

MORTGAGE FORECLOSURES IN BANKRUPTCY

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I. INTRODUCTION

The purpose of these materials is to outline the two primary issues that a mortgagee encounters when a mortgage borrower files bankruptcy: the automatic stay and discharge of debt.

After a mortgagor falls behind on mortgage payments, the mortgagee begins the foreclosure process by declaring a default and accelerating the loan. Once accelerated, the entire amount of the mortgage loan is due and payable immediately. To save the property from the foreclosure selling block, the property owner must meet the virtually insurmountable task of reinstating the loan. Property owners facing this predicament are looking with increasing frequency to the Bankruptcy Code for relief. Thus, it is important to understand the impact that bankruptcy has upon mortgages and their foreclosure.

II. THE AUTOMATIC STAY

A. Basics Of The Automatic Stay

1. Relief from Acts of Creditors

- a. The automatic stay is one of the most significant protections provided by the Bankruptcy Code. In re Vierkant, 240 B.R. 317 (B.A.P. 8th Cir. 1999).
- b. The moment the debtor files for bankruptcy petition, the automatic stay springs into being and operates without necessity for judicial intervention. In re Soares, 107 F.3d 969 (1st Cir. 1997).
- c. It provides the debtor a “breathing spell” by placing a freeze, for a limited time, on any action taken against the debtor or the debtor’s property. Farley v. Henron, 2 F.3d 273, 274 (8th Cir. 1993); In re Ahlers, 794 F.2d 388 (8th Cir. 1986); In re Donovan, 266 B.R. 862 (Bankr. S.D. Iowa 2001).

2. Acts Prohibited

a. 11 U.S.C. § 362(a)

- (i) Commencement or continuation of an action or proceeding against the debtor on a claim that arose pre-petition;
- (ii) Enforcement against the debtor or against property of the estate of a judgment;
- (iii) Any act to obtain possession of property of the estate or to exercise control over property of the estate;
- (iv) Any act to create, perfect or enforce any lien against property of the estate;
- (v) Any act to create, perfect or enforce against property of the debtor any lien securing a claim that arose pre-petition;
- (vi) Any act to collect, assess or recover a claim against the debtor that arose pre-petition;
- (vii) Set off using a claim that arose pre-petition; and
- (viii) Commencement or continuation of a proceeding before the U.S. Tax Court.

b. In the mortgage context this includes:

- (i) Commencing a suit by serving a complaint;
- (ii) Obtaining a foreclosure judgment;
- (iii) Issuing a petition to foreclose;
- (iv) Notifying all interested parties;
- (v) Coordinating the time, place and terms of the sale;
- (vi) Hiring an officer to conduct the sale;
- (vii) Advertising the sale; and
- (viii) Conducting a foreclosure sale.

3. Actions in Violation of the Stay

- a. The courts are divided on whether an act in violation of the stay is void or merely voidable. Carpio v. Smith (In re Carpio), 213 B.R. 744, 748-49 (Bankr. W.D. Mo. 1997) (collecting cases addressing the issue).
- b. Some courts hold that actions in violation of the stay are void, even if the party performing the act did not have notice of the bankruptcy case, because it places the burden on the creditor to obtain relief from the stay freeing the debtor to focus on reorganizing. Farley v. Henson, 2 F.3d 273, 275 (8th Cir. 1993); Ellis v. Consolidated Diesel Electric Corp., 894 F.2d 371 (10th Cir. 1990); In re Louisiana Ship Management, Inc., 761 F.2d 1025 (5th Cir. 1985); In re Vierkant, 240 B.R. 317 (B.A.P. 8th Cir. 1999); In re Donovan, 266 B.R. 862 (Bankr. S.D. Iowa 2001); In re Boston Bus. Mach., 87 B.R. 867, 870 (Bankr. E.D. Pa. 1988).
- c. Other courts, however, hold that actions in violation of the stay are merely voidable because actions in violation of the stay may be validated or otherwise cured. Bronson v. United States, 46 F.3d 1573 (Fed. Cir. 1995); Easley v. Pettibone Michigan Corp., 990 F.2d 905 (6th Cir. 1993); Picco v. Global Marine Drilling Co., 900 F.2d 846 (5th Cir. 1990); In re Reichenbach, 174 B.R. 997, 1001 (Bankr. E.D. Ark. 1994); In re Oliver, 38 B.R. 245, 248 (Bankr. D. Minn. 1984).

