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The Housing Bubble and Consumer Bankruptcy (Parts I and II)

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by

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Once again, Americans are enjoying the glorious summer of a housing bubble. The clouds of the 2008 recession that loured over the consumer homestead are now in the deep bosom of the ocean buried. Recently bankrupt consumers have found themselves eyeing a stupendous profit if they sell their home.[1] What are the prospects that the debtors can keep this profit away from their prepetition creditors? The answer depends on whether the debtor filed a chapter 7 or chapter 13 bankruptcy.

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[1] In the period between 2008 and 2017, just under half of chapter 7 consumer cases involve home ownership. Richard Hynes & Nathaniel Pattison, *A Modern Poor Debtor's Oath*, 108 VA. L. REV. 915, 934 (2022).

Part I covers the scene in chapter 7 cases, where the debtor cannot exclude underwater mortgage lenders from appreciation value. Arguably the Bankruptcy Code, as originally promulgated, invited debtors to "strip" underwater mortgages. In the notorious case of *Dewsnup v. Timm*[2] the Supreme Court ended that practice.

A chapter 7 debtor may still strip a judgment lien in whole or part, thereby diverting appreciation value from the judgment creditor to the debtor. Under either federal or state law, a debtor is usually entitled to a monetary exemption on a home. Any appreciation value funds the monetary exemption at the expense of the judgment creditor.[3]

Everything changes in a chapter 13 case. Part II explains that the underwater senior mortgage lender is guaranteed the first right to drink from the waterfall of appreciation value. *Nobelman v. American Savings* Bank[4] expressly protects the senior mortgage lender from lien stripping. A junior mortgage lender, however, can be stripped, if the second mortgage is "out of the money" – the first mortgage lender is under water and there is no valuable remaining equity available for the junior mortgage lender. Once a chapter 13 plan is confirmed, the debtor gets appreciation value above and beyond the claim of the first mortgage lender. But if during the plan, the debtor realizes a capital gain from the sale of the house, the gain can be captured by the creditors because the gain is "disposable income" which the debtor is ultimately supposed to pay into the plan.

Part III[5] addresses the recent developments giving a chapter 13 debtor a real hope in keeping appreciated value away from the unsecured creditors by converting to a chapter 7 case. In such circumstances the law turns especially obscure.

In addressing ownership of appreciation value, I embrace the dry and desiccated spirit of positivism. I take no position on who deserves the windfall of appreciation value. Consumer bankruptcy is founded on the contradiction that creditors deserve to be paid and debtors deserve a discharge and a fresh start in life. I have no moral intuition as to which of these intuitions should predominate. These issues I leave to divine law. Rather, I examine whether allocations of value can be grounded in the text of the Bankruptcy Code as it currently exists.

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[2] 502 U.S. 410 (1992). Bankruptcy experts hold *Dewsnup* in low regard. *See, e.g.,* Lawrence Ponoroff, *The Last Dance: Righting the Supreme Court's Greatest Apostasy*, 96 AM BANKR. L.J. 199, 200, 204 (2022) ("Dewsnup v. Timm is right up there in the running for the worst decision in the Court's venerable history" . . . wide of the mark on so many levels it is hard to count").

[3] 11 U.S.C. § 522(f). Unless otherwise noted all statutory references in the text of the article are to the United States Bankruptcy Code, 11 U.S.C. §101, *et. seq.*

[4] 508 U.S. 324 (1993).

[5] Part III will appear in the next issue of the American Bankruptcy Law Journal, Volume 97, Issue 3.

The result, I fear, will strike the reader as unsatisfactory. Obtuseness and shadow dominate over clarity and light. Dark night strangles the travelling lamp of bankruptcy jurisprudence. A great many issues covered here were obviously not anticipated by the drafters of the Bankruptcy Code, and their scrivenings will seem arbitrary in application. In addition, Supreme Court interventions, no doubt well intentioned, have greatly complicated the scene. One gets the strong impression that the results demanded by a positivist approach are unintended and accidental. It is definitely not possible to say in general that either the creditors are entitled to the appreciation value, or that debtors may retain it as part of their fresh start. The reader should prepare for a bumpy ride.

OVERVIEW

Prior to examining the fate of the housing bubble in consumer bankruptcies, we need to rehearse the mechanics of liquidating exempt property in bankruptcy. The Bankruptcy Code is surprisingly opaque on these matters.

We learn in § 541(a) that "commencement of a case … creates an estate."[6] The bankruptcy estate includes "all legal and equitable interests in property as of the commencement of the case."[7] Bankruptcy therefore constitutes a transfer by a debtor (*D*)[8] of property to the bankruptcy trustee (*T*) on behalf of creditors.

In all bankruptcy cases, whether chapter 7 or 13, exempt property initially goes into the bankruptcy estate and must be fetched out[9] by *D*. This was not so under the 1898 Bankruptcy Act. There, "property of the bankruptcy estate" was defined as property as to which a judicial lien might attach. Exempt property never was part of the bankruptcy estate in the first place.[10] In the modern era, then, whether the home is exempt or not, into the bankruptcy estate it goes.

When *D* owns a house and files for bankruptcy, the house becomes an asset of the bankruptcy estate. Title to the property does not transfer to *T* and *D* continues to hold the fee simple interest to the house.[11] For this

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[6] § 541(a).

[7] Id.

[8] In many consumer bankruptcies, *D* may be a married couple. But I will refer to *D* in the singular.

[9] Schwab v. Reilly, 560 U.S. 770, 772 (2010).

[10] The Bankruptcy Act of 1898, ch. 541, 30 Stat. 544, as amended § 70(a)(5) (repealed 1978) (defining property of the estate as property "which might have been levied on and sold under judicial process); *See* White v. Stump, 266 U.S. 310 (1924) (emphasizing that exempt property never enters the bankruptcy estate).

[11] This is because *T* is a mere lien creditor, not a fee owner. David Gray Carlson, *Bankruptcy's Organizing Principle*, 26 FLA. ST. U. L. REV. 549, 562 n.47 (1999).

reason, *D* may live in the house after bankruptcy and is no trespasser in it.[12] *T*, however, may use, sell or lease the house court permission.[13] Thus, *D* could be in danger of losing the house under certain circumstances.

When the house is *D*'s principal residence it is usually, at least in part, exempt property under state law or as federalized by the Bankruptcy Code.

The homestead is usually exempt from execution by unsecured creditors. In seven jurisdictions,[14] *D* gets an "exemption in kind" meaning the entire house is exempt. In the other states, and under federal law,[15] *D*'s homestead exemption is monetarily limited. In bankruptcy, *T* is a hypothetical judicial lien creditor.[16] This means that, where *D* has only a monetary exemption, *T* has a judicial lien on the debtor's equity in the home for the value above and beyond the exemption amount.[17]

Very frequently, when the nation is in a recession, the mortgage is under water. The exemption, of course, is no good against the mortgage.[18] Suppose the value of the house exceeds the amount of mortgage liens (*ML*) on the property plus the monetary exemption (*ME*). (The sum of these amounts I will refer to as *ML+ME*). Equity above *ML+ME* is not common at the commencement of a consumer bankruptcy. If *D* has a sizable equity in the home after the mortgage, *D* can often dull the edge of husbandry by borrowing against equity, thus staving off the evil day of bankruptcy.

Nevertheless, it is not unknown for the value of the home to exceed *ML+ME*.[19] In such a case, *T* can sell the home free and clear of the mortgages and the exemption. That *T* may sell free and clear of the mortgages is established by § 363(f)(3).[20] The Bankruptcy Code never says

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[12] Hyman v. Plotkin (*In re* Hyman), 967 F.2d 1316, 1321 & n.11 (9th Cir. 1992) (until the sale, *D* gets to live in the house for free).

[13] § 363(b).

[14] ARK. CODE ANN. § 16-66-210 (2023); D.C. CODE § 15-501 (2023); FLA. CONST. ART. X, § 4 (2023); IOWA CODE § 561.16 (20230; KAN. STAT. ANN. § 60-2301 (2023); S.D. CODIFIED LAWS § 43-45-3 (2023); TEX. PROP. CODE ANN. § 41.001(a) (West 2023).

[15] § 522(d)(1).

[16] § 544(a)(1).

[17] T is also a bona fide purchaser of real property pursuant to § 544(a)(3). Purchasers take free and clear of their seller's homestead rights. Logically, *T* takes real property free of state-created homestead rights, but this occurs at the beginning of the bankruptcy proceeding. After that, § 522(l) invites *D* to fetch the homestead out of the bankruptcy estate, so no harm is done by § 544(a)(3). *See* David Gray Carlson, *Fraudulent Transfers and Constructive Trusts: When Worlds Collide*, 103 MARQ. L. REV. 365, 389-94 (2019) (discussion of problems involving § 544(a)(3)).

[18] Kleinman v. Hylton, No. 6:20-CV-03319-NKL, 2021 WL 612406, at *8 (W.D. Mo. Jan. 27, 2021), *appeal dismissed*, No. 21-1351, 2022 WL 496029 (8th Cir. Feb. 3, 2022)

[19] This occurred in about half the cases between 2008 and 2017. Hynes & Pattison, *supra* note 1, at 934.

[20] According to § 363(f)(3):

> "The trustee may sell property under subsection (b) … free and clear of any interest in such property of an entity other than the estate, only if—

that *T* can sell free and clear of the monetary exemption, but under state law judicial lien creditors can do so.[21] Therefore it is logical and universally assumed that *T* can also do so,[22] since *T* is a hypothetical judicial lien creditor under § 544(a)(1).

By way of example, here is the situation involving a judicial lien under New York state law. A judgment creditor (*JC*) may not, apparently, sell free and clear of a senior mortgage. According to New York's CPLR § 5236(a), "the interest of the judgment debtor in real property … which was subject to the lien of judgment … shall be sold by the sheriff …"[23] Where *D* has conveyed a mortgage to *ML* and where *JC* subsequently obtains a judgment lien, the sheriff can only sell *D*'s interest as encumbered by *ML*.

