extent of the value of the collateral.¹³ Any remainder of the claim above this value is unsecured.¹⁴ Essentially, the lien is said to be "stripped down" where it is held at the value of the collateral as of the date of the petition, regardless of whether the value of the collateral subsequently rises.¹⁵

Subsection (d) of § 506 states that a lien is void to the extent that it secures a claim that is not an "allowed secured claim."¹⁶ Although, when taken as a whole, § 506 seems to authorize lien-stripping of any secured debt down to the value of the collateral, the Supreme Court in *Dewsnup v. Timm* held that § 506 does not authorize Chapter 7 debtors to do so.¹⁷ Purportedly, the Court

professional license. *In re Spurlin*, 350 B.R. 716, 720 (W.D. La. 2006). Other courts have held that a small amount of relatively fortuitous periods of employment qualifies an individual as "an individual with regular income." See, e.g., *Matter of Cole*, 3 B.R. 346, 349 (S.D. W. Va. 1980) (holding that the debtor's skills were adequate enough to believe that he would continue to gain adequate "odd-job" employment throughout his Chapter 13 case).

9. 11 U.S.C. § 524(a)(1).

10. *Id.* § 103(a).

11. *Id.* §§ 501-511.

12. *Id.* § 506.

13. *Id.* § 506(a)(1). Where the debtor is in Chapters 7 or 13, the value of the collateral is its replacement value as of the date of the bankruptcy filing. *Id.* § 506(a)(2).

14. *Id.* § 506(a)(1). The rule works both ways as § 506(b) provides that where the value of the collateral exceeds the amount of a secured creditor's claim, the excess value justifies the accruing of interest and other costs and fees tacked on to the underlying debt. *Id.* § 506(b).

15. *In re King*, 290 B.R. 641, 645 (Bankr. C.D. Ill. 2003). Where a strip-down occurs, the creditor will likely recover even less, since the trustee in bankruptcy recovers from the value of the collateral any expenses incurred in holding it for the benefit of the estate and secured party. 11 U.S.C. § 506(c).

16. 11 U.S.C. § 506(d). This rule is subject to two exceptions: (1) it does not apply to any amount that has been disallowed as an unmatured debt, and (2) it does not apply to certain amounts that may be disallowed by the court as they fall under reimbursement or contribution. *Id.*

17. See *Dewsnup v. Timm*, 502 U.S. 410, 417 (1992) (clarifying that its

established this prohibition in order to preserve a common law “pre-Code” imperative that liens survive bankruptcy proceedings.¹⁸

Chapter 7 debtors, however, occasionally seek additional relief by subsequently filing under Chapter 13.¹⁹ This type of debtor is amusingly referred to as a “Chapter 20” debtor.²⁰ The “Chapter 20” debtor chooses to file under Chapter 13 after receiving a discharge under Chapter 7 in order to take advantage of the alternative relief offered by Chapter 13.²¹ Because a lien on the debtor’s home traditionally passes through Chapter 7 intact, the debtor might receive a discharge of personal liability in Chapter 7, but the creditor is thereafter permitted to proceed *in rem* with foreclosure in state court following the bankruptcy case. In a “Chapter 20,” the debtor simply files for bankruptcy again (this time in Chapter 13) and prepares a reorganization plan, which was unavailable under the prior Chapter 7 case.²² Although the personal liability under the mortgage has already been

interpretation of the statute applies only to the facts before it, which consisted of a Chapter 7 debtor seeking to strip an undersecured mortgage). The debtor here defaulted on a mortgage and filed for Chapter 11 relief before the secured party could foreclose on her property, and the bankruptcy court dismissed her Chapter 11 petition twice. *Id.* at 412-13. She then filed for Chapter 7 and asked that the court reduce the amount she owed on the note (\$120,000) to the fair market value of her home (\$39,000), but the court refused to do so. *Id.* at 413. Recognizing that no interpretation of § 506 would be satisfactory to all, the Court interpreted it to mean that the debtor could not strip down the mortgage because it was a lien that was “fully allowed” under § 502. *Id.* at 417. The Court declined however to extend the rule all situations. *Id.* at 416-17.

18. *Id.*

19. *Grandstaff v. Casey (In re Casey)*, 428 B.R. 519, 521 (Bankr. S.D. Cal. 2010).

20. *Id.*

21. *Johnson v. Home State Bank*, 501 U.S. 78, 82-83 (1991). In *Johnson*, when the debtor defaulted on loans secured by his farm, his creditor filed for foreclosure. *Id.* at 80. Before judgment was entered, the debtor filed for Chapter 7, which placed an automatic stay on the foreclosure proceeding. *Id.* The debtor was discharged from his personal liability to the amount owed and his non-exempt assets were liquidated. *Id.* After the case was closed, the automatic stay was lifted and the creditor proceeded to foreclose on the property *in rem*. *Id.* Before the foreclosure sale took place, the debtor filed for Chapter 13 and listed the foreclosing creditor’s mortgage as a claim to be addressed by the reorganization plan. *Id.* at 80-81. The creditor objected, claiming that the debtor could not address the claim in the plan because the debtor was personally relieved of any deficiency under the Chapter 7 discharge. *Id.* at 81. The bankruptcy court approved the plan over the objection, the district court reversed, and the court of appeals affirmed, based on the argument that no claim could be listed in the Chapter 13 because of the Chapter 7 discharge. *Id.* Examining the definition of a “claim” in § 101 of the Code, the Supreme Court reversed, holding that the mortgage interest that survives a discharge is a claim that can be listed in the reorganization plan. *Id.* at 84.

22. *Id.* at 82.

eliminated as a result of the prior discharge, the debtor is nevertheless entitled to list the mortgage as a “claim” against the estate under the Chapter 13 reorganization plan.²³ Thus, where the debtor files for Chapter 13 after receiving the Chapter 7 discharge, that debtor opens up a door to further relief in the form of a reorganization plan in which the mortgage would be listed.²⁴ This allows the debtor to avoid foreclosure where a mere Chapter 7 discharge would be insufficient to do so.²⁵

Under Chapter 13, the debtor can now bypass the restriction that *Dewsnup* placed on § 506 of the Code by taking shelter under § 1322. Section 1322(b)(2) provides that under a reorganization plan, a debtor may “modify” the rights of any of its creditors, secured or unsecured, except for the rights of a creditor secured only by a mortgage on the debtor’s home (the antimodification clause).²⁶ The Supreme Court affirmed the understanding of this exception in *Nobelman v. American Savings Bank* when it prohibited a Chapter 13 debtor from using §§ 506 and 1322 to strip down a mortgage that was undersecured, i.e., one under which the debtor owed more than the value of the home.²⁷ The Court focused in on the fact that § 1322 refers to modifying the “rights” of creditors.²⁸ Where a creditor has a claim that is undersecured, that creditor is still a “holder of a secured claim” under § 1322(b)(2), and the debtor cannot affect that creditor’s rights.²⁹

Thus, the rule was firm in regards to stripping liens of secured and even undersecured home mortgage creditors in Chapter 13. But the question still remained: What if there was no value left in the collateral? This occurs commonly where the claim secured is under a mortgage that constitutes a junior lien, and the value of the collateral is completely absorbed by multiple senior liens or a single undersecured senior lien.³⁰

In *Pond v. Farm Specialist Realty*, the Second Circuit faced just such a scenario.³¹ Farm Specialist Realty had a \$10,630.58 mortgage lien on the debtor’s property, but was fourth in priority behind a \$1,505.18 property tax lien, and two other mortgages totaling \$68,995.63.³² The value of the debtor’s home was \$69,000, and yet the value of the first three liens on it aggregated beyond

23. *Id.* at 84.