4. Penalties for Violation

- a. The debtor is entitled to recover any actual damages, including the debtor's attorneys' fees caused by a "willful violation" of the automatic stay, and in "appropriate circumstances" the debtor may also recover punitive damages. 11 U.S.C. § 362(h).
 - (i) Courts are divided over whether the section 362(h) penalty applies only to individual debtors or also to other debtor entities such as corporations.
 - (ii) Even Courts that find this section applicable only to individuals often conclude that the Court can punish violations as to non-individual debtors through its equitable powers. 11 U.S.C. § 105(a).
- b. A violation of the stay is willful if the violating entity knew that the debtor was in bankruptcy. In re Carroll, 903 F.2d 1266, 1272 (9th Cir. 1990).

- c. The violating entity’s good faith belief that its action would not violate the stay does not render the violation not willful. In re Crysen/Montenay Energy Co., 902 F.2d 1098, 1105 (2d Cir. 1990).

B. Limitations On And Obtaining Relief From Stay

1. 11 U.S.C. § 362(d) – Relief from the Stay

- (d) On request of a party in interest and after notice and a hearing, the Court shall grant relief from the stay provided under subsection (a) of this section, such as by terminating, annulling, modifying, or conditioning such stay –
 - (i) for cause, including the lack of adequate protection of an interest in property of such party in interest;
 - (ii) with respect to a stay of an act against property under subsection (a) of this section, if –
 - (A) the debtor does not have an equity in such property; and
 - (B) such property is not necessary to an effective reorganization.

2. “For Cause”

a. Bad faith

- (i) Courts have held that a bad-faith filing constitutes “cause” for relief from the stay. Noreen v. Slattengren, 974 F.2d 75, 77 (8th Cir. 1992); In re Little Creek Dev. Co., 779 F.2d 1068, 1072 (5th Cir. 1986); Farmers & Merchants Bank & Trust of Watertown v. Trail West, Inc., 28 B.R. 389, 394 (D. S.D. 1983); In re Sparklet Devices, Inc., 154 B.R. 544 (Bankr. E.D. Mo. 1993); In re Mill Place Ltd. P’ship, 94 B.R. 139 (Bankr. D. Minn. 1988).
- (ii) Courts examine the following factors in determining if a petition was filed in bad faith:
 - Bankruptcy filed immediately preceding a scheduled foreclosure sale;
 - Debtor has one asset;
 - The asset is encumbered by the liens of secured creditors and debtor has no equity in the asset;

- Debtor has no employees;
- Debtor has no unencumbered cash flow;
- There is little or no evidence of other available sources of income to sustain a plan or maintain the property;
- There are no or few unsecured creditors with small claims;
- The property was posted for foreclosure because of arrearages;
- Bankruptcy was the only possibility of forestalling the loss of property;
- Venue chosen by the debtor is removed from location of property;
- Bankruptcy filing used to resolve two-party dispute and debtor is not otherwise financially distressed;
- Pre-petition threats to file bankruptcy.

In re Phoenix Piccadilly, Ltd., 849 F.2d 1393 (11th Cir. 1988); In re Soost, 290 B.R. 116, 122 (Bankr. D. Minn. 2003); In re Mill Place Ltd. P'ship, 94 B.R. 139 (Bankr. D. Minn. 1988).

b. Lack of Adequate Protection

- (i) Adequate protection requires the debtor to safeguard the secured party's interest in the collateral. In re Lilyerd, 49 B.R. 109 (Bankr. D. Minn. 1985).
- (ii) To determine adequate protection, the bankruptcy Court must establish the value of secured party's interest, identify risks to secured creditor's value resulting from the automatic stay, and determine whether debtor's adequate protection proposal protects value as nearly as possible against risks to that value consistent with the concept of indubitable equivalence. In re Rankin, 49 B.R. 565 (Bankr. W.D. Mo. 1985).
- (iii) An equity cushion may constitute adequate protection, but it must generally exceed 20% of the secured claim. In re Coast, 112 B.R. 829, 831 (D. Wyo. 1989).