In New York, if *JC* wishes to execute on the surplus above the monetary exemption of $150,000,[24] she must start a special proceeding.[25] The court must order that the sale occur, either through a sheriff or a receiver. Presumably, the court must pay *D* first for the exemption amount[26] (keeping in mind that *ML* survives the sale). As is true in many states,[27] the money remitted to *D* is entailed:

> Money, not exceeding ⟦the exemption amount⟧, paid to a judgment debtor, as representing his interest in the proceeds, is exempt for one year, after the payment, unless, before the expiration of the year, he acquires an exempt homestead, in which case, the exemption ceases with respect to so much of the money as was not expended for the purchase of that property⟦.⟧[28]

> (3) such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of all liens on such property …."

[21] Schwaber v. Reed (*In re* Reed), 940 F.2d 1317. 1321 (9th Cir. 1991).

[22] Schwab v. Reilly, 560 U.S. 770 (2010) (allowing Chapter 7 trustee to sell equipment when value of equipment exceeded amount of allowable exemption); Hyman v. Plotkin (*In re* Hyman), 967 F.2d 1316 (9th Cir. 1992) (trustee permitted to sell exempt homestead and remit dollar value of exemption to debtors upon sale).

[23] N.Y. C.P.L.R. § 5236(a).

[24] This is the *ME* in New York City and adjoining counties. The exurbs get only $125,00 and the rural poor must struggle by with $75,000. N.Y.C.P.L.R. § 5206(a) (McKinney 2023).

[25] *Id.*, § 5206(e).

[26] Prior to the 2011 amendment to N.Y.C.P.L.R. § 5206, subsection (e) said this directly. Now we must infer this result. *In re* Frank, 39 B.R. 166, 167-68 (Bankr. E.D.N.Y. 1984).

[27] For a list of states with similar rules, *see* Laura B. Bartell, *The "Snapshot Rule" and Proceeds of Exempt Property in Chapter 7 - Bringing a Doctrine Into Focus*, 95 AM. BANKR. L.J. 563, 570-71 n.42 (2021).

[28] N.Y. C.P.L.R. § 5206(e). Courts deeply disagree whether, in bankruptcy proceedings, *D* must pay back proceeds of homesteads. *Compare* Viegelahn v. Frost (*In re* Frost), 744 F.3d 384 (5th Cir. 2014) (bankruptcy estate takes back proceeds after the period for reinvestment lapses), *with* Rockwell v. Hull (*In re* Rockwell), 968 F.3d 12 (1st Cir. 2020), *cert. denied*, 141 S. Ct. 1372 (2021) (once the proceeds are exempted, *D* owns them free and clear, even if no reinvestment).

As for the surplus above the exemption amount, the court (presumably) pays the sheriff's or receiver's fee[29] and remits the balance to *JC*.[30]

PART I. Chapter 7

A. EXEMPT PROPERTY

When the house is *D*'s principal residence it is usually, at least in part, exempt property under state law or as federalized by the Bankruptcy Code. If there is no equity beyond *ML+ME T* cannot, or should not sell, the home in a chapter 7 case.[31] But if equity exists, *T* can do what *JC* could not do under state law —sell free and clear of *ML*.[32] In analogy to *JC*, *T* can sell the whole of the house, in spite of the monetary exemption.[33]

T's power to sell free and clear of *ML* generally does not exist in state law and is rather unique to federal law.[34]

Presumably, *T* must, off the top, pay proceeds to *ML*. Where in the Bankruptcy Code is this provided for? It is hard to say. According to § 552(b)(1):

> ⟦I⟧f the debtor and an entity ⟦*ML*⟧ entered into a security agreement[35] before the commencement of the case[36] and if the security interest[37] created by such security agreement extends to property of the debtor acquired before the commencement of the case and to proceeds … then such security interest extends to such proceeds … acquired by the estate after the commencement of the case to the extent provided by such security agreement … [38]

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[29] *Matter of* Lew v. Sobel, 136 N.Y.S.3d 900, 901 (App. Div. 2021)

[30] The New York law of judgments is largely a game of "connect the dots" provided sporadically by the occasional statute. The statutory coverage is quite patchy. The microscopic details of sheriffs' sales is covered in David Gray Carlson, *Critique of Money Judgment (Part I: Judicial Liens on New York Real Property)*, 82 ST. JOHNS L. REV. 1291 (2008).

[31] Schwaber v. Reed (*In re* Reed), 940 F.2d 1317, 1322 (9th Cir. 1991).

[32] § 363(f)(3).

[33] *See* Kim v. Dome Entertainment Ctr., Inc. (*In re* Kim), 748 F.3d 647 (5th Cir. 2014) (sale to access cash surplus over the monetary exemption); Hyman v. Plotkin (*In re* Hyman), 967 F.2d 1316 (9th Cir. 1992). In *In re* Childers, 526 B.R. 608 (Bankr. D.S.C. 2015), *D* granted an unrecorded mortgage to *ML* and then filed for bankruptcy. *T* avoided ML's mortgage, preserved it for the benefit of the estate, § 551, and enforced the mortgage by selling the home. *D*'s monetary exemption was held to be no impediment.

[34] Not only may *T* sell free and clear under the Bankruptcy Code but the federal government may do so when it holds a junior lien. United States v. Rodgers, 461 U.S. 677 (1983).

[35] "The term 'security agreement' means agreement that creates or provides for a security interest." § 101(50).

[36] "Commencement of the case" means the time a bankruptcy petition is filed. §§ 301-03.

[37] "The term 'security interest' means lien created by an agreement." § 101(51).

[38] § 552(b)(1).

This provision is designed (clumsily at that) to cover security interests in personal property under Article 9. It does not so clearly cover *ML*, whose mortgage agreement will probably not mention proceeds in free-and-clear sales. Nevertheless it is assumed (sensibly) that when *T* sells free and clear of *ML*, *ML* has "cash collateral."[39] *T* is obliged to surrender this cash collateral to *ML* by § 725:

> After the commencement of a case ⟦in chapter 7⟧, but before final distribution of property of the estate under section 726 … , ⟦*T*⟧ … shall dispose of any property in which an entity other than the estate has an interest, such as a lien, and that has not been disposed of under another section of this title.[40]

So far, we have established, largely through assumption and not via legislative clarity, that, after the free-and-clear sale, *T* must first pay *ML* her share of the proceeds.

The second thing *T* must do is to pay *D* the monetary exemption amount (which for purposes of this example is $150,000). Nothing in the Bankruptcy Code commands it. Arguably the conclusion is founded in the same above-quoted § 725. If *D*'s federal exemption right is "property in which an entity other than the estate has an interest,"[41] *T* should pay $150,000 to *D* before distributing the surplus to the unsecured creditors.[42]

Perhaps *T* will not be able to sell *D*'s house at all. Where there is modest equity above the mortgage, an exemption often applies to deny the chapter 7 trustee access to the house. Suppose, for example, that the home is valued at $500,000 and *ML* claims $400,000. Suppose *D* is entitled to an exemption of $150,000. *T* ought not to sell this home, as the unsecured creditors will not benefit. *T* ought to abandon the home to *D*.[43] If she does so, the home is expelled from the bankruptcy estate. The automatic stay lapses as to the home,[44] and *ML* may now foreclose.

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[39] § 363(a).

[40] § 725.

[41] Schwab v. Reilly, 560 U.S. 770, 782 (2010). *See also In re* Adams, 641 B.R. 147, 153 (Bankr. W.D. Mich. 2022) ("In effect, most exemptions which entitle a debtor to a representative value, measured by former ownership of particular property, operate as a charge against that property, much like a lien to secure payment of the specified amount, rather than title to the thing itself.").

[42] Schwaber v. Reed (*In re* Reed), 940 F.2d 1317, 1322 (9th Cir. 1991).

[43] § 554(a).

[44] § 362(c)(1).

Suppose *T* does not abandon. The Bankruptcy Code invites *D* to claim the house as exempt[45] on Schedule C.[46] If no creditor objects to the exemption, the equity is expelled from the bankruptcy estate.[47]

Now you might be tempted think that, once the house is exempt, the house cannot be reached by *T*. The house belongs to *ML* and *D*, and *T* has no interest in it. Therefore, appreciation value belongs solely to *ML* and *D* (where *ML* was under water at the time of the bankruptcy).

This may not be so. In *Schwab v. Reilly*,[48] the Supreme Court implied that appreciation value belongs to *T*. In *Schwab*, *D* claimed restaurant equipment as exempt, under a combined "tool of the trade" and "wildcard" exemption provided by § 522(d). On Schedule C, *D* valued the equipment at $10,718, less than a combined tool-wildcard exemption of $12,075.

T did not challenge the exemption within the time limit required by Federal Rule of Bankruptcy Procedure 4003(b)(1).[49] Reading the Supreme Court's prior opinion in *Taylor v. Freeland & Kronz*,[50] *D* figured that she owned the equipment outright. The equipment had been expelled entirely and finally from the bankruptcy estate, she justifiably thought. She was wrong. Only the proceeds up to the value of the available exemption were expelled. The value above and beyond $12,075 remained within the estate. *T* could therefore sell the equipment under § 363(b)(1).