24. *Id.* at 83-84.

25. *Id.* at 87. It also allows the debtor to pay down any arrearage on the mortgage loan that has accrued since the debtor fell behind on mortgage payments. 11 U.S.C. § 1322(b)(5).

26. *Id.* § 1322.

27. *Nobelman v. Am. Sav. Bank*, 508 U.S. 324, 332 (1993).

28. *Id.* at 328.

29. *Id.* at 328-29.

30. *In re Tran*, 431 B.R. 230, 234 (Bankr. N.D. Cal. 2010).

31. *Pond v. Farm Specialist Realty*, 252 F.3d 122 (2d Cir. 2001).

32. *Id.* at 123-24.

\$70,000.³³ Because the value of the property was insufficient to satisfy the creditor's mortgage, the court allowed the plan to strip it from the home completely.³⁴ Accordingly, other circuits followed the same logic, including the Third,³⁵ Fifth,³⁶ Sixth,³⁷ and Eleventh

33. *Id.*

34. *Id.* at 127.

35. *McDonald v. Master Fin., Inc.*, 205 F.3d 606 (3d Cir. 2000). In *McDonald*, there was a dispute between the debtor and the creditor as to the value of the home, but even upon the debtor's allegation, the home only held about \$1200 less than the amount owed on a senior mortgage. *Id.* at 608. The court pointed out that Justice Thomas's opinion in *Nobelman* focused on the fact that the lien in question still attached to something, and thus it was secured, albeit undersecured. *Id.* at 611. But in *McDonald*, this was obviously not the case, as the creditor's lien was entitled to none of the value in the property. *Id.* at 614. For this reason, the court held that the creditor's lien on the farm was not covered by the antimodification clause, i.e., the debtor could "modify" the creditor's rights under § 1322(b)(2) within his Chapter 13 reorganization plan, even to the point of stripping the wholly unsecured mortgage. *Id.* at 615.

36. *Bartee v. Tara Colony Homeowners Ass'n*, 212 F.3d 277 (5th Cir. 2000). In *Bartee*, the bankruptcy court sustained the creditor's objection to the debtor's lien-stripping plan. *Id.* at 280. A senior lien was greater than \$88,000, while the debtor's home was only worth \$87,000. *Id.* at 281. The secured party in the case was the debtor's homeowners association, which claimed an amount of uncollected assessments secured by a lien on the debtor's home. *Id.* Under Texas state law, there was a statutory lien for homeowners association's claims for assessments. *Id.* at 284. The debtor wished to strip down the lien and effectively make the homeowners association an unsecured creditor, and the association objected. *Id.* at 281. The association claimed that since *Nobelman*'s holding was based on the rights of particular creditors rather than the amount secured under their liens, there was no merit in looking to the fact that the collateral had no value to support its lien. *Id.* at 287-88. However, the court disagreed, noting that the value in the home was key, and because the lien was "unsupported by any value in the residence after satisfaction of the first mortgage" it held the association's lien unsecured. *Id.* at 291.

37. *Lane v. Interstate Bancorp*, 280 F.3d 663, 669 (6th Cir. 2002). In *Lane*, the debtors had taken out two mortgages one year apart. *Id.* at 665. Two years later, they filed for relief under Chapter 13. *Id.* The parties agreed that the value of the home was less than the amount owed on the senior mortgage. *Id.* The court thus characterized the creditor's junior mortgage as "totally under water," as opposed to the *Nobelman* situation of "partially under water." *Id.* at 664. Just like in *Bartee*, the bankruptcy court and district court in *Lane* both applied the minority view, and accepted the creditor's objection to a plan that would treat the creditor as unsecured and strip the mortgage. *Id.* at 665. Noting that the terms "secured claim" and "unsecured claim" are terms of art, the court of appeals criticized the lower court's minority view, which treated the differently a creditor who obtained security and one that never did. *Id.* at 668. The court went on to find that Congress intended to distinguish between claims that are secured to value in some sort of collateral and those claims not attached to collateral. *Id.* The court, thus, approached the question of whether the antimodification clause applied as related to whether the debtor's home has "economic value." *Id.* at 664. Accordingly, the district court was reversed, and the case was remanded to conform to an interpretation of § 1322(b)(2)

Circuits.³⁸

B. The Impact of BAPCPA

Although the concept of lien-stripping was essentially universal, the process by which courts went about stripping liens varied. In one view, the strip is allowed within the process of confirming the debtor's Chapter 13 plan.³⁹ In another view, the lien is stripped within an adversary proceeding.⁴⁰ Either way, one requirement consistently applied is notice, meaning that a wholly undersecured junior lien-holder must be notified by name within the debtor's Chapter 13 plan that its lien will be stripped due to

consistent with the intent of Congress. *Id.* at 669.

38. *Tanner v. FirstPlus Fin., Inc.*, 217 F.3d 1357, 1360 (11th Cir. 2000). In *Tanner*, a debtor financed the purchase of her home entirely by a mortgage loan in the amount of \$62,000. *Id.* at 1357. Less than a year later, she obtained a loan from a creditor in the amount of \$23,000. *Id.* at 1357-58. At the time of her Chapter 13 filing, the home was worth \$622,000. *Id.* at 1358. The court bifurcated a creditor's claim to a secured home mortgage under § 506(a), and then protected the secured portion under § 1322(b)(2)'s antimodification clause. *Id.* at 1360. Where the bifurcation produces only an unsecured claim, then the creditor is not entitled to protection under the antimodification clause, and the debtor may accordingly treat the claim as it would any other unsecured claim in her reorganization plan. *Id.* The court also noted that had the creditor's approach been taken, the lien been protected and the property sold to satisfy all of the secured interests attached, the debtor would still receive nothing. *Id.* Thus the lien-stripping approach is the more practical of the two. *See Lam v. Investors Thrift*, 211 B.R. 36, 40 (B.A.P. 9th Cir. 1997) (noting if there is no security in the collateral left to satisfy the lien, there is nothing to preserve the creditor's rights), *appeal dismissed*, 192 F.3d 1309 (9th Cir. 1999).