- (iv) The mortgagee is entitled to be protected against a decline in the value of its collateral, which includes keeping the property insured, keeping current on tax obligations which would become senior liens against the collateral if not paid, and paying interest on the claims of other creditors with senior interests in the collateral. In re Barnes, 125 B.R. 484, 486 (Bankr. E.D. Mich. 1991); In re Robbins, 119 B.R. 1, 6 (Bankr. D. Mass. 1990).
 - (v) The mortgagee is not entitled to cash payments to compensate it for lost opportunity cost if its claim exceeds the value of the collateral. United Sav. Ass'n v. Timbers Assoc., Ltd., 484 U.S. 365 (1988).
3. No Equity and Not Necessary for an Effective Reorganization
- a. No equity in the property
 - (i) In valuing the property, the question is what could the debtor get for the property. In re Nat'l Real Estate Ltd. P'ship II, 87 B.R. 986 (Bankr. E.D. Wis. 1988).
 - (ii) In determining whether the debtor has equity in the property, all liens against it, not just that of the creditor seeking to lift the stay, shall be considered. In re Cardell, 88 B.R. 627 (Bankr. E.D. N.Y. 1988); In re Marysville Body Works, Inc., 86 B.R. 51 (Bankr. E.D. Pa. 1988).
 - b. Property not necessary for an effective reorganization
 - (i) If the debtor is proceeding under Chapter 7 (liquidation), the creditor need only show the debtor has no equity in the property.
 - (ii) Debtor must make some showing of a "reasonable possibility of a successful reorganization within a reasonable time." United Sav. Ass'n v. Timbers Assoc., Ltd., 484 U.S. 365 (1988).
 - (iii) If the motion is made early in the case, however, the debtor need not demonstrate a great likelihood of successful reorganization. In re Marion Street P'ship, 108 B.R. 218, 225 (Bankr. D. Minn. 1989).
 - (iv) Mere speculation and conjecture about possible outside investment, however, is not sufficient to meet the debtor's burden, even early in the case. In re Embassy Enterprises, 125 B.R. 552, 555 (Bankr. D. Minn. 1991).

4. Single Asset Real Estate

- a. Single asset real estate “means real property constituting a single property or project, other than residential real property with fewer than four residential units, which generate substantially all the gross income of a debtor who is not a family farmer and on which no substantial business is being conducted by a debtor other than a business of operating the real property and activities incidental.” 11 U.S.C. § 101(51B).
- b. Typical examples of single asset real estate cases are debtors that own apartments, hotels, or are single-purpose real estate holding companies.
- c. Special provisions apply to single asset real estate cases, particularly relating to relief from the stay. They exist to address perceived abuses in which debtors have attempted to delay mortgage foreclosures even when there is little chance that they can reorganize successfully.
- d. The court may grant relief from the automatic stay if, within ninety days after the case is filed, the debtor has not filed a plan of reorganization that has a “reasonable possibility of being confirmed with any reasonable time” or commenced monthly payments in an amount equal to interest at the inapplicable non-default contract rate. 11 U.S.C. § 362(D)(3).
- e. These deadlines may be extended “for cause.” 11 U.S.C. § 362(d)(3). In re Heather Apts. L.P., Bky. 06-43101 (Bankr. D. Minn. March 28, 2007) (analyzing what constitutes cause).

5. Serial filings

- a. A serial filer is a debtor who abuses the bankruptcy process by filing successive petitions after earlier petitions are dismissed, repeatedly using the automatic stay to forestall creditors.
- b. The Bankruptcy Code excepts from the application of the stay any act to enforce a lien or security interest in real property if the debtor was ineligible to file a case under 11 U.S.C. § 109(g). 11 U.S.C. § 362(b)(21).
- c. A debtor is ineligible to file a case under section 109(g) if the debtor is an individual and in the 180 days preceding the bankruptcy case (i) a previous case was dismissed by the Court for willful failure to abide by an order or (ii) the debtor voluntarily dismissed the case after a motion for relief from stay was filed.

- d. The Bankruptcy Code also provides that a stay “with respect to the debtor” shall automatically terminate after 30 days if a second bankruptcy case was commenced within one year of the dismissal of the prior case. 11 U.S.C. § 362(c)(3). Due to the limitations – “with respect to the debtor” – courts have held that the stay as to property of the debtor continues. In re Moon, 339 B.R. 668, 671 (Bankr. N.D. Ohio 2006).
- e. If a second repeat filing takes place within that one-year period, the automatic stay will not spring into effect. The Court is required to promptly enter an order confirming the inapplicability of the stay on request of a party in interest. 11 U.S.C. § 362(c)(4).
- f. In the instance where one or more cases is filed within one year of a previous case (as compared to within 180 days), a presumption arises that the current filing was in bad faith. The debtor, however, may rebut that presumption and obtain the imposition or extension of the stay. 11 U.S.C. § 362(c)(3) and (4).
- g. To rebut the presumption of bad faith filing, the debtor must demonstrate “clear and convincing evidence” that the filing was in good faith, which may include demonstrating a substantial excuse for dismissal of the previous case or a substantial change in the financial or personal affairs of the debtor since the dismissal of the previous case. 11 U.S.C. § 362(c)(3) and (4).