Important for this article is what the Supreme Court had to say about the function of § 522(a)(2), which defines value to mean:

> fair market value as of the date of the filing of the petition or, with respect to property that becomes property of the estate after such day, the date such property becomes property of the estate.[51]

You would think that this provision means that, when *T* requests permission to sell a house under § 363(f), *T* must pretend the value is the bankruptcy-day value, not the present value. Since the bankruptcy-day value was below *ML+ME*, *T* cannot sell. Not so. In *Schwab*, *T* had the right to sell the equipment for market value, even though *D* had estimated value at below *ML+ME*. Therefore, the Supreme Court has effectively read § 522(a)(1) out of the Bankruptcy Code, insofar as *T-D* relations are concerned. The implicit holding in *Schwab* is that, where an exemption

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[45] § 522(b)(1) ("Notwithstanding section 541 … , an individual debtor may exempt from property of the estate the property listed in either paragraph 2 ⟦sic⟧ or, in the alternative paragraph (3)").

[46] Official Form 106C.

[47] § 522(l).

[48] 560 U.S. 770 (2010).

[49] FED. R. BANKR. PRO. 4003(b)(1).

[50] 503 U.S. 638, 644 (1992).

[51] § 522(a)(2).

enters the bankruptcy estate with value below *ML+ME* and where, before the case closes, value is above *ML+ME*, appreciation value above *ML+ME* belongs to *T*.[52]

This is straightforwardly illustrated by *Gebhart v. Gaughan (In re Gebhart)*,[53] where *D* valued a house at $210,000. *ML* and *ME* were $121,000 + $100,000 = $221,000. So, on bankruptcy day, *T* could not sell. *T* should have abandoned the property. *T* did not do so. Two years later, *T* thought she could find a buyer for an amount exceeding *ML+ME*=$221,000. She moved for permission to sell. *D* counter-moved to compel abandonment because "the value of the homestead for the purposes of the bankruptcy case had been locked in at the time of the bankruptcy filing . . ."[54]

The Ninth Circuit, applying *Schwab*, held that *T* was not bound to pretend that bankruptcy-day value is still the present value. Rather, *T* could sell in the hopes of achieving a realization in excess of *ML+ME*. The *Gebhart* court warned:

> The Supreme Court's decision in ⟦*Schwab*⟧ was based on a somewhat different situation than is present here. In ⟦*Schwab*⟧, the debtor underestimated the value of the exempt property at the time of filing. In both of the current cases, by contrast, the debtors accurately valued the equity interests in their homestead properties at the time of bankruptcy filing, but the fair market values of the properties increased subsequent to filing. This distinction, however does not alter the analysis. Under ⟦*Schwab*⟧, an

[52] An exception exists when, on Schedule C, *D* illegally claims that the thing-in-itself was exempt, rather than a monetary charge against the thing. A noteworthy aspect of Justice Thomas's opinion is that he gives advice to debtors who wish to make illegal claims of exemption in the hope that T will not manage to object by the deadline. The key is to claim (illegally) the thing-in-itself, not just a monetary exemption. *Schwab*, 560 U.S. at 792-94. *See also* David Gray Carlson, *The Role of Valuation in the Federal Bankruptcy Exemption Process: The Supreme Court Reads Schedule C,* 18 AM. BANKR. INST. L. REV. 461, 489-90 (2010).

In Masingale v. Munding, 644 B.R. 530, 543 (9th Cir. B.A.P. 2022), D filed in chapter 11 and claimed a homestead exemption under Bankruptcy Code § 522(d)(1) ("$45,950"). In the column labeled "value of claimed exemption," she listed "100% of FMV." At the time, this was accurate. After *ML*, debtor equity was worth $35,000. The *ME* was $49,950. So given the valuation, *D*'s share of expected value (after *ML*) was 100%. As debtor-in-possession under chapter 11, *D* neglected to object to her own exemption, and neither did any unsecured creditor. Federal Rules of Bankruptcy Procedure 4003(b)(a) ("party in interest" may object). In the converted chapter 7 case, T_7 claimed appreciation value above *ML+ME*. But the surplus belonged to *D*. *D* had complied with the Supreme Court's advice as to how to flummox the bankruptcy trustee (which in this case was her own self as debtor-in-possession). Therefore, T_7 could not resist her claim to *ME* plus the surplus over *ML+ME*. *Id.* at 540 (*D* "followed the Supreme Court's suggestion to the letter").

[53] 621 F.3d 1206 (9th Cir. 2010).

[54] *Id.* at 1209.

> exemption claimed under a dollar-value exemption is limited to the value claimed at filing. At least when the total fair market value of the property is in fact greater than the exemption limit at the time of filing … any additional value in the property remains the property of the estate, regardless of whether the extra value was present at the time of filing or whether the property increased in value after filing.
>
> The debtors argue that this conclusion is inconsistent with ⟦§ 522(a)(1)⟧. The debtors argue that this provision effectively freezes the value of property claimed as exempt as of the date of bankruptcy filing. ⟦but⟧ what is frozen as of the date of the filing the petition is the value of the debtor's exemption, not the fair market value of the property claimed as exempt.[55]

This very last observation is confusing. What is frozen on bankruptcy day? Entitlement to the exemption (which comes from a statute and has nothing to do with value of the exempted thing). Thus, *qualitatively*, whether *D* is entitled to the exemption is decided on bankruptcy day. This is the so-called "snapshot" rule, induced from the ancient case of *White v. Stump*.[56] In *White*, *D*'s homestead right required *D* to file notice of the homestead claim in the real estate records. *D* filed for bankruptcy and thereafter filed the homestead recordation. The Supreme Court said that the homestead recordation was too late.

> ⟦T⟧he point of time which is to separate the old situation from the new in the bankrupt's affairs is the date when the petition is filed … When the law speaks of property which is exempt and of rights to exemptions it of course refers to some point of time. In our opinion this point of time is the one as of which the general estate passes out of the bankrupt's control, and with respect to which the status and rights of the bankrupt, the creditors and the trustee in other particulars are fixed. The provisions before cited show—some expressly and others impliedly—that one common point of time is intended and that is the date of the filing of the petition. The bankrupt's right to control and dispose of the estate terminates as of that time, save only as to "property which is exempt." § 70a. The exception, as its words and the context show, is not of property which

[55] *Id.* at 1211 (internal citations omitted).
[56] 266 U.S. 310 (1924).

> would or might be exempt if some condition not performed were performed, but of property to which there is under the state law a present right of exemption—one which withdraws the property from levy and sale under judicial process.[57]

The "snapshot" is strictly qualitative. What is exempt? This is decided by the law as it existed on bankruptcy day. Quantitative criteria, however, are not frozen. Thus, the meaning of *Schwab* is that § 522(a)(2) is a dead letter in adjudicating exemptions by *D* from the bankruptcy estate. This will be an important principle for what follows.

What happens if the value of the house exceeds *ML+ME*? In such a case, the monetary exemption is expelled from the bankruptcy estate, but the house, as such, is not. *T* may liquidate the house. Because the value of the house is above the amount of the mortgage lien, *T* may sell free and clear of the mortgage[58] The Bankruptcy Code nowhere prevents *T* from selling where value is above the mortgage amount but below the sum of the mortgage amount and the exemption amount.[59] But since a sale below *ML+ME* yields nothing for the unsecured creditors and affirmatively harms *D*, a court will presumably deny permission when *T* moves to sell under § 363(b)(3).[60]

B. ABANDONMENT

Eventually, *T* must close the chapter 7 case. According to § 350(a): "After an estate is fully administered and the court has discharged the trustee, the court shall close the case." But "⟦a⟧ case may be reopened in the court in which such case was closed to administer assets …."[61] Thus, if *D*'s house was fully administered, *T* cannot reopen the case and recapture *D*'s appreciation value. But if the house was *not* fully administered, *T* may reopen the case and retrieve the appreciation value.

Section 554(a) invites *T*, "⟦a⟧fter notice and a hearing," to abandon property "that is burdensome to the estate or of inconsequential value."[62] If

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[57] *Id.* at 313.

[58] § 363(f)(3).

[59] *In re* Adams, 641 B.R. 147, 153-54 (Bankr. W.D. Mich. 2022). A California statute makes this express for judgment creditors under state law. Cal. Civ. Proc. Code § 704.800(a).

[60] Cases exist where *T* wishes to sell and *D* opposes the sale because transaction costs guarantee *T* will lose money, since *T* must first fund *ML+ME*. Courts sometimes let *T* proceed with the sale on the assumption that *T* will abandon the effort if the bankruptcy estate is faced with a loss. Hyman v. Plotkin (*In re* Hyman), 967 F.2d 1316, 1321 (9th Cir. 1992); *but see In re* Hodges, 518 B.R. 445, 452-53 (E.D. Tenn. 2014) (*T* forced to abandon in light of projected transaction costs); In re Perez, 345 B.R. 137 (Bankr. D. Del. 2006) (valuation should be net of sales expense).

[61] § 350(b).

[62] § 554(a).

T troubles to abandon the exempted house, *T* cannot get the house back. Section 554(c) adds that property scheduled by the debtor as required by § 521(a)(1)(B)(i) is deemed abandoned when the case is closed.[63] If an asset is not disclosed on the schedules § 554(d) says that "unless the court orders otherwise, property of the estate that is not abandoned under this section and that is not administered in the case remains property of the estate."[64]

When is the house "administered"? "Neither the Bankruptcy Code nor the Bankruptcy Rules define when an estate is 'fully administered.'"[65] A sensible interpretation is that the house is administered when *D* schedules the house on Schedule A and C and *T* closes the case. Under § 554(c), the house is deemed abandoned—*unless* the court orders otherwise. But *T* may, with court permission, close a case *and* retain a judicial lien on exempt property. In *In re Orton*,[66] the case was closed, but *T* was permitted to reserve in perpetuity a judicial lien on a mineral royalty to which *D* had applied $1 of his federal "wildcard" exemption. Therefore, if the lessee struck oil years after the case was closed, *D* would get $1 from the gusher and the rest would go to the unsecured creditors of the bankruptcy case, once *T* re-opened it.[67]

After an underwater house is exempted, may *T*, citing *Orton*, reserve, after case closure, a lien on the homestead in case a surplus over *ML+ME* appears in a rising market?[68] After all, it costs *T* nothing to sit around and wait for prices to go up.