39. *See In re Black*, No. 01-11520, 2002 Bankr. LEXIS 1752, at *6 (Bankr. N.D. Ind. Sept. 23, 2002) (confirming the debtor's confirmation plan over creditor's objection that the plan strip's its wholly undersecured lien on the debtor's home). In *Black*, the creditor was third in priority. *Id.* at *1. The value of the home was insufficient to support the mortgage, and thus the debtor sought to remove it in his Chapter 13 plan. *Id.* The court ordered the plan affirmed, ruling that the lien had no value, the creditor was unsecured, and thus the debtor could modify the creditor's rights pursuant to § 1322(b)(2). *Id.* at *6.

40. *See Waters v. Money Store*, 276 B.R. 879, 888 (Bankr. N.D. Ill. 2002) (allowing the avoidance of a wholly undersecured junior mortgage under the debtor's already-confirmed plan to be contingent on the debtor completing the plan, and dismissing the case if not consummate with the plan). Such a proceeding would be an "adversary proceeding" under Bankruptcy Rule 7001(2). FED. R. BANKR. P. 7001(2). In *Waters*, the debtor's property was worth \$87,000 around the time of the Chapter 13 filing. 276 B.R. at 880. The senior lien holder held a mortgage securing a claim of \$92,361.99. *Id.* Behind another junior lienholder, a creditor had a claim of \$3,999.52. *Id.* at 880-81. The court ruled that the *Nobelman* holding applied to the undersecured senior lien. *Id.* at 883. The wholly unsecured junior lien, however, was subject to the plan under which the debtor could modify the creditor's rights pursuant to § 1322(b)(2). *Id.* at 888.

the insufficiency in the value of the collateral.⁴¹

Of primary import is the practice of some courts that integrate the completion of the lien-strip with the timing of the discharge, upon the completion of the debtor's reorganization plan.⁴² While this requirement may appear to be harmless on its face, in the case of a "Chapter 20" debtor, it becomes considerably more onerous. The courts following this line of reasoning place emphasis on the timing, meaning that a "Chapter 20" debtor is required to obtain a discharge upon the completion of the Chapter 13 plan in order to effectuate a lien-strip, even though the debtor had already been discharged of personal liability in Chapter 7.⁴³ Initially, this requirement had little impact upon the process. Discharge is one of the available methods of relief within Chapter 13, so debtors would accordingly have little trouble qualifying for a discharge in Chapter 13.⁴⁴ But, a problem arose with the passing of BAPCPA.⁴⁵

BAPCPA was created with the intention to make filing for bankruptcy more difficult for individuals.⁴⁶ The most significant

41. *In re Zimmerman*, 276 B.R. 598, 603 (Bankr. C.D. Ill. 2001). In *Zimmerman*, the debtors objected to a claim filed by one of its creditors. *Id.* at 600. Although the lien here was merely a purchase money security interest in a vacuum, the case stands for the important lien-stripping principle that where the Chapter 13 plan does not provide for the lien, the lien passes through bankruptcy without being stripped regardless of the value of the collateral. *Id.* at 603. After the court lifts the automatic stay, the creditor could then foreclose on the property. *Id.* Thus, the plan must at the very least acknowledge the existence of the interest, and propose some sort of treatment. *Id.* Additionally, where the debtor seeks to strip the lien, the plan should explain why the lien should be stripped. *Id.* For example, the plan should explain that the collateral has been destroyed or significantly depreciated, or as in most of these cases, the value of the property is completely absorbed by a senior lien. *Id.* The debtor's plan here failed to provide in some way for the creditor's lien. *Id.* at 604. Thus, the court denied the debtor's claim. *Id.* at 606.

42. *In re Stroud*, 219 B.R. 388, 390 (Bankr. M.D.N.C. 1997). *Stroud* is an example of a stripping of a judicial lien. *Id.* at 389. Here, General Motors Acceptance Corporation (GMAC) won a judgment in a suit against the debtor. *Id.* A lien was placed on the debtor's home to secure the judgment. *Id.* The debtor's Chapter 13 plan did not list the lien as a secured claim, but rather treated it as an unsecured claim. *Id.* The debtor moved to avoid and cancel the lien to effectuate the treatment given under the plan. *Id.* The court, however, held that the debtor would need to complete the plan in order to avoid the lien, and if the property were sold prior to the completion of the plan, the proceeds from the sale would be held in escrow, so that GMAC could recover from the proceeds should the debtor fail to complete the plan. *Id.* at 391.

43. *In re Jarvis*, 390 B.R. 600, 604 (Bankr. C.D. Ill. 2008).

44. *Id.*

45. *Id.*

46. *Opening Statement Sen. Chuck Grassley at the Bankruptcy Reform Hearing*, GRASSLEY.SENATE.GOV (Feb. 10, 2005), http://grassley.senate.gov/news/Article.cfm?customel_dataPageID_1502=9716. The original BAPCPA Bill, passed in 2000, was not signed by President Clinton, amounting to a pocket veto and setting the Bill on the "back burner."

change enacted by the legislation was the “means test,” under which a filing debtor’s income would be carefully scrutinized to ensure it met rigid standards.⁴⁷ Debtors who do not qualify may be presumed to be abusing the system, and may be subject to dismissal or transfer to Chapter 13.⁴⁸

A significant restriction that the Act put into place deals with repeat filings.⁴⁹ Before BAPCPA, there was no restriction on “Chapter 20” debtors to obtain a Chapter 13 discharge after having been discharged in Chapter 7.⁵⁰ Thus, the requirement by some courts to obtain a subsequent discharge was no significant obstacle.⁵¹ The “Chapter 20” debtor would complete the reorganization plan, and most often receive a discharge under Chapter 13.⁵² BAPCPA changed this by adding § 1328(f), which states that a court cannot grant a discharge in Chapter 13 within four years of granting a discharge in Chapter 7.⁵³

If the stripping of a lien is, as some courts require, contingent upon the debtor receiving a discharge after the completion of the reorganization plan, then § 1328(f) fundamentally alters the ability to strip liens in “Chapter 20.”⁵⁴ The question of the availability of lien-stripping for these “Chapter 20” debtors is, thus, an ardently disputed topic among bankruptcy courts, and the

because the congressional session ended soon afterward. *Id.* Clinton apparently believed the Bill was unfair and “badly flawed.” Deb Riechmann, *Clinton Vetoes Bankruptcy Bill*, LUBBOCKONLINE (Dec. 19, 2000), http://lubbockonline.com/stories/121900/upd_075-5725.shtml. Senator Grassley, in his 2005 statement, claimed as support for his Bankruptcy Reform Bill that in the 1990s it was feared that the number of bankruptcy filings would rise to 1.4 million and yet by 2004 the number of filings had risen to 1.6 million. *Opening Statement Sen. Chuck Grassley at the Bankruptcy Reform Hearing, supra.* As is discussed in Section III of this Comment, Senator Grassley purports that BAPCPA is geared towards making it more difficult for “high rollers who gain the current system” to file for bankruptcy. *Id.* Professionals involved with the system have stated otherwise. See Robert M. Lawless et al., *Did Bankruptcy Reform Fail? An Empirical Study of Consumer Debtors*, 82 AM. BANKR. L.J. 349, 353 (2008) (suggesting that more than any effect of targeting high-income debtors, BAPCPA gave creditors a stronger ability to affect the circumstances of all creditors).