6. In Rem Relief

- a. The Bankruptcy Code also limits the ability of multiple debtors to file a succession of cases to stay the foreclosure of a mortgage on a particular parcel of land. 11 U.S.C. § 362(d)(4).
- b. In cases involving either (i) transfers of real property collateral without the consent of the secured creditor or Court approval or (ii) multiple bankruptcy filings involving the same real property, the Court may issue an order for relief from the automatic stay upon finding that the case was filed with the intent to hinder, delay or defraud a creditor.
- c. An order granting relief from the stay, if properly recorded, is binding on all owners of the property for two years.
- d. The Bankruptcy Code expressly provides that once an order is issued granting relief from stay under 11 U.S.C. § 362(d)(4), an act to enforce any lien against or security interest in real property is not subject to the automatic stay for two years.

- e. The debtor in a subsequent case filed involving that property may seek imposition of the automatic stay. The debtor must demonstrate that it was filed in good faith as to the creditors sought to be stayed.

7. Annulment as relief

- a. Courts have held that an action taken in violation of the automatic stay is void and of no effect. See Section II(A)(3).
- b. Creditors that inadvertently violated the automatic stay nevertheless have looked to the broad language of the relief from stay provisions and, particularly, to the annulment language, in an attempt to establish the validity of their post-petition actions. In re Calder, 907 F.2d 953 (10th Cir. 1990); In re Albany Partners, 749 F.2d 670 (11th Cir. 1984); In re Vierkant, 240 B.R. 317 (B.A.P. 8th Cir. 1999); In re Harris, 268 B.R. 199 (Bankr. W.D. Mo. 2001); In re Donovan, 266 B.R. 862 (Bankr. S.D. Iowa 2001); In re Behr, 78 B.R. 447 (Bankr. S.C. 1987); In re Tanksley, 70 B.R. 429 (Bankr. E.D. Mo. 1987).
- c. Annulment of the stay can validate the sale process and provide a purchaser with good title even though foreclosure proceedings were conducted after the automatic stay took effect. In re Harris, 268 B.R. 199 (Bankr. W.D. Mo. 2001).
- d. Such relief is granted “sparingly.” In re Vierkant, 240 B.R. 317 (B.A.P. 8th Cir. 1999); In re Donovan, 266 B.R. 862 (Bankr. S.D. Iowa 2001).
- e. The following circumstances are considered when deciding whether to grant annulment:
 - (i) Whether creditor had actual or constructive knowledge of debtor’s bankruptcy and, therefore, of stay;
 - (ii) Whether debtor has acted in bad faith;
 - (iii) Whether there was equity in the property;
 - (iv) Whether property was necessary for an effective reorganization;
 - (v) Whether grounds for relief from stay existed, such that a stay relief motion, if filed, would have been granted prior to violation;

- (vi) Whether failure to grant retroactive relief would cause unnecessary expense to creditor;
- (vii) Whether creditor has detrimentally changed its position on basis of action taken;
- (viii) Whether creditor took some affirmative action post-petition to bring about stay violation;
- (ix) Whether creditor promptly sought retroactive lifting of stay.

In re Harris, 268 B.R. 199 (Bankr. W.D. Mo. 2001).

C. Dealing With The Stay

1. Continuing the Foreclosure Sale

- A foreclosure sale can be postponed during the automatic stay until the bankruptcy process is completed or the creditor obtains relief from the automatic stay. The creditor need not cancel the foreclosure sale, which would require the creditor to nullify the foreclosure action and begin the process again. In re Fine, 285 B.R. 700, 702 (Bankr. D. Minn. 2002).