Price theory gives courts a reason to prevent *T* from encumbering the home for years even after the case is closed. Market value is a weighted average of possible future values. By definition, baked into market value is the probability that housing prices may go up and that housing prices may go down. If housing prices are certain to go up in the future, present value would already be higher today. By definition, *T* cannot second-guess the trend in the real estate market. Therefore, *T* has no economic reason to suppose that the bankruptcy estate will benefit if *T* lies in the weeds in the

[63] § 554(c).

[64] § 554(d).

[65] Baker v. Bank of Am., N.A., 837 Fed. Appx. 754, 760 (11th Cir. 2020) (When "the trustee has filed a final report and final account and has certified that the estate has been fully administered," and there is no objection, "there shall be a presumption that the estate has been fully administered." Fed. R. Bankr. P. 5009(a).").

[66] 687 F.3d 612 (3d Cir. 2012).

[67] *Accord*, Potter v. Drewes (*In re* Potter), 228 B.R. 422 (B.A.P. 8th Cir. 1999).

[68] Yes, via an *ex parte* motion of which *D* had no notice. *In re* Prospero, 107 B.R. 732, 734-35 (Bankr. C.D. Cal. 1989).

hope of appreciation value. In *In re Barrera*[69] (a significant opinion we shall examine later), Judge Elizabeth Brown wrote:

> [I]f the chapter 7 estate is left open for some period of time, and the assets appreciate or the liens are reduced during this period, then the chapter 7 estate will reap the benefit of that increase in equity. Because of this, any debtor's lawyer worth his salt will file a motion to abandon the asset under § 554 early in the chapter 7 case if it look like the estate will remain open for a significant period of time. Not doing so would be tantamount to malpractice. [70]

The assumption here is that *of course* a bankruptcy court would force *T* to abandon where *T* is simply stalling in the hope of appreciation value.[71]

We may conclude, then, that appreciation value in exempt homes (above *ML+ME*) belongs to *T* until the case is closed. After case closure, so long as the house appeared in the schedule of assets filed by *D*, appreciation value belongs to the mortgage lender (if the mortgage is under water) and then to the debtor. Abandonment signals the end of *T*'s right to a surplus over *ML+ME*.

C. DEWSNUP V. TIMM

Consumer chapter 7 cases usually wind up in a matter of months. Over the course of this short time, appreciation value is not likely to accrue. But in the present hot market, the phenomenon is not unknown. In any event, the case law provides examples of consumer chapter 7 cases that last for years.[72]

When *D* owns an underwater house and files for chapter 7, appreciation value belongs at first to *ML* and then to *D* to the extent of the monetary exemption.[73] Thereafter, *T* takes the surplus over *ML+ME*. Appreciation value is a waterfall, if I may mix hydric metaphors.

When the Bankruptcy Code was first promulgated, things were thought to be different. At first, *T* could divert the waterfall from *ML* to *T* (or, where the property was exempt from *ML*, to *D* and then to *T*). Such a

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[69] 620 B.R. 645 (Bankr. D. Colo. 2020), *aff'd*, No. BAP CO-20-003, 2020 WL 5869458 (10th Cir. BAP (Colo.) Oct. 2, 2020), *aff'd*, 22 F.4th 1217 (10th Cir. 2022).

[70] *Barrera*, 620 B.R. at 654.

[71] *Cf.* Gebhart v. Gaughan (*In re* Gebhart), 621 F.3d 1206 (9th Cir. 2010) (Where *T* waited three years to sell, with regard to a house that was under *ML+ME* on bankruptcy day, the court held *T* was not estopped because *T* never intended *D* to believe that *T* had released all rights to the house. The court also found that abandonment was not a remedy to counteract *T*'s malfeasance in not administering the assets more efficiently.).

[72] *Id.*

[73] Robertson v. Alsberg (*In re* Alsberg), 161 B.R. 680, 683 (B.A.P. 9th Cir. 1993), *aff'd*, 68 F.3d 312 (9th Cir. 1995).

belief was fueled by Bankruptcy Code § 506(d): "To the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void … "Promulgated in 1978 and amended in 1984, § 506(d) was thought to mean that an underwater lien was capped at the appraised value of the collateral. This seemed to be implied by § 506(a)(1):

> An allowed claim of a creditor secured by a lien on property on which the estate has an interest … is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property … and is an unsecured claim to the extent that the value of such creditor's interest … is less than the amount of such allowed claim.[74]

Suppose *ML* claim a lien of $400,000 on property worth $350,000. Section 506(a) says that *ML* holds a bifurcated claim that is secured for $350,000 and is unsecured for $50,000. [75] The meaning of § 506(d) is then supposed to be this: To the extent *ML* claimed a lien for the $50,000 unsecured claim, such lien was void.[76] Not *voidable*, mind you, but void[77]—a state of unbeing. Thus, where appreciation value accrues, *ML* would be capped at $350,000 and *T* could have the appreciation value. This legal result came to be known as *lien stripping*.[78]

The Supreme Court ended lien stripping in Chapter 7 cases in *Dewsnup v. Timm*.[79] The *Dewsnup* majority ruled that "allowed secured claim" means one thing when used in § 506(a). There, it means a claim capped by the value of the collateral. In our example, *ML* is a secured creditor for $350,000 under § 506(a)(1). But "allowed secured claim" means something else in § 506(d). In subsection (d), "allowed secured claim" means the pre-bifurcation claim of the secured creditor, as secured by a lien.[80] In our example, *ML* is a

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[74] *See* Mary Josephine Newborn, *Undersecured Creditors in Bankruptcy:* Dewsnup, Nobelman, *and the Decline of Priority*, 25 ARIZ. ST. L. REV. 547 (1993) for an excellent study of the origins of § 506(a) and (d).

[75] United States v. Ron Pair Enters., Inc., 489 U.S. 235, 239 n.3 (1989).

[76] § 506(d); *see also* Gaglia v. First Fed. Sav. & Loan Assoc., 889 F.2d 1304 (3d Cir. 1989) (emphasizing voidness); Margaret Howard, *Stripping down Liens: Section 506(d) and the Theory of Bankruptcy*, 65 AM. BANKR. L.J. 373, 375-78 (1991).

[77] This became true after the 1984 amendments to the Bankruptcy Code.

[78] Howard, *supra* note 76.

[79] 502 U.S. 410 (1992).

[80] As Professor Margaret Howard pointed out (before *Dewsnup*), Congress eliminated a reference in § 506(d) to allowability under § 502(a), strongly suggesting § 506(d) has nothing to do with the operations of § 502(a). Howard, *supra* note 76, at 378-80. She emphasizes the following 1978 legislative history as congressional intent that the § 506(a) definition applies to § 506(d):

> ⟦Section 506(a)⟧ separates an undersecured creditor's claim into two parts—he has a secured claim to the extent of the value of his collateral; he has an unsecured claim for the balance of his claim … *Throughout the bill, references to secured*

secured creditor for $400,000 under § 506(d).[81] As the Supreme Court would later put it:

> *Dewsnup* considered several possible definitions of the term "secured claim" in §506(d). The definition it settled on—that a claim is "secured" if it is "secured by a lien" and "has been fully allowed pursuant to §502" …

Under the second meaning of "allowed secured claim, appreciation value belongs to *ML*, not to *T* or to *D*.

Assuming house value is $350,000, what if there are two mortgages? ML_1 claims $400,000 and is underwater. ML_2 claims $75,000 and is completely out of the money. *Dewsnup* protects ML_1 but what about ML_2? Again, referring to § 506(a)(1), ML_2 has an allowed claim if she files a proof of claim. The allowed claim is "secured by a lien on property on which the estate has an interest … "But this claim is a secured claim only "to the extent of the value of such creditor's interest in the estate's interest in such property … ." Since value is zero, ML_2 arguably has no secured claim at all. But ML_2 has a *lien*, and *T* needs an avoidance theory to dispatch ML_2's lien. In *Bank of America, N.A. v. Caulkett*,[82] the Supreme Court ruled that, for purposes of § 506(d), ML_2 is indeed a secured creditor under the *Dewsnup* definition. In chapter 7 cases, lien stripping is out by either *T* or *D*, even as against ML_2.

In support of the Supreme Court's result is a deeper inquiry as to what value is. In our hypothetical, house value was stipulated to be $350,000. So conceived, ML_2 would indeed seem to have a secured claim worth zero, or perhaps we should say no "secured claim" at all on the wording of § 506(a)(1).[83] But in fact the $350,000 is a weighted average of all future outcomes. If we conceive of $350,000 as a function f(x), ML_2 has a claim of positive value. In Figure 1, the value of ML_2's junior position is a positive amount, as illustrated by the shaded area between ⟦b,x⟧ on the abscissa.

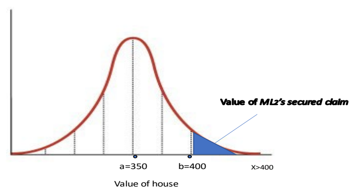
> *claims are only to the claim determined to be secured under this subsection*, and not to the full amount of the creditor's claim.

Howard, *supra* note 76 at 381, n. 38 (emphasis original).

[81] Woolsey v. Citibank, N.A. (*In re* Woolsey), 696 F.3d 1266, 1273 (10th Cir. 2012) ("It's surely a topsy-turvy result to give these two related provisions in the same statutory section entirely different (even opposing) meanings").

[82] 575 U.S. 790 (2015).

[83] Under § 506(a)(1), ML_2's claim is a secured claim "to the extent of the value of such creditor's interest in the estate's interest in such property … "Since the value of ML_2's mortgage is zero, ML_2's mortgage does not exist.



$$\int_b^x f(x)dx > 0$$

Figure One

The mathematical theory of probability fully supports the idea that *Dewsnup* protects ML_2 as well as ML_1.[84] Accordingly, when ML_1 is under water, ML_1 is the first to enjoy appreciation value accruing in a chapter 7 case.[85] ML_2 is second. Where the home is exempt property, *D* is third, to the extent of *ME*. *T* benefits from the waterfall in fourth place.