47. Jeanne Sahadi, *The New Bankruptcy Law and You*, CNN MONEY (Oct. 17, 2005), http://money.cnn.com/2005/10/17/pf/debt/bankruptcy_law/index.htm. BAPCPA also requires debtors to meet for ninety minutes for credit counseling within the six months prior to the bankruptcy filing. *Id.*

48. *Id.*

49. See 11 U.S.C. § 727(a)(8) (2011) (requiring that the court refuse to grant a discharge under Chapter 7 where the debtor had received a discharge within the eight years prior).

50. *In re Jarvis*, 390 B.R. at 604.

51. *Id.*

52. *Id.*

53. 11 U.S.C. § 1328(f).

54. Peenesh Shah, *Post-BAPCPA Availability of Lien-Stripping to a Chapter 20 Debtor*, 85 AM. BANKR. L.J. 161, 162 (2011).

answer could potentially reduce the incentive to extract home equity.

III. ANALYSIS

The issue of whether a discharge is required in order to give effect to a lien-strip is a starkly contested matter facing bankruptcy courts today.⁵⁵ Currently, the result of a bankruptcy is unclear for a debtor facing numerous mortgages that are partially or completely underwater. The debtor could lose his home despite an attempt to take every available shelter the Code allows.⁵⁶ Chapter 13 exists to protect the debtor from this fate, regardless of the availability of a discharge. The tension between these two sides of the lien-strip dispute is further agitated by the ambiguity infused into the law by BAPCPA.⁵⁷ Various arguments posited by the courts can be found on both sides of the dispute. Examining their application will expose the reality that while some resolution may be achieved, more drastic measures are required to truly resolve this question and restore sanity to the currently precarious nature of financing against one's home.

A. In re King and Courts Requiring a Discharge

When the Second Circuit allowed the debtor in *Pond* to strip off its creditor's completely undersecured mortgage, the court made a bold move.⁵⁸ All of the circuits that followed the same logic in distinguishing *Nobelman* from the facts before them entered into an area of the law that had been left uncharted by the Supreme Court.⁵⁹ But to take the issue one step further, it is unclear how these courts would have ruled had § 1328(f) been in force at the time.

In re King is a pre-BAPCPA case that touches upon the issue of a subsequent discharge under "Chapter 20" and whether one is

55. David P. Leibowitz, *Can a Fully Unsecured Lien Be Stripped in Chapter 13 Without Discharge?*, AM. BANKR. INST. J., July-Aug. 2011, at 30.

56. See e.g., *King*, 290 B.R. at 643 (noting that the junior creditor's motive for moving to modify the automatic stay was to allow the junior creditor to foreclose on the property before the close of the case).

57. 11 U.S.C. §§ 101-1329.

58. See *Pond*, 252 F.3d at 125 (noting how the Supreme Court in *Nobelman* essentially left discussion of wholly undersecured liens open and declined to rule on it). Other cases are similar. See *McDonald*, 205 F.3d at 611 (acknowledging that there is some ambiguity in *Nobelman*'s language, and thus, the idea that a wholly unsecured mortgage escapes § 1322(b)(2)'s antimodification clause is within its holding); *Bartee*, 212 F.3d at 287 (noting that Justice Thomas, in writing the opinion for the majority in *Nobelman*, advised the reader that its holding should not be interpreted as preventing the debtor from modifying the creditor's rights).

59. *Pond*, 252 F.3d at 125.

required to strip an unsecured mortgage.⁶⁰ In *King*, the debtors filed under Chapter 13, converted to a Chapter 7, and received a discharge.⁶¹ Several months later they filed under Chapter 13 and created a reorganization plan.⁶² They valued their home at \$38,000, and scheduled their first mortgage at \$40,000 and their second mortgage at \$48,000.⁶³ Their proposed plan was to satisfy any arrearage and continue making payments under the first mortgage loan, but to strip off the second mortgage completely.⁶⁴ The junior creditor failed to appear and object to the confirmation of the plan, but later submitted a claim with instructions on post-petition mortgage payments.⁶⁵

The debtors objected to this, arguing that the plan was confirmed without objection, that the mortgage was stripped during the plan confirmation hearing, and that the creditor was in effect now unsecured.⁶⁶ The creditor filed a motion to modify the automatic stay so that it might foreclose on the property, arguing among other things that *Nobelman* prohibits the strip, and that a confirmation of the plan in and of itself is not sufficient to strip a lien.⁶⁷

The court first noted that the strip was not prohibited under *Nobelman*, citing that many circuits, including the Second Circuit in *Pond*, have allowed a strip where there is no value left in the property to cover the junior mortgage.⁶⁸ Then it addressed the creditor's arguments regarding whether the confirmation of the plan was sufficient to strip the mortgage.⁶⁹ The creditor argued that case law interpreting the Code requires an adversary proceeding to consider evidence on the value of the home in order to strip a lien.⁷⁰ The court rejected the creditor's arguments as being unsupported by law,⁷¹ but held that proper notice is required within the proposed confirmation plan.⁷² Because the plan had specifically addressed the creditor's interest and proposed that it be stripped, the plan provided proper notice.⁷³ Accordingly, the creditor's motion to modify the automatic stay was denied.⁷⁴

60. *King*, 290 B.R. at 651.

61. *Id.* at 643.

62. *Id.* at 644.

63. *Id.*

64. *Id.*

65. *Id.* at 644-45.

66. *Id.* at 645.

67. *Id.*

68. *Id.* at 646.

69. *Id.*

70. *Id.* at 645.

71. *Id.* at 647.

72. *Id.* at 648-49.

73. *Id.* at 650.

74. *Id.* at 651.