2. Serial Filings

- a. As previously noted, a serial filer is a debtor who abuses the bankruptcy process by filing successive petitions after earlier petitions are dismissed, repeatedly using the automatic stay to forestall creditors.
- b. The filing of a bankruptcy petition merely to prevent a foreclosure proceeding without the ability or intention to reorganize is an abuse of the bankruptcy code and is considered a bad faith filing. In re Huerta, 137 B.R. 356, 369-70 (Bankr. C.D. Cal. 1992); In re Trina Assocs., 128 B.R. 858, 872 (Bankr. E.D. N.Y. 1991); see also In re Spectee Group, Inc., 185 B.R. 146, 156 (Bankr. S.D. N.Y. 1995) (“Serial filings are a ‘badge’ of bad faith.”).
- c. However, the challenge is how to stop the abusive serial filings. The Bankruptcy Code and the Courts address and deal with a serial filer in a variety of ways:
 - (i) The Bankruptcy Code limits the length of the stay or it does not spring into effect at all. See Section (II)(B)(5).

- (ii) The Court can dismiss the case on bad faith grounds and impose sanctions and costs. In re Bono, 70 B.R. 339, 345 (Bankr. E.D. N.Y. 1987); In re Prud'Homme, 161 747, 749 (Bankr. E.D. N.Y. 1993); Section (II)(B)(2).
- (iii) The Court can issue an order containing prospective relief from the automatic stay. In re Keller, 1996 WL 590877 (E.D. Pa. Oct. 10, 1996).
 - Generally, such orders require a hearing after the subsequent petition is filed to permit the debtor to demonstrate that there has been a change in circumstances to justify the subsequent filing. In re Friend, 191 B.R. 391 (Bankr. W.D. Tenn. 1996); In re Brengettcy, 177 B.R. 271 (Bankr. W.D. Tenn. 1995).
- (iv) The Court can dismiss the case and bar a serial filer from filing another petition for a certain period of time. 11 U.S.C. § 349; In re Cavazos, Bky. 07-32032 (Bankr. D. Minn. April 10, 2008) (barring debtors from commencing another bankruptcy case to stay foreclosure); see also Spencer Zane Baretz, Combating The Chapter 13 Serial Filer: An Argument For Orders Containing Prospective Relief From the Automatic Stay Provision, 25 Hofstra L. Rev. 1315 (1997).
 - Any act to enforce a lien against a security interest in real property is expressly excepted from the automatic stay if it is filed in violation of a bankruptcy Court order prohibiting the debtor from being a debtor in another case. 11 U.S.C. § 362(b)(21)(B).

3. Contracts for deeds, options

- The automatic stay does not toll the running of a statutory period for redeeming mortgaged property or curing the default on a land contract. Johnson v. First Nat'l Bank, 719 F.2d 270 (8th Cir. 1983).

III. DISCHARGE AND MORTGAGE LIENS IN BANKRUPTCY

A. Discharge of Individual

1. 11 U.S.C. § 524(a)

- (a) A discharge in a case under this title –
- (1) voids any judgment at any time obtained, to the extent that such judgment is a determination of the personal liability of the debtor with respect to any debt discharged under section 727, 944, 1141, 1228, or 1328 of this title, whether or not discharge of such debt is waived;
 - (2) operates as an injunction against the commencement or continuation of an action, the employment of process, or an act, to collect, recover or offset any such debt as a personal liability of the debtor, whether or not discharge of such debt is waived; and
 - (3) operates as an injunction against the commencement or continuation of an action, the employment of process, or an act, to collect or recover from, or offset against, property of the debtor of the kind specified in section 541(a)(2) of this title that is acquired after the commencement of the case, on account of any allowable community claim, except a community claim that is excepted from discharge under section 523, 1228(a)(1), or 1328(a)(1), or that would be so excepted, determined in accordance with the provisions of sections 523(c) and 523(d) of this title, in a case concerning the debtor's spouse commenced on the date of the filing of the petition in the case concerning the debtor, whether or not discharge of the debt based on such community claim is waived.
2. Effect: Lien Survives Bankruptcy
- a. A bankruptcy discharge eliminates the debtor's personal liability and operates as a permanent injunction against any act to collect, recover or offset a debt as a personal liability of the debtor.
 - b. This does not affect liens or other in rem property rights.
3. Reaffirmation: 11 U.S.C. § 524(c)
- a. Reaffirmation is a post-petition agreement to pay a pre-petition obligation. It reestablishes the debtor's personal liability and is therefore disfavored by Courts.
 - b. Although the general principles and procedures remain the same, recent amendments to the Bankruptcy Code significantly altered the conditions for effectiveness of a reaffirmation agreement. 11 U.S.C. § 524(c) and (k).