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[84] According to the materials gathered in JON ROGAWSKI & COLIN ADAMS, CALCULUS: EARLY TRANSCENDENTALS 425-26 (3d ed. 2015), probability of an event p(x) is defined as

$$\int_{-\infty}^{\infty} p(x)dx = 1$$

which states that nothing is impossible and that all the probabilities sum up to 1. Assume that the probability distribution is a bell curve. Standard deviation σ measures the height of the curve. For example, σ=0.5 produces a spikey distribution curve (compared to σ=1) and therefore is more appropriate to the value of the house than σ=1. Since a normal density function is symmetrical, the mean value (μ) appears at the top of the curve.

Probability that the result X will exceed 4 (in $100,000) is $P(4 \leq X \leq \infty)$. The probability that an auction will yield a result greater than 4 is given by

$$p(x) = \frac{1}{\sigma\sqrt{2 \cdot \pi}} e^{-(x-\mu)^2/(2\sigma^2)}$$

where e=2.7162. . . is the value of a dollar continuously invested for a 100% return for one year. ALPHA CHIANG, FUNDAMENTAL METHODS OF MATHEMATICAL ECONOMICS 273 (3d ed. 1984). So

$$P(4 \leq X \leq \infty) = \frac{1}{\sigma\sqrt{2 \cdot \pi}} \int_4^{\infty} e^{-(x-3.5)^2/(2 \cdot 0.5^2)} dx$$
$$= \frac{1}{\sigma\sqrt{2 \cdot \pi}} \lim_{R \to \infty} e^{-(x-3.5)^2/(1^2)} |_4^R = \frac{1}{\sigma\sqrt{2 \cdot \pi}} \left(0 - (-e^{0.25})\right) = .273$$

Thus, given the curve, there is a 27.3% chance that X will exceed $400,000, meaning that ML_2's out-of-the-money claim always has a (minimal) positive value.

[85] *See Dewsnup v. Timm*, 502 U.S. 410, 417 (1992) ("Any increase over the judicially determined valuation during bankruptcy rightly accrues to the benefit of the creditor, not to the benefit of the debtor and not to the benefit of other unsecured creditors whose claims have been allowed and who had nothing to do with the mortgagor-mortgagee bargain").

In *Wilson v. Rigby*,[86] the Ninth Circuit held otherwise. *D* was limited to whatever value existed for *D* above $ML_{1\text{-}2}$'s claims on bankruptcy day. Any appreciation value went first to $ML_{1\text{-}2}$. *D* was passed over and *T* got a bonus on behalf of the unsecured creditors at the expense of *D*'s exemption. Whereas neither *T* nor *D* could "lien strip" *ML* of appreciation value, *T* was able to "exemption strip" against *D*.

In *Wilson D* filed a Schedule C claiming that her Washington condominium was worth $250,000. Since it was subject to *ML*'s claim of $246,244, *D*'s equity was worth $3,560. *D* elected the federal exemptions and used the "wildcard"[87] to protect her equity in a condominium. Three years later, appreciation value paid a call. The condo was now worth $412,500. *D* filed an amendment to Schedule C, switching her election to the state exemptions and claiming "100% of fair market value, up to any applicable statutory limit."[88] The *Wilson* court ruled *D* was frozen at $3,560. Appreciation value could not fill out *D*'s monetary exemption. With *ML* fully funded, all appreciation value went to *T*.[89]

The *Wilson* court derived this result from the "snapshot" rule in *White v. Stump*.[90] But the derivation was erroneous. *White* involved a *qualitative* distinction—one that asks on bankruptcy day whether *D* has any exemption right or not. The *Wilson* court also took the snapshot rule to be a *quantitative* one. "This rule determines not only what exemptions a debtor may claim, it also fixes the value that a debtor is entitled to claim in her exemption,"[91]

The court felt the result reached was compelled by § 522(a)(2), which, once again, defines value to mean

> fair market value as of the date of the filing of the petition or, with respect to property that becomes property of the estate after such day, the date such property becomes property of the estate.[92]

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[86] 909 F.3d 306 (9th Cir. 2018).

[87] § 522(d)(5) ("The debtor's aggregate interest in any property, not to exceed $1,475 in value plus up to $13,950 of any unused amount of the exemption provided under paragraph (1) of this subsection.").

[88] *Wilson*, 909 F.3d at 308.

[89] Masingale v. Munding, 644 B.R. 530, 543 (9th B.A.P. 2022), citing to Wilson v. Rigby, 909 F.3d at 306, 308 (9th Cir. 2018) ("it is well settled that postpetition appreciation of estate property inures to the benefit of the bankruptcy estate".).

[90] 266 U.S. 310 (1924).

[91] *Wilson*, 909 F.3d at 308. The *Wilson* court misreads Gebhart v. Gaughan (*In re* Gebhart). 621 F.3d 1206 (9th Cir. 2010). As we saw earlier, on bankruptcy day: "what is frozen as of the date of filing the petition is the value of the debtor's exemption, not the fair market value of the property claimed as exempt." *Gebhart*, 621 F.3d at 1211. The Wilson dissent forcefully objects to the distortion of *Gebhart's* "frozen" remark. *Wilson*, 909 F.3d at 321.

[92] § 522(a)(2).

We have already seen that the Supreme Court has eliminated this provision in *D-T* relations, though, as we shall see,[93] it still mediates relations between *D* and *JC*. For the moment, it can be observed that the *Wilson* court applied the rule of § 522(a) to cap *D*'s exemption right, but it ignored the rule when *T* were to sell for an amount above *ML+ME*. The court allowed *T* in *Wilson* to have her cake and eat it too.

As it turns out, this use of § 522(a) would not apply to the usual monetary exemption enacted into state law. The *Wilson* court tied the result to the exact wording of RWC § 6.13.030, which at the time of *Wilson* read:

> A homestead may consist of lands, as described in RCW 6.13.010, regardless of area, but the homestead exemption amount shall not exceed the lesser of (1) the total net value of the lands … as described in RCW 6.13.010, or (2) the sum of ⟦$125,000⟧ in the case of lands …[94]

The idea of the *Wilson* majority was that, under the Washington statute, *D* was only entitled to the lesser of equity on bankruptcy day or $125,000.

Shocked by this interpretation, the Washington legislature hastily amended RCW § 6.13.030 to read:

> (1) A homestead exemption amount is the greater of:
>
> (a) $125,000;
>
> (b) the county median sale price of a single-family home in the preceding calendar year …[95]

Since *D* no longer is limited to the lesser of $125,000 or "total net value of the lands," Washington bankrupts, after May 12, 2021, are entitled to the full benefit of the waterfall, free and clear of the wrongly decided *Wilson* opinion.

D. AVOIDANCE UNDER § 522(F)(1)

D may have suffered money judgments prior to bankruptcy. Those money judgments may exist as liens on *D*'s home,[96] subject to *D*'s exemption.[97] Ordinarily, if *D* gets a discharge in bankruptcy, the discharge voids any judgment held by *JC* against the home,[98] provided *JC*'s claim was

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[93] *See infra* text accompanying notes 126-32.

[94] West's Revised Code of Washing Annotated. § 6.13.030.

[95] *Id.* § 6.12.030.

[96] *E.g.*, N.Y.C.P.L.R. § 5203(a).

[97] *Id.* § 5205(a).

[98] Under § 524(a)(1), a discharge "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 …".

discharged. Discharge affects the judgment that proclaimed *D*'s *in personam* liability, but not the underlying judicial lien that may have attached prepetition.[99] Where prepetition judgment liens encumber the house, these survive *D*'s discharge. When appreciation value rears its head, these surviving judgment creditors would take the appreciation value once *ML+ME* is covered.

But *D* has the opportunity to capture any appreciation value back from these prepetition judgment creditors. According to § 522(f)(1)

> the debtor may avoid the fixing of a lien on an interest of the debtor in property to the extent that such lien impairs an exemption to which the debtor would have been entitled under [§522(b)], if such lien is—
>
> (A) a judicial lien, other than a judicial lien that secures a debt of a kind that is specified in section 523(a)(5) … [100]

Section 523(a)(5) in turn references domestic support obligations. What we are about to describe is not possible when *JC* is an aggrieved family member.[101]

We have seen that *Dewsnup* prevents lien stripping with regard to *ML*.[102] Oddly, what is not permitted to *T* or *D* under § 506(d) is fully invited by § 522(f)(1) with regard to judicial liens on the homestead. Section 522(f)(1) provides that *D* may avoid judicial liens on the home to the extent the judicial lien impairs the exemption. But § 522(f)(1) does more than allow *D* to avoid judicial liens on the home to the extent the judicial lien impairs the exemption. It allocates to *D* appreciation value above and beyond *ML+ME* that accrues after the bankruptcy petition.[103]

Now this was probably an accident. The legislative history to the 1978 Bankruptcy Reform Act is brief: § 522(f)

> protects the debtor's exemptions, his discharge, and thus his fresh start by permitting him to avoid certain liens on exempt property. The debtor may avoid a judicial lien on

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[99] Moser v. Schachar (*In re* Thaw), 620 Fed. Appx. 304, 307-307 (5th Cir. 2015).

[100] § 522(f)(1). Although we assume we are in the midst of a chapter 7 case, § 522(f)(1) applies in chapter 13 cases as well. *In re* Badolato, 641 B.R. 806 (Bankr. E.D. Pa. 2022); *In re* Petersen, 561 B.R. 788, 791 (Bankr. D. Utah 2016).