Recall that *King* was decided two years before BAPCPA was passed.⁷⁵ Thus, although it dealt with the requirements to strip a lien in “Chapter 20”, the *King* court was not operating within the confines of § 1328(f).⁷⁶ Subsequent post-BAPCPA cases, however, look to *King* as persuasive authority in interpreting § 1328(f) and in forming the requirements for stripping liens in Chapter 13.⁷⁷ One in particular is *In re Jarvis*, which was decided by the same court as *King*.⁷⁸

In *Jarvis*, the court addressed the issues surrounding the hearing for confirmation of the debtor’s Chapter 13 plan.⁷⁹ The debtor had filed for Chapter 13 approximately seven months after receiving a discharge in Chapter 7.⁸⁰ The debtor’s home was worth \$66,700, and there were two mortgages scheduled in the petition, one securing \$70,677 of debt and the other securing \$8,720.⁸¹ The debtor’s proposed plan offered to make payments to the first mortgagee and to a secured creditor with an interest in the debtor’s vehicle.⁸² Since the amount owed on the first mortgage completely consumed the value of the home, the debtor’s plan proposed to strip the second mortgage and treat it as unsecured.⁸³

The court, however, denied confirmation of the plan.⁸⁴ Looking back to its decision in *King*, the court concluded that the strip of a lien is contingent upon the debtor receiving a discharge order following completion of the plan.⁸⁵ Here, § 1328(f)(1) prohibited such a discharge, as the debtor had already received a discharge within the four years prior to the date upon which the debtor anticipated completing his Chapter 13 plan.⁸⁶ Therefore, the court concluded that because it would be unable to order a discharge at the completion of the plan, it could not approve the

75. *Id.* at 641. This point is admitted by the subsequent post-BAPCPA courts that use *King* as precedent to require a subsequent discharge to strip a lien. *Jarvis*, 390 B.R. at 604.

76. 11 U.S.C. § 1328(f).

77. *See Jarvis*, 390 B.R. at 604 (deferring to the dicta in *King* stating that if the debtor does not finish the plan and get a discharge, then the strip effectuated as of the confirmation of the plan would be ineffective and the lien would pass through bankruptcy); *In re Fenn*, 428 B.R. 494, 500 (Bankr. N.D. Ill. 2010) (citing to *King* when holding that lien avoidance occurs at discharge); *In re Mendoza*, 2010 Bankr. LEXIS 664, *9 (Bankr. D. Colo. Jan. 21, 2010) (citing to *King* through *Jarvis* to obtain the rule that permanent modification of a secured creditor’s rights is contingent upon discharge after completion of the reorganization plan).

78. *Jarvis*, 390 B.R. at 604.

79. *Id.* at 601.

80. *Id.*

81. *Id.* at 601-02.

82. *Id.* at 602.

83. *Id.*

84. *Id.* at 601.

85. *Id.* at 604.

86. *Id.* at 601.

lien strip, and thus denied confirmation.⁸⁷

In holding that the debtor was ineligible for a lien-strip because he was ineligible for a discharge, the court adopted the view that allowing the strip would be an expansion of the debtor's rights, which Congress could not have intended when it implemented § 1328(f).⁸⁸ This view has been held by other courts for the same reason.⁸⁹ Under similar facts in *In re Fenn*, the Bankruptcy Court for the Northern District of Illinois noted that § 1325(a)(5) of the Code was of primary concern to the debtor.⁹⁰ Section 1325 requires among other things that in order for a court to confirm a plan, the plan must provide for "each allowed secured claim" in one of three ways.⁹¹ One way includes allowing the holder of such a claim to retain its interest until either the debt is paid off or the debtor obtains a discharge.⁹² Accordingly, the court thus held that because § 1328(f) prohibited the latter discharge, the debtor could only remove the mortgage by satisfying the underlying debt.⁹³

B. Hill and the Lien-Stripping Courts

In contrast, several courts have followed the view that a discharge upon completion of the plan is irrelevant to the strip, including the court in *In re Hill*.⁹⁴ In *Hill*, the court acknowledged the consistent use by a number of courts of the *Jarvis* line of

87. *Id.* at 607. The court in *Jarvis* also looked to *In re Lilly*, 378 B.R. 232 (Bankr. C.D. Ill. 2007), to determine the requirement of a discharge upon completion of a Chapter 13 plan where the debtor sought to some way modify a secured creditor's rights. *Jarvis*, 390 B.R. at 605. In *Lilly*, the creditor held a claim to the debtor's vehicle. *Lilly*, 378 B.R. at 233. The debtor did not dispute that the claim was actually secured. *Id.* Rather, the debtor sought to modify the creditor's rights by altering the post-petition interest rate at which the claim was accruing. *Id.* The contract rate of interest was 17.95% but the debtor sought to pay the claim at 10.5% under the reorganization plan. *Id.* at 234. The creditor objected. *Id.* at 233. The court, thus, had to determine whether § 1325(a)(5)(B)(i)(I) prevented the debtor from doing this, as subsection (B)(i)(I) required that a plan provide that the creditor hold the lien until it is paid off or discharged. *Id.* at 234. The creditor argued that a correct construction of this section results in a retention of the contract rate of interest. *Id.* at 235. The court disagreed, stating that the debtor could modify the interest rate under § 1325, provided that the debtor receive a discharge upon completing the plan. *Id.* at 235-36.

88. *Jarvis*, 390 B.R. at 605-06.

89. *See Fenn*, 428 B. R. at 503 (noting that Congress did not have the intention of expanding debtors' rights).

90. *Id.* at 500; *see also* 11 U.S.C. § 1325(a)(5) (2011) (pointing to the debtor's acceptance of the plan and retention of the lien; *Fenn*, 428 B.R. at 502 (explaining that this section of the Code was added through BAPCPA).

91. 11 U.S.C. § 1325(a)(5)(B)(i)(I).

92. *Id.*

93. *Fenn*, 428 B.R. at 500.

94. *In re Hill*, 440 B.R. 176, 181-82 (2010).

reasoning, but believed that the requirements for a lien-strip tie more into the Code's rules on the sufficiency of a reorganization plan, instead of the rules regarding the availability of a discharge.⁹⁵ The court deferred to the logic established in *Johnson v. Home State Bank*, in which the Supreme Court acknowledged that a "Chapter 20" debtor, upon filing for Chapter 13 to create a reorganization plan, has already obtained a discharge of his personal liability to the debt.⁹⁶ The Hill court, thus, saw the requirement of any subsequent discharge as being "redundant."⁹⁷

In re Tran is another leading case on the issue of "Chapter 20" lien-stripping without the requirement of a subsequent discharge.⁹⁸ In *Tran*, the court additionally looked to § 109, which examines who is eligible to be a debtor.⁹⁹ The court noted that nowhere in this section is a debtor's eligibility for relief under Chapter 13 contingent upon the debtor's eligibility for a discharge.¹⁰⁰ Additionally, the court noted that § 1325 does not mention any requirement that the debtor be qualified for a discharge in order for the court to confirm the debtor's proposed plan.¹⁰¹

The court also made a distinction between the reinstatement of a lien where a case is dismissed pursuant to § 349(b)(1)(C), and the completion of a confirmed plan where a case is considered closed.¹⁰² These considerations are the principal statutory constructions used to evince an understanding of the Code that allows for lien-stripping even absent the availability of a subsequent discharge like in a "Chapter 20" case.¹⁰³

95. *Id.*

96. *Johnson*, 501 U.S. at 82-83.