- c. The general conditions for an effective reaffirmation agreement include the following:
- (i) The debtor received an extensive set of disclosures described in 11 U.S.C. § 524(k);
 - (ii) The debtor, pursuant to 11 U.S.C. § 524(k)(6), signed prior to filing the reaffirmation agreement, a statement disclosing the debtor's income, actual current monthly expenses, resulting balance available to pay the debt proposed to be reaffirmed;
 - If this statement reflects insufficient income, a presumption arises that the agreement is an undue hardship on the debtor. The Court is directed to review the presumption and, if the debtor has not rebutted the presumption in writing to the Court's satisfaction, the Court may disapprove the agreement.
 - (iii) The reaffirmation agreement is in writing;
 - (iv) The reaffirmation is made before the discharge is granted;
 - (v) The reaffirmation agreement contains a clear and conspicuous statement advising the debtor that can be rescinded within sixty days after filing with the Court;
 - (vi) It contains a clear and conspicuous statement advising the debtor that the reaffirmation is not required;
 - (vii) The reaffirmation agreement has been filed with the Court;
 - (viii) The debtor's attorney has declared in writing that the agreement is informed, voluntary and is not imposing an undue hardship, the attorney has advised the debtor of the legal consequences, or the Court approves the agreement as not imposing undue hardship and in the best interests of the debtor.
- d. The District Court of Minnesota was adopted a local form for reaffirmations. Local Form 4008-1.
- e. There exists a fine line between permissible and impermissible reaffirmation agreement negotiation. The creditor cannot use coercion or harassment. Cox v. Zale Del. Inc., 219 F.3d 910 (7th Cir. 2001); Pertuso v. Ford Motor Credit Co., 233 F.3d 417 (6th Cir. 200); In re Jamo, 262 B.R. 159, (B.A.P. 1st 2001).

- f. Creditors are allowed to receive payments both prior to the filing of a reaffirmation agreement and under agreements “which the creditor believes in good faith to be effective.” 11 U.S.C. § 524(l).

4. Chapter 7

- a. In the consumer context in Chapter 7, the debtor can often retain mortgaged property without reaffirmation of the debt by maintaining current loan payments during the bankruptcy case. In Chapter 11 or 13, the debtor must address the lien in a plan.
- b. The Chapter 7 process of continuing payment without reaffirmation was referred to as “ride-through;” it recognizes that the lien flows through bankruptcy even though the debt is discharged, and allows the debtor to ride the lien through the bankruptcy without reaffirmation on the grounds that the lack of a payment default and the bankruptcy filing precluded the secured creditor from foreclosing on the lien. McCellan Fed. Credit Union v. Parker, 139 F.3d 668 (9th Cir.1998); Capital Community Fed. Credit Union v. Boodrow, 126 F.3d 43 (2d Cir. 1997); Homeowners Funding Corp. of Am. v. Belanger, 962 345 (4th Cir. 1992); Lowry Fed. Credit Union v. West, 882 F.2d 1543 (10th Cir. 1989); but compare Bank of Boston v. Burr, 160 F.3d 843 (1st Cir. 1999) (debtor not permitted to ride-through).

5. Chapter 11

- a. Chapter 11 for individuals was uncommon, but has been used with increasing frequency. If an individual proposes and confirms a plan of reorganization, the terms of that plan are binding on all creditors, including secured creditors who receive notice, and the plan can affect liens.
- b. For this reason it is very important that a secured creditor pay attention in Chapter 11 to the proposed treatment of its claim, to assure that its lien is recognized and continues after confirmation.

B. Discharge of Corporation

1. Chapter 11 Reorganization

- a. Corporations are only entitled to a discharge under Chapter 11. 11 U.S.C. § 1141(d)(1).
- b. This discharge is obtained by confirmation of a plan through the reorganization process. A discharge occurs when the confirmed plan becomes effective.

2. Distinguish Liquidating Plan

- a. Chapter 11 does not equate to reorganization. A Chapter 11 orderly liquidation is often the result of a failed reorganization attempt or a debtor can file a Chapter 11 petition intending to file and confirm a liquidating plan.
- b. The mechanism for liquidation varies. Often a liquidation trustee is appointed and is responsible for complying with the trust agreement (liquidation plan), liquidating the assets, and making distributions to the trust beneficiaries (creditors).
- c. The creditor with a lien on real property is entitled to either a return of the property in full satisfaction of its claim or the proceeds from liquidation.
- d. A corporate debtor under a liquidating plan is not entitled to a discharge. 11 U.S.C. § 1141(d)(3). This prevents trafficking in corporate shells. The Bankruptcy Code assumes that upon liquidation, the debtor corporation will cease to exist.