[101] § 101(14A) defines "domestic support obligation" as, basically, alimony, child support and the like. The domestic support exception overrules Owen v. Owen, 500 U.S. 305 (1991), where a deadbeat husband seemingly used § 522(f)(1) to whittle down the judgment lien of an ex-spouse.

[102] *See supra* text accompanying notes 72-77.

[103] Lawrence Ponoroff, *Exemption Impairing Liens Under Bankruptcy Code Section 552(f): One Step Forward and One Step Back*, 70 U. COLO. L. REV. 1, 31 (1999).

> any property to the extent that the property could have been exempted in the absence of a lien …[104]

Section 522(f) was necessary to effectuate the new federal exemption option. A federally exempt item might arrive in the bankruptcy estate encumbered by a state judicial lien (where the item is not exempt under the relevant state law). So § 522(f)(1) removes the lien and allows for the federal exemption to take effect.[105] In some states homesteads are not exempt until *D* files a claim of homestead with the real estate recording office.[106] Where *JC* has a lien on the homestead prior to bankruptcy and *D* has recorded a homestead claim and then files for bankruptcy, § 522(f) permits *D* to snatch back the home from *JC*, as the Supreme Court showed in *Owen v. Owen*.[107]

On these occasions, § 522(f)(1) saves *D* from losing the exemption. But that is not all that § 522(f)(1) does. It is now a device by which *D* might deprive *JC* of postpetition appreciation value. Impairment is robotically defined in § 522(f)(2):

> For the purposes of this subsection, a lien shall be considered to impair an exemption to the extent that the sum of—
>
> (i) the lien;
>
> (ii) all other liens on the property; and
>
> (iii) the amount of the exemption that the debtor could claim if there were no liens on the property;
>
> exceeds the value that the debtor's interest in the property would have in the absence of any liens.[108]

For example, suppose *D*'s exemption is for $150,000. *D* owes $400,000 on a mortgage, and the court values the house at $500,000. Suppose further that *JC* claims $1 million. The impairment formula defines the quantity of avoidance by which *D* may cut down the size of the judicial lien. Thus

> ⟦the lien+other liens+exemption⟧ -FMV of house impairment

[104] Senate Rep. No. 95-989, 95th Cong., 1st Sess. 362 (1977).

[105] Robert H. Bowmar, *Avoidance of Judicial Liens that Impair Exemptions in Bankruptcy: The Workings of 11 U.S.C. 522(f)(1),* 63 AM. BANKR. L.J. 375, 385-86 (1989).

[106] White v. Stump, 266 U.S. 310 (1924).

[107] 500 U.S. 305 (1991). In *Owen*, *JC* had a judicial lien on *D*'s Florida condominium, which was not exempt. Later, the Florida legislature permitted condos to be exempt. *D* was able to avoid *JC*'s lien because the lien impaired an exemption to which *D* would have been entitled, if only the lien had never attached. Section 522(f)(1) does not, it appears, honor the snapshot rule of *White v. Stump*, 266 U.S. 310 (1924).

[108] § 522(f)(2).

⟦$1 million+$400,000 +$150,000⟧- ⟦500,000⟧ = $1.05 million

We must now set the $1.05 million impairment calculation to work on *JC*'s judicial lien securing the judgment for $1 million. Since the entire lien impairs the exemption the judicial lien is entirely avoided—with $50,000 of avoidance power left unused.[109] Later, when the case is closed, appreciation value belongs first to *ML* and then to *D*, but not to *JC*. *D* recovers the exemption amount ($150,000) — and more! *JC* has lost her place in the waterfall. Suppose value increases to $650,000. We would distribute this fund as follows:

1.	*ML*'s lien	$400,000
2.	*D*'s exemption	$150,000
3.	*D*'s surplus equity	$100,000
		$650,000

In this example, the amount of avoidance ($1.05 million) exceeds the amount of the lien, and so *JC*'s lien entirely disappears. We get a more efficient match-up of avoidance *puissance* and the judgment lien avoided where the judicial lien is smaller. Suppose *JC* claims $51,000. The three-term sum (*ML+ME+JC*) is now $501,000, which exceeds the appraised value of the house ($500,000). The excess gives *D* $1000 worth of avoidance. So, if value increases to $650,000, *ML* receives $400,000, *D* receives the exemption amount of $150,000, *JC* receives $50,000 and *D* receives surplus appreciation value that, under state law, *JC* would have received. We have the following priority:

1.	*ML*'s lien	$400,000
2.	*D*'s exemption	$150,000
3.	*JC*'s lien	$ 50,000
4.	*D*'s surplus equity	$ 50,000
		$650,000

JC appears in this list because only $1,000 of *JC*'s lien impaired *D*'s exemption. The rest ($50,000) impairs *D*'s *equity* but *not D*'s *exemption.*[110]

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[109] Barclay v. Boskoski, 52 F.4th 1172 (9th Cir. 2022) (entire lien avoided).

[110] What if there are two separate judgments, owned by JC_1 and JC_2 respectively? We learn in § 522(f)(2)(B): "In the case of a property subject to more than 1 lien, a lien that has been avoided shall not be considered in making the calculation under subparagraph (A) with respect to other liens." An unstated premise in § 522(f) is that one should first apply the calculation to JC_2, and only after that to JC_1. Once JC_2 is destroyed, we may ignore JC_2 per § 522(f)(2)(B). If you start with JC_1 and then move on JC_2, then JC_1 perishes and JC_2 survives. "Last in right is first in calculation." *See* David Gray Carlson,

Later, when the property is abandoned, *JC* sells for $250,000. *D* gets $200,000 (more than the exemption amount) and *JC* obtains $50,000 on her judgment of $51,000.

One obscure piece of knowledge concerns the fact that, when a lien is avoided, it does not just disappear. It is preserved.[111] According to § 551, "Any transfer avoided under section 522, 544, 545, 547, 548, 549, or 724(a) . . . , or any lien void under section 506(d) . . . is preserved for the benefit of the estate but only with respect to property of the estate."[112] "⟦A⟧voidance is a misnomer . . . Preservation, not avoidance, should be the theme of fraudulent transfer's tongue."[113] Metaphysical philosophers will recognize here the Hegelian moment of *Aufhebung*[114] in § 551.[115]

The attentive reader will have noticed that § 551 applies to avoidance under § 522. Has the Bankruptcy Code pulled a mean trick on *D*? When *D* avoids *JC*'s lien under § 522(f)(1), does the lien go back to *T* for *T* to enforce or sell? By no means! By the time *D* is avoiding *JC*'s lien, the monetary exemption has been expelled from the bankruptcy estate. Preservation works "only with respect to property of the estate."[116] When *D* pursues an action under § 522(f)(1), *D* seeks avoidance with respect to property that is *not* property of the estate.

But *D* still benefits from lien preservation pursuant to § 522(i):

> Notwithstanding section 551 of this title, a transfer avoided under . . . subsection (f) . . . may be preserved for the benefit of the debtor to the extent that the debtor may exempt such property under subsection (g) or paragraph (1) of this subsection.[117]

The reference to subparagraph (g) is otiose here. Subparagraph (g) cancels lien preservation for the benefit of *D* where *D* has voluntarily conveyed away the exempt property. Subparagraph (g) does not apply because the attachment of *JC*'s judgment lien was *D*'s *in*voluntary conveyance.[118]

What § 522(i)(2) says is that *D* subrogates to *JC*'s lien on *D*'s exempted home. Does this mean that preservation permits *D* to snatch appreciation

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Security Interests on Exempt Property After the 1994 Amendments to the Bankruptcy Code, 4 AM. BANKR. INST. L. REV. 57, 66 (1996).

[111] Ponoroff, *supra* note 103, at 32-33.

[112] § 551.

[113] David Gray Carlson, *The Logical Structure of Fraudulent Transfers and Equitable Subordination* 45 WM. & MARY L. REV. 157, 161 (2003).

[114] In German, *aufgehoben* means "to cancel" and "to preserve."

[115] David Gray Carlson, *Hegel's Theory of Quality*, 22 CARDOZO L. REV. 425, 452-53 (2001).

[116] § 551.

[117] § 522(i).

[118] The reference to subparagraph (i)(1) is mysterious. Subparagraph (i)(1) gives *D* the rights of avoidance under § 550 (even though § 550 does not apply to *D*'s avoidances under § 522(f)(1)).

value from senior *ML*? It does not. *JC* has no right to snatch that value from *ML*. *D* only gets rights that *JC* had, and *JC* could not prevent *ML* from taking appreciation value. Therefore, neither can *D*.

But the story is different if *ML* is junior to *JC*. In 1994, Congress saw fit to legislate into § 522 the dissenting opinion in *In re Simonson*.[119] In that case, the following priority arose (in rounded numbers):

1.	*ML*'s	$25,000	
2.	JC_1	$13,000	Exemption = $7,500
3.	JC_2	$ 1,000	Value of house = $58,000
4.	ML_2	$41,000	

Simonson arose before the mechanical "impairment" test was enacted (1994). At that time, courts had to figure out, to their dismay, what impairment meant.[120]

According to the majority, $JC_{1\text{-}2}$ did not impair the exemption because the combined mortgages of $ML_{1\text{-}2}$ ($25,000+41,000=$66,000) exceeded the value of the house ($58,000). Therefore, the liens of $JC_{1\text{-}2}$ continued to exist, and *D* obtained no benefit from the exemption ($7,500). This makes perfect sense. JC_1 came into existence when *D* had $58,000-$25,000=$23,000 in value. JC_1 ($13,000) did not impair the exemption. JC_1 impaired the surplus *above* the exemption. JC_2 *did* impair the exemption. But *D* gave the exemption away to ML_2 and so deserved nothing at the expense of JC_2.[121]

Judge Edward R. Becker dissented, and Congress would endorse this dissent as the meaning of the 1994 amendments.[122] According to Judge Becker, *D* should be able to avoid part of JC_1's lien and the entirety of JC_2's lien. These liens are *preserved*, and *D* is subrogated to them. Therefore, after bankruptcy when the automatic stay has ended, ML_1 can foreclose, and the proceeds are to be distributed according to this priority:

1.	ML_1	$25,000
2a.	JC_1	$ 6,500
2a.	*D*	$ 6,500

[119] 758 F.2d 103, 106 (3d Cir. 1985).