97. *Hill*, 440 B.R. at 182.

98. *In re Tran*, 431 B.R. 230, 235 (Bankr. N.D. Cal. 2010).

99. *Id.* at 235; 11 U.S.C. § 109.

100. *Tran*, 431 B.R. at 235.

101. *Id.* It is interesting to note what the court intends by this statement. Section 1325 does require that a plan provide for a discharge pursuant to § 1328 for the plan to be confirmed under § 1325(a)(5)(B). § 1325(a)(5)(B)(i)(I)(bb). The court seems to bypass this by emphasizing subsection (II) of § 1325(a)(5)(B)(i), which only provides for the reinstatement of a stripped lien where the case is dismissed without the completion of the plan. *Tran*, 431 B.R. at 235.

102. *Id.*

103. It is also commonly held that there is no clear language in the Code regarding the availability of a discharge as a condition to obtaining a lien strip. *Hart v. San Diego Credit Union*, 449 B.R. 783, 792-93 (S.D. Cal. 2010). In *Hart*, the District Court for the Southern District of California reviewed an order of the bankruptcy court conditioning the debtors' lien avoidance motion on the receipt of a discharge. *Id.* at 784. The debtors had previously received a discharge in Chapter 7. *Id.* at 785. In Chapter 13, the trustee objected to the proposed Chapter 13 reorganization plan, which led to a hearing. *Id.* at 784-85. However, before the hearing was held the debtors moved to avoid a junior lien that was completely undersecured, and scheduled a separate hearing

C. Good Faith as the “Chapter 20” Gatekeeper

Some bankruptcy professionals propose that the only meaningful restriction on lien-stripping, even where a discharge is unavailable, is the requirement that the Chapter 13 petition be filed in good faith.¹⁰⁴ In fact, the court has a duty to raise *sua sponte* the issue of good faith where needed.¹⁰⁵ For example, in *Tran*, the court noted that its own holding regarding the irrelevance of the debtor’s eligibility for a subsequent discharge

beyond the hearing for the trustee’s objection. *Id.* at 785. The court ordered a continuance since notice was defective, and at the later hearing, the court struggled to reconcile the debtor’s motion with the rationale in *Dewsnup*, as the debtors would have been unable to obtain the avoidance if they were still in Chapter 7. *Id.* The bankruptcy court eventually granted the motion, but prohibited the avoidance on the basis of § 506(d), and rather allowed it under § 1322(b)(2). *Id.* In doing so, the court also required that the plan be completed and a subsequent discharge be obtained in order to avoid the lien. *Id.* The debtors appealed to the district court to determine whether the bankruptcy court erred in refusing to use § 506 to strip the lien, whether the requirement of a discharge was in error, and whether § 1322(b)(2) could be used to avoid liens in the first place. *Id.* at 786. The mortgagee relied substantially on the holding and ratio given by *Jarvis*. *Id.* at 790. The district court answered by distinguishing the facts from those in *Jarvis*, noting that *Jarvis* ruled the way it did based on the precedent set by *King*. *Id.* at 792. The court noted that California had no *King* of its own, and thus was free to decide whether it believed the debtor still had the right to avoid the lien under § 1328(f). *Id.* The court, thus, reversed the order granted by the bankruptcy court, holding that the debtors could avoid and strip the lien pursuant to § 506 in Chapter 13, and that the avoidance was good upon confirmation of the plan, not upon a subsequent discharge after the completion of the plan. *Id.* at 792-93.

104. See Leibowitz, *supra* note 55, at 71 (claiming “[t]he issue is not whether there is a discharge; it is whether the debtor has acted in good faith”). Mr. Leibowitz suggests the current trend is that courts are increasingly approving “Chapter 20” lien-strips, and as long as this continues, the “next wave” of suits will be geared toward and centered on this requirement of good faith. *Id.* at 30. He divides the discharge-requiring cases into two camps, those that prohibit lien-stripping on the basis of § 1328(f), and those that do so on the belief that it violates the principle laid down in *Dewsnup*, that a debtor may not strip liens in Chapter 7. *Id.* Mr. Leibowitz, opposing both camps, asserts that § 1328 is not as applicable as these cases assume, because it does not refer to liens at all. *Id.* He believes rather that lien-stripping is a relief far more complex than mere discharge, and thus, it is not covered by § 1328(f). *Id.* Instead, the process of lien-stripping is and always was based on a balance between §§ 506 and 1322(b)(2). *Id.* On the other hand, Mr. Shah argues that the unavailability of the discharge is dispositive on the issue. Shah, *supra* note 54, at 176. Mr. Shah bases his argument on a combination of looking at the Code as a whole, using basic rules of statutory construction, and deferring to the reasoning in *Dewsnup*. *Id.* Where *Dewsnup* construed the language of “allowed secured claim” in § 506(d) to essentially mean an allowed claim that was at least at one point secured, the same construction should be applied to the same term in § 1325(a)(5). *Id.*

105. See *Hill*, 440 B.R. at 184 (holding that the court has an “independent duty” to ensure that the good faith requirements of § 1325 are met before confirming the plan).

was not dispositive to its analysis of the debtor's eligibility for a lien-strip.¹⁰⁶ It also noticed that the debtor's plan intended to cure very little of the arrearages owed to the secured parties, and that there were no tax liens or other unsecured debt under the plan.¹⁰⁷ Additionally, the court noted that the debtor was actually legally solvent.¹⁰⁸ For these reasons, the court found the debtor's Chapter 13 petition was nothing short of a bad faith attempt to bypass *Dewsnup*'s prohibition of lien-strips in Chapter 7.¹⁰⁹

In contrast, *Hill* decided another way. The court compared and distinguished the circumstances surrounding the Hills's Chapter 13 petition to those of the debtor in *Tran*.¹¹⁰ The Court noted first that the debtors were insolvent and that Mr. Hill was unemployed until shortly before the Chapter 13 petition was filed.¹¹¹ Upon noting the liberality in the plan, which sought to satisfy student loans, \$18,000 on the senior mortgage on their home, and taxes, the court found that the Hills had substantively acted in good faith in their Chapter 13 petition and proposed reorganization plan.¹¹² The court held that they acted in good faith in filing the Chapter 13 petition, and accordingly allowed the completely unsecured mortgage to be stripped.¹¹³ Good faith, thus, became the prime standard with which cases like *Hill* and *Tran* police a "Chapter 20" debtor's eligibility for stripping a completely undersecured lien rather than the requirement of a subsequent