C. “Valuation” of Liens

1. 11 U.S.C. § 506: Valuation of Property

- a. A mortgage lender has a secured claim to the extent of the value of the property. 11 U.S.C. § 506(a)(1). To the extent the value of the property exceeds the mortgagee’s secured claim, the mortgagee is entitled to interest and attorneys’ fees. 11 U.S.C. § 506(b).
- b. If the value of the property is less than the mortgage debt, the excess debt is treated as an unsecured claim in the bankruptcy case. How much of the claim the debtor has to pay, to retain the property, however, depends on the type of bankruptcy.
- c. In Chapter 11, it is common for debtors to treat and pay as a secured claim *only* the portion of the claim equal to the value of the property. The rest is treated as an unsecured claim. This is known as “strip down” of the secured claim (i.e. stripping it down to the value of the property collateral).

2. No Strip-Down in Chapter 7

- a. Chapter 7 debtors have argued that they can avoid a lien on mortgaged property to the extent that lien exceeds the value of the property – “strip down.”

- b. Debtors have argued that a “strip down” is compelled by section 506(a)(1), which defines an “allowed secured claim” as the judicially determined value of the property. To the extent the claim exceeds the value of the property, the Court is required to void the lien under section 506(d) because it is not an “allowed secured claim” within the meaning of section 506(a)(1).
- c. The Supreme Court has rejected this rationale. Dewsnup v. Timm, 502 U.S. 410 (1992). A Chapter 7 debtor is not entitled to “strip-down” the mortgage because the mortgagee’s secured claim is secured by a lien and has been fully owed pursuant to § 502 and, therefore, cannot be classified as “not an allowed secured claim” for purposes of the lien-voiding provision of § 506(d).

3. Limited Strip-Down in Chapter 13.

- a. Chapter 13 of the Bankruptcy Code authorizes adjustment of debts of individuals with regular income. The debtor must propose a “plan” that explains how the debtor intends to address outstanding obligations.
- b. This plan may “modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor’s principal place of residence, or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims.” 11 U.S.C. § 1322(b)(2).
- c. Where permitted, the debtor may modify the amount to be paid, timing of payment and interest rate.
- d. As noted, modification of loans on the debtor’s principal residence is generally not permitted.
 - (i) Section 1322(b)(2) “protects the home loan industry from perceived adverse consequences that might otherwise result from the general application of § 506(b) to it in Chapter 13 cases.” In re Sauber, 115 B.R. 197 (Bankr. D. Minn. 1990).
 - (ii) Thus, a mortgagee’s claim cannot be bifurcated into secured and unsecured portions and then striped down. Nobleman v. Am Savings Bank, 508 U.S.324 (1993); In re McConnell, 296 B.R. 197 (Bankr. D. Minn. 2003); In re Hussman, 133 B.R. 490 (Bankr. D. Minn. 1991).
 - (iii) However, a mortgagee’s lien in the debtor’s homestead may be stripped down if:

- The debtor is seeking to strip-down a wholly unsecured claim. Thus, a junior lender whose claim is wholly unsecured can be striped-down because there is no “allowed secured claim” at all under section 506(a)(1). In re McDonald, 205 F.3d 606 (3d Cir. 2000); In re Zempel, 244 B.R. 625 (Bankr. W.D. Ky. 1999); but compare Keith M. Lundin, Chapter 13 Bankruptcy, § 4.46 at 4-56 (2d ed. 1995) (stating wholly unsecured mortgage cannot be avoided).
 - The undersecured mortgagee has taken other collateral for the loan in addition to the home, so that the “other than” clause of section 1322(b)(2) does not apply.
 - In the event that the debt subject to strip-down was incurred within one year of the filing of the case, it cannot be stripped down. 11 U.S.C. § 1325(a)(5).
- (iv) The Bankruptcy Code now precludes a Chapter 13 plan from providing for release of the lien upon payment of a stripped-down secured claim. Rather, the creditor must be allowed to retain the lien until the full amount of the claim is paid or the plan is completed.

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