[120] On this struggle, see Bowmar, *supra* note 105.

[121] For the record, in New York, the congressionally scorned majority opinion in *Simonson* describes the result under state law. In New York, if ML_1 were to foreclose, the monetary proceeds are not considered exempt property. The proceeds are personal property and not exempt. First Fed. Savs. & Loan Ass'n v. Brown, 434 N.Y.S. 2d 306, 308 (App. Div. 1980). Therefore, ML_1 takes first, JC_1 second, and JC_2 third. ML_2 gets no windfall and *D* enjoys no fruits of exemption. Carlson, *Critique*, *supra* note 30, at 1386-88.

[122] *Simonson*, 758 F.2d at 106-13.

3.	*D*	$ 1,000
4.	ML_2	$41,000

Thus, *D* climbs into the shoes of JC_2 and into the left shoe of JC_1 to gain a priority over ML_2.[123]

Suppose *ML* is under water and *JC* is completely out of the money. Many a *D* will despair of the utility of dispatching *JC*'s lien and so will not bring the avoidance proceeding, figuring that there is no profit in it.[124] The chapter 7 case is closed. The trustee abandons the property. Suppose, however, years go by and real estate prices skyrocket. *JC* now is poised to capture the appreciation value from *D*. Can *D*, years later, get rid of *JC*?

The surprising answer is yes. *D* can have the chapter 7 case re-opened for the purpose of bringing the § 522(f) avoidance. And when she does so, *D* will be able to use the degraded value of the home that existed on bankruptcy day.[125] Recall that *D* has an avoidance theory if the three-term sum (*ML+ME+JC*) exceeds "the value that the debtor's interest in the property would have in the absence of any liens." Value is a function of time. And § 522(a) provides "In this section … (2) 'value' means fair market value as of the date of the filing of the petition … "This means that *D* can reach back for a very low value, which will have the effect of obliterating *JC*'s current lien. Seemingly back into the money, *JC* can be expelled from the waterfall. Although we have seen that § 522(a)(2) is a dead letter in *D*-*T* relations, it is very much alive in *D*-*JC* relations. Strange but true!

In many cases, § 522(f)(1) captures appreciation value for *D* and deprives *JC* of it, contrary to the result that would occur under state law. But we must acknowledge the following absurdity bestowed upon us by the Supreme Court. Suppose *JC* has a judgment against *D* and *D* has no real property. Obviously, *JC* has no lien on anything because *D* has no property. But now suppose *D* buys a home in the county where *JC*'s judgment is docketed. In New York and many other states, *JC*'s judgment has a "dragnet" effect. The instant *D* takes title to the real property, *JC*'s lien attaches. *D* and *JC* are simultaneous takers.[126] When this occurs, § 522(f)(1) cannot be used against *JC*. Why not? According to § 522(f)(1), *D* "may

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[123] To show how difficult this problem is, two accomplished bankruptcy experts miss the fact that JC_2's lien is preserved for *D*'s benefit. They bemoan the promotion of ML_2 over *ME*. Lawrence Ponoroff & F. Stephen Knippenberg, *The Immovable Object Versus the Irresistible Force: Rethinking the Relationship Between Secured Credit and Bankruptcy Policy*, 95 MICH. L. REV. 2234, 2275-77 (1997).

[124] In a chapter 7 case, *D* must foot the legal bill because *D*'s attorney is not entitled to an administrative claim. Lamie v. United States Trustee, 540 U.S. 526 (2004). In contrast, *D*'s lawyer *is* entitled to an administrative claim in a chapter 13 case. § 330(a)(4)(B).

[125] David G. Waltrip LLC v. Sawyers (*In re* Sawyers), 2 F.4th 1133 (8th Cir. 2021).

[126] Carlson, *Critique*, *supra* note 30, at 1367-69.

avoid the fixing of a lien on an interest of the debtor in property" that the lien impairs. In the dumbfounding case of *Farrey v. Sanderfoot*,[127] *JC*'s lien never affixed itself to *D*'s home. Fixation, it seems, means that *first D* owns the land and *then JC*'s lien attaches. When *D* and *JC* are simultaneous takers, *JC* has a lien *but not via "fixing."* And therefore § 522(f)(1) does not apply.[128] When *JC* claims *D*'s after-acquired property, *JC* owns appreciation value (to the extent of the judgment) and *D* does not.[129]

Who then owns appreciation value in chapter 7? First, *ML* owns it if *ML* is underwater. *D* is next for *ME*. If § 522(f)(1) whittles down (or does not affect) *JC*, *JC* is third. Beyond that *D* owns the surplus. Although § 522(f)(1) aims at preserving the monetary exemption, it actually does more for *D*. It enables *D* to take appreciation value away from *JC*. *D* gets an extra-fresh start.

Part II. Chapter 13

In chapter 13, everything changes. From the beginning, a chapter 13 debtor is entitled to possess the house as licensee of the bankruptcy estate. In the pre-confirmation period, § 1306(b) establishes *D*'s right of possession: "Except as provided in a confirmed plan or order confirming a plan, the debtor shall remain in possession of all property of the estate."[130] The chapter 13 trustee cannot sell. Sales out of the ordinary course are governed by § 363(b), but § 1303 informs us that "the debtor shall have exclusive of the trustee, the rights and powers of a trustee under sections 363(b), 363(d), 363(e), 363(f), and 363(*l*) . . ."[131] *D* may sell the house with court permission, but *T* may not. This describes *D*'s rights in the house prior to confirmation of a plan.

Chapter 13 ultimately invites *D* to buy back property of the chapter 13 estate, including the house. Upon confirmation of the plan the bankruptcy estate is usually transferred from *T* back to *D*.[132] *D* in effect buys the house back from *T* with postpetition wages, which, in a chapter 7 case, would not

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[127] 500 U.S. 291 (1991).

[128] Marine Midland Bank v. Scarpino, 113 F.3d 338, 340-41 (2d Cir. 1997).

[129] Owen v. Owen, 500 U.S. 305 (1991), was decided the same day as *Farrey*. In *Owen*, the Supreme Court remanded with instructions that the lower courts had to figure out whether *Farrey* applied. *Id.* at 314. It did. So *JC*'s lien was unaffected and *JC*'s lien could not be avoided. Owen v. Owen (*In re* Owen), 961 F.2d 170 (11th Cir. 1992).

[130] § 1306(b).

[131] § 1306(b).

[132] § 1327(b) (""Except as otherwise provided in the plan or the order confirming the plan, the confirmation of plan vests all of the property of the estate in the debtor.").

have been property of the estate.[133] This may be described as "the basic chapter 13 bargain."[134]

A. MORTGAGES IN CHAPTER 13

1. Underwater First Priority Mortgages

When dealing with *nonresidential* mortgages in chapter 13, such a mortgage, if underwater, can be stripped down and capped. *Dewsnup v. Timm* prohibits D's use of § 506(d) to strip down a mortgage in chapter 7 cases. But chapter 13 operates on an entirely different set of principles that in no way relies on § 506(d).[135] Suppose the nonresidential property is valued at $350,000 and ML_1's total claim is for $400,000. According to § 506(a)(1), ML_1 is a secured creditor for $350,000 and is an unsecured creditor for $50,000. Under chapter 13 *D* may write a plan that "crams down" ML_1. *D* must pay ML_1 enough dollars over the life of a plan such that present value of the payments (according to a market rate of interest)[136] equals $350,000.[137] *D* can treat the $50,000 deficit as an unsecured claim. Who owns any appreciation value that arises after confirmation of a chapter 13 plan? That is controversial, but it does not belong to ML_1, so long as the chapter 13 case continues and is completed.

Argus-eyed from the first, the home mortgage industry saw the danger of cram-down. It therefore insisted upon and got special treatment. Section 1322(b) is a list of things a chapter 13 can accomplish. Subsection (b)(2) invites debtors to "modify the rights of holders of secured claims." But the mortgage industry obtained a prohibition arising in the middle of this permission. A plan may *not* modify "a claim secured only by a security interest in real property that is the debtor's principal residence . . . ."[138]

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[133] § 541(a)(6).

[134] David Gray Carlson, *Modified Plans of Reorganization and the Basic Chapter 13 Bargain*, 83 AM. BANKR. L.J. 585 (2009).

[135] Wells Fargo Bank, N.A. v. Scantling (*In re* Scantling), 754 F.3d 1323, 1326 (11th Cir. 2014) ("The strip off procedure was a two-step process guided by 11 U.S.C. § 506[[a]] and 1322(b) of the Bankruptcy Code").

[136] In *Till v. SCS Credit Corp.* the security agreement called for 21% interest. The bankruptcy court had reset the cram down rate at the prime rate plus 1.5%. The bankruptcy court was upheld by the Supreme Court in a plurality opinion. Till v. SCS Credit Corp., 541 U.S. 465, 468-69 (2004),

[137] According to § 1325(a)(5), the court must confirm a plan that, *inter alia*, provides that "the value, as of the effective date of the plan, of property to be distributed under the plan on account of [[*ML*'s allowed secured]] claim is not less than the allowed amount of such claim . . . ."