106. *Tran*, 431 B.R. at 237. The definition of good faith, like most areas of the law, is difficult under § 1325 as well. *Deans v. O'Donnell*, 692 F.2d 968, 972 (4th Cir. 1982). A general test has been to determine whether the debtor appears to be attempting an "abuse of the provisions, purpose, or spirit of the chapter in the proposal." *Kitchens v. GA R.R. Bank and Trust Co.*, 702 F.2d 885, 888 (11th Cir. 1983). Additionally, there is sometimes a distinction made between filing a Chapter 13 petition in good faith, and proposing a Chapter 13 reorganization plan in good faith. See *In re Love*, 957 F.2d 1350, 1354 (7th Cir. 1992) (noting the two separate good faith analyses required of the court in a Chapter 13 case). One analysis is required to file the petition in the first place, and the other is required to determine the confirmation of the debtor's proposed reorganization plan). *Id.* The Seventh Circuit in *Love* made the distinction that under the former analysis, the consequences can be far more drastic to the debtor. *Id.* Where the court finds a lack of good faith in the filing of a Chapter 13 petition, the entire case can be dismissed and terminated, or even converted to a Chapter 7 proceeding, under which the debtor would be unable to restructure his debt. *Id.* On the other hand, where a lack of good faith is found in the proposal of a reorganization plan, the court could still dismiss, but is more likely to merely deny confirmation of the plan. *Id.*

107. *Id.* at 238.

108. *Id.*

109. *Id.* Because the debtor could not strip the lien in Chapter 7, the court reasoned she filed the Chapter 13 petition for the overwhelming purpose of accomplishing what she could not in Chapter 7. *Id.*

110. *Hill*, 440 B.R. at 184.

111. *Id.*

112. *Id.*

113. *Id.*

discharge.¹¹⁴

IV. PROPOSAL FOR UNIFORMITY

The “equity cushion” built up in one’s home, referred to by Chairman Greenspan, is the proper safeguard against a downturn in the real estate market.¹¹⁵ But when this cushion is instead used as the homeowner’s private line of credit, its ability to protect is diminished or even eliminated. On a broad scale, the elimination of this safeguard could lead to severe financial destruction. The prevention of excessive home equity extraction is a relatively manageable burden that can be passed to secured lenders and incentivized through the bankruptcy system. The lender, as the party to the loan transaction with the greater likelihood of market expertise, knows of the potential consequences that could arise should the real estate market fall. Thus, the lender should be less willing to extend excessive credit secured by a junior mortgage in the borrower’s home, in order to avoid its interest being stripped in bankruptcy. The line of circuit court cases post-*Nobelman* sealed the fate for wholly unsecured creditors facing a typical Chapter 13 lien-strip, but the bankruptcy court split over the issue of whether a subsequent discharge is required has compromised the efficiency of the system. This, together with BAPCPA’s repeat-discharge restriction in § 1328(f), has severely diminished the effectiveness of the lien-stripping tool in bankruptcy court. The resolution of this issue in favor of a clear authorization to strip liens at the time of confirmation, regardless of the debtor’s ability to obtain a second discharge, would create a clear direction for bankruptcy courts. It would also be an obvious incentive for home-equity-line-

114. The problem posed by this mechanism is that there is no solidified test to determine good faith, rather the analysis is left completely to the discretion of the bankruptcy court judge. *Fin. One of GA, Inc. v. McKithian*, 23 B.R. 268, 271 (N.D. Ga. 1982). On top of this, courts must add to the test the various income considerations BAPCPA added to the Code. *Baxter v. Johnson*, 346 B.R. 256, 261 (Bankr. S.D. Ga. 2006). In *Kitchens*, the court listed a number of factors to be included in an analysis of good faith, including: the amount of the debtor’s income, any basic living expenses incurred by the debtor and the debtor’s family, attorney’s fees, expected duration of the Chapter 13 plan, the debtor’s motivation for seeking Chapter 13 relief, the debtor’s degree of effort and ability to earn, any medical expenses, debtor’s previous bankruptcy filings, and the debtor’s eligibility for a discharge. *Kitchens*, 702 F.2d at 888-89. The court in *Baxter* rightly noted that many of these factors were subsumed into § 1325 by BAPCPA. *Baxter*, 346 B.R. at 262. But leaving the good faith analysis completely to the discretion of the judge means that the decision is made essentially independent of the same analyses done by other courts. *Schaffer v. IRS*, 95 B.R. 62, 65 (E.D. MI 1988).

115. *Remarks by Chairman Alan Greenspan*, *supra* note 3. It appears Chairman Greenspan was in fact referring to the “equity cushion” as a shock absorber for market downturn rather than its potential as collateral for future loans. *Id.*

of-credit lenders to take a second look at how secured they really are, and whether it would be prudent and in their best interest to extend such credit to riskier borrowers.

As it stands, the case of *Johnson v. Home State Bank*, in particular, gives crucial insight into the nature of a discharge.¹¹⁶ *Johnson* shows how a discharge has no effect on a lien interest and thus no bearing on the strip of a lien.¹¹⁷ Admittedly, *Johnson's* presence does not eliminate the possibility of clarifying this issue through a simple amendment to the Code, with an express provision authorizing the practice of lien-stripping in "Chapter 20" without a second discharge.

A. *Johnson and the Nature of a Discharge*

The prime issue before the Supreme Court in *Johnson* was whether the "Chapter 20" debtor could list the secured creditor's mortgage on the debtor's farm as a claim to be addressed by the debtor's proposed plan, where the debtor, as a result of the Chapter 7 discharge, had no personal liability left in the claim.¹¹⁸ The Chapter 13 filing interrupted and stayed the foreclosure sale that was about to take place.¹¹⁹ The Court held that the debtor could include the secured creditor's interest as a claim in Chapter 13, over the secured creditor's objection.¹²⁰ In laying out the opinion, the Court cuts to the very nature of a discharge, that it "extinguishes only one mode of enforcing a claim, namely, an action against the debtor *in personam*, while leaving intact another, namely, an action against the debtor *in rem*."¹²¹ This insight sheds inescapable doubt on the rationale of the courts that require a discharge to give effect to a lien strip, as what exactly could a subsequent discharge do to strip the lien from the mortgage if by the very nature of a discharge it can only relieve personal liability? The answer is that it in fact does nothing to alter the attachment of a security interest, because after discharge, the secured creditor can always proceed *in rem*. Thus, in light of *Johnson*, to require a subsequent discharge in "Chapter 20" in order to give effect to a lien strip is frivolous at best and certainly not a requirement. In deferring to *Johnson* and referring to a subsequent discharge as "redundant," the *Hill* court comes closest to accepting the full logical framework handed down by the Supreme Court in *Johnson*.¹²²

116. *Johnson*, 501 U.S. at 84.

117. *Id.*

118. *Id.* at 80-81.

119. *Id.*

120. *Id.* at 84-85.

121. *Id.* at 84.

122. *Hill*, 440 B.R. at 182.

B. Amending the Code

Congressional action would be the most effective catalyst for unifying the courts. If Congress is to pass effective legislation on lien-stripping, the Bill should be concise and direct, as the courts have already brought the system close to where it needs to be.¹²³ The language of the Bill should both clarify that lien-stripping relief is possible upon the mere completion of a Chapter 13 plan and codify the holding of the post-*Nobelman* courts.¹²⁴

The first amendment to Chapter 13 would modify 1322(b)(2) and would read as follows:

. . . [the plan may] upon plan confirmation and without regard the availability of a discharge under § 1328, modify the rights of holders of secured claims, other than a claim secured only by a security

123. Some seem to suggest that Congress need not make any changes to effect change in this way. For example, in *In re Fair* the Bankruptcy Court for the Eastern District of Wisconsin pointed out that Congress, in drafting § 1328(f), did not draft “on a clean slate.” 450 B.R. 853, 857 (E.D. Wis. 2011). The court there logically presumed that when Congress enacted § 1328(f), it knew full well the difference between a discharge of *in personam* liability and the modification of *in rem* liability. *Id.* “In many Chapter 13 cases, ‘it is the ability to reorganize one’s financial life and pay off debts, not the ability to receive a discharge, that is the debtor’s holy grail.’” *Id.* (citing *In re Bateman*, 515 F.3d 272, 283 (4th Cir. 2008)). Nevertheless, the presence of so stark a split amongst the courts on the matter evinces a need for congressional clarity.

124. This is something that proposed legislation has overlooked in favor of a more broadly sweeping amendment to the Code. The Helping Families Save Their Homes Act of 2009, for example, sought to eliminate the antimodification clause altogether. H.R. 1106, 111th Cong. § 103 (2009). The Bill attempted to amend § 1322 to allow the debtor to modify the rights of any home mortgage creditor. *Id.* The post-*Nobelman* courts already permit this to a reasonable extent: upon the demonstration that the mortgage loan is completely undersecured. *Pond*, 252 F.3d at 127. Under those circumstances, the mortgage creditor does not even qualify for the protection of § 1322(b)(2), since its claim is no longer secured at all under § 506, and thus it is not covered by the § 1322(b)(2) exception. *Id.* The antimodification clause, as noted by Justice Stevens in his concurring opinion to *Nobelman*, was intended by Congress to promote the “flow of capital” into the residential real estate market. *Nobelman*, 508 U.S. at 332 (Stevens, J., concurring). The purpose behind the antimodification clause would thus be preserved by a codification of the holding of the post-*Nobelman* courts, since the junior mortgages most likely to be stripped were not taken in exchange for a loan to purchase the home in the first place, which is the type of financing Justice Stevens appears to be referring to. If one looks at any of the mortgages stripped by the post-*Nobelman* courts, one finds that they sanctioned the stripping of a mortgage that was wholly undersecured, and it was wholly undersecured because it was a junior mortgage, securing a secondary loan, behind the senior mortgage that was used to finance the purchase of the home. *Pond*, 252 F.3d at 123-24; *McDonald*, 205 F.3d at 608; *Bartee*, 212 F.3d at 281; *Lane* 280 F.3d at 665; *Tanner* 217 F.3d at 1357-58. Priority was acknowledged for the senior mortgages—those mortgages taken in exchange for the financing of the purchase of the home—the type of mortgages protected both by § 1322(b)(2) and by *Nobelman*. *Nobelman*, 508 U.S. at 332.

interest in real property that is the debtor's principal residence, provided the value of the collateral is sufficient to at least partially secure such a claim. . . .¹²⁵

Another amendment would add similar language to § 1325(a)(5) to clarify that a wholly undersecured mortgage is not protected by the requirements of § 1325(a)(5). It would read as follows:

(5) with respect to each allowed secured claim provided for by the plan, for which the value of the collateral is sufficient to at least partially secure such a claim.¹²⁶

125. Since the current language in § 1322(b)(2) is already riddled with confusing commas and clauses, it should also be reformatted with new subsections, in addition to the proposed language. Section 1322(b)(2) would thus read as follows:

- (B) Subject to subsections (a) and (c) of this section, the plan may— . . .
- (2) upon plan confirmation and without regard the availability of a discharge under § 1328-
- (A) 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, provided the value of the collateral is sufficient to at least partially secure such a claim.
- (B) modify the rights of holders of unsecured claims, or
- (C) leave unaffected the rights of holders of any class of claims;

126. Section 1325(a)(5) would thus in part read as follows:

- (A) Except as otherwise provided in subsection (b), the court shall confirm a plan if . . .
- (5) with respect to each allowed secured claim provided for by the plan, for which the value of the collateral is sufficient to at least partially secure such a claim.
- (A) the holder of such claim has accepted the plan;
- (B)
- (i) the plan provides that-
- (I) the holder of such claim retain the lien securing the claim until the earlier of-
- (aa) the payment of the underlying debt determined under nonbankruptcy law; or
- (bb) discharge under section 1328; and
- (II) if the case under this chapter is dismissed or converted without completion of the plan, such lien shall also be retained by such holder to the extent recognized by applicable nonbankruptcy law;
- (ii) the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim; and
- (iii) if-
- (I) property to be distributed pursuant to this subsection is in the form of periodic payments, such payments shall be in equal monthly amounts; and
- (II) the holder of the claim is secured by personal property, the amount of such payments shall not be less than an amount sufficient to provide to the holder of such claim adequate protection during the period of the plan; or

The addition of this language would reflect the logic of the post-*Nobelman* courts, acknowledging that a wholly undersecured junior mortgagee is not entitled to the same protections as secured creditors. It also provides a clear tool of statutory construction for the timing of a lien-strip, so that the four-year mandate between serial discharges no longer impacts courts' ability to strip a wholly unsecured mortgage in "Chapter 20."

V. CONCLUSION

There is no doubt that the adherence to an entire collection of sound legal and financial principles will be necessary to prevent another financial crisis. However, the sweeping destruction caused in part by the excessive extraction of equity from one's home for personal finances played a large role in exacerbating what could have been a much more manageable economic downturn. With clear guidelines on the authority and process of stripping liens in bankruptcy court, secured lenders will be better equipped to assess the risks of extending credit to debtors. Greater risk for lenders will in turn inhibit a homeowner's ability to extract equity from the home, limit unnecessary consumer spending, and provide the needed home equity cushion to soften the effect of market downturns.

(C) the debtor surrenders the property securing the claim to such holder;