[138] Where, however, the maturity date of the mortgage is before the plan is completed, § 1322(b)(2) does not apply. ML_1 can be capped at $350,000, and appreciation value then belongs to *D*. § 1322(c)(1). Is § 1322(b)(2) special interest legislation for the benefit of a politically powerful group of lenders? Observe that § 1322(b)(2) is by no means limited to purchase money lending. If it were, then the program could be defended as making home acquisition cheaper. But protection is extended to *any* mortgage on the principal residence. *See* Nobelman v. American Savings Bank, 508 U.S. 324, 332 (1993) (Stephens, J., concurring), Grubbs v. Houston 1st Am. Sav. Assn, 730 F.3d 236, 246 (5th Cir. 1984) (§ 1322(b)(2)

Section 1322(b)(2) governs the mortgage going forward. Looking backward, if *D* entered the bankruptcy in arrears, the cure price may be paid within "a reasonable time."[139] Thus, by the time the plan has been completed, the cure has been accomplished and the mortgage continues forward after the plan is finished.[140] Cram down of the senior home mortgage is not possible in a chapter 13 case.

Debtors have chafed under this prohibition against cramming down the home mortgage and have launched sneak attacks on ML_1. For example, if ML_1's mortgage covered wall-to-wall carpeting, then § 1322(b)(2) did not apply, since carpet is personal property and § 1322(b)(2) required ML_1 to be secured "*only* by a security interest in real property."[141] The Bankruptcy Abuse Prevention and Consumer Protection Act[142] probably put an end to this subterfuge in 2005.[143]

A most prominent subterfuge was the assertion by *D* that, under § 506(a)(1), ML_1 is a secured creditor only for $350,000. Therefore, *D* could write a plan that honors the mortgage agreement with the proviso that mortgage principal is lowered to $350,000. The plan had to preserve monthly payments at the contractual interest rate, but when those payments retired $350,000 worth of principal, the mortgage lien was discharged.[144] This was odd. A chapter 13 debtor craves financial relief *immediately*. The subterfuge gave relief a decade or more down the road, by terminating the payment stream slightly early.

"was apparently in response to perceptions, or to suggestions advanced in the legislative hearings, that home mortgage lenders, performing a valuable social service through their loans, needed special protection against modification"). On whether § 1322(b)(2) qualifies as special interest legislation, see Lynn M. LoPucki, *House Swaps: A Strategic Bankruptcy Solution to the Foreclosure Crisis,* 112 MICH. L. REV. 689, 729-33 (2014).

[139] According to § 1322(b)(5) a plan may, "notwithstanding paragraph (2) of this subsection, provide for the curing of any default within a reasonable time . . . ."

[140] *See* § 1322(b)(5) (a plan may "provide for . . . maintenance of payments while the case is pending on any secured claim on which the last payment is due after the date on which the final payment under the plan is due . . .").

[141] § 1322(b)(2) (emphasis added). *See* Sapos v. Provident Inst. of Sav., 967 F.2d 918, 925 (3d Cir. 1992) (security interest on wall-to-wall carpeting fatal to §1322(b)(2) protection).

[142] Pub. L. No. 109-8, 119 Stat. 23 (2005) (hereinafter "BAPCPA").

[143] *See* § 101(13A) (new definition of "debtor's principal residence"); § 101(27B) (new definition of "incidental property," as used in subsection (13A)).

[144] *See* Bellamy v. Federal Home Loan Mortgage Co. (*In re* Bellamy), 962 F.2d 176, 179-82 (2nd Cir. 1992) *abrogated by* Nobleman v. American Savings Bank, 508 U.S. 324 (1993); *In re* Honett, 116 B.R. 495, 497 (Bankr. E.D. Tex. 1990) (payments maintained, but maturity date foreshortened); Mark S. Scarberry & Scott M. Riddle, *Home Mortgage Strip Down in Chapter 13 Bankruptcy: A Contextual Approach to Sections 1322(b)(2) and (b)(5)*, 20 PEPPERDINE L. REV. 425 (1993); Jane Kaufman Winn, *Lien Stripping After Nobelman*, 27 LOYOLA L.A. L. REV. 541, 555-57 (1994).

The Supreme Court in *Nobelman v. American Savings Bank*,[145] put an end to this subterfuge. ML_1 may be a secured creditor for $350,000 under § 506(a)(1), but ML_1 had the *right* to be paid $400,000, and § 1322(b(2) prohibits modifying this or any other *right* of ML_1.

Since *Nobelman*, it has been clear that first-priority home mortgages may not be capped or bifurcated in chapter 13. Thus, where *D*'s house is valued at $350,000 and ML_1 claims $400,000, the plan must leave unmolested ML_1's right to be paid the full amount owing pursuant to the mortgage agreement. This guarantees that ML_1 is in the first position in the chapter 13 waterfall engendered by appreciation value.

2. Second Mortgages Out of the Money

In our example, the house is worth $350,000 and ML_1 claims $400,000. ML_1 is underwater. Suppose there is also ML_2, claiming $75,000 and therefore is completely out of the money, since ML_1 takes all the value ($350,000). We have seen that in chapter 7 cases, *D* cannot rid herself of ML_2's mortgage lien.[146] But in chapter 13, a theory sprang up whereby ML_2 could be capped at zero, even though ML_1 cannot be capped at all. As it now stands, ML_2 can be expelled from the waterfall.

Section 1322(b)(2) invites a plan to "modify the rights of holders of secured claims," but not a claim secured" by a residential mortgage. Recall that § 506(a)(1) provides: "An allowed claim of a creditor secured by a lien on property on which the estate has an interest … is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property … ." According to the vast weight of authority, ML_2 is not the holder of a secured claim (even though ML_2 has a mortgage which could be foreclosed under state law). Under § 506(a)(1), ML_2 has a secured claim to the extent of the value available to her, which is zero. A secured claim for zero is supposedly not a secured claim at all. Therefore, ML_2 is not protected by § 1322(b)(2). ML_2's claim is an allowed *unsecured* claim (even though ML_2 has a mortgage lien).[147] ML_2 can be "stripped off."[148] Six courts of appeal have blessed this theory.[149]

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[145] 508 U.S. 324 (1993).

[146] Bank of America, N.A. v. Caulkett, 575 U.S. 790 (2015).

[147] In some of the cases, ML_1 owns two mortgages, the second of which is out of the money. The second mortgage can be stripped off. Wells Fargo Bank, N.A. v. Scantling (*In re* Scantling), 754 F.3d 1323 (11th Cir. 2014); *In re* Tran, 431 B.R. 230 (Bankr. N.D. Cal. 2010), *aff'd*, 814 F. Supp. 2d 946 (N.D. Cal. 2011). ML_1 would have been wise to consolidate the two mortgages instead of receiving a "separate" second mortgage.

[148] Capping ML_1 to an amount less than the proper principal amount is called "strip down." Eliminating ML_2 altogether is called "strip off." Burkhart v. Grigsby, 886 F.3d 434, 437 (4th Cir. 2018).

[149] *Id.*; Zimmer v. PSB Lending Corp. (*In re* Zimmer), 313 F.3d 1220 (9th Cir. 2002); Lane v. Western Interstate Bancorp (*In re* Lane), 280 F.3d 663 (6th Cir. 2002); Bartee v. Tara Colony Homeowners Ass'n (*In re* Bartee), 212 F.3d 277 (5th Cir. 2000); Tanner v. FirstPlus Fin., Inc. (*In re*

Is this theory still viable after the Supreme Court's ruling in *Bank of America, N.A. v. Caulkett*?[150] As a caveat, *Dewsnup* dropped the following footnote: "Accordingly, we express no opinion as to whether the words 'allowed secured claim' have different meaning in other provisions of the Bankruptcy Code."[151] Therefore, the Supreme Court has reserved the right to define "allowed secured claim" in § 1325(a)(5) to exclude ML_2's out-of-the-money" claim. If so, ML_2 is not entitled to the § 1322(b)(2) protection and can be treated as an unsecured creditor.

I assume here that § 506(d) is irrelevant to the operation of chapter 13. Not everyone agrees.[152] *Caulkett* and *Dewsnup* are interpretations of § 506(d). But chapter 13 bifurcation works independently of § 506(d).[153] In a chapter 13 case, should a court ignore *Dewsnup* and rely solely on the definition of § 506(a)?

a. Hints from the Supreme Court

Nobelman v. American Savings Bank[154]has contradictory things to say about this question. In *Nobelman*, decided a year after *Dewsnup*, the Supreme Court implied at one point that § 506(a)(1) supplies the chapter 13 definition, at least when reading § 1322(b)(2) as it applies to ML_1. In describing *D*'s argument that ML_1 could be written down to $350,000, Justice Thomas remarked that *D* was

> correct in looking to § 506(a) for a judicial valuation of the collateral to determine the status of the bank's secured claim. It was permissible for petitioners to seek a valuation in proposing their Chapter 13 plan, since § 506(a) states that "such value shall be determined … in conjunction with any hearing … on a plan affecting such creditor's interest." But even if we accept petitioners' valuation, the bank is still the "holder" of a "secured claim," because petitioners' home

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Tanner), 217 F.3d 1357 (11th Cir. 2000); McDonald v. Master Fin., Inc. (*In re* McDonald), 205 F.3d 606 (3d Cir. 2000), *cert. denied*, 531 U.S. 822 (2000); Pond v. Farm Specialist Realty (*In re* Pond), 252 F.3d 122 (2d Cir. 2001); Griffey v. U.S. Bank (*In re* Griffey), 335 B.R. 166 (B.A.P. 10th Cir. 2005).

[150] *Caulkett*, 575 U.S. 790 (2015); *see supra* text accompanying notes 82-86.

[151] Dewsnup v. Timm, 502 U.S. 410, 416-17 (1992) ("Hypothetical applications that come to mind and those advanced at oral argument illustrate the difficulty of interpreting the statute in a single opinion that would apply to all possible fact situations. We therefore focus upon the case before us and allow other facts to await their legal resolution on another day.").

[152] *See infra* text accompanying notes 165-69.

[153] Some courts have held that *Dewsnup* governs § 506(d) in chapter 7 cases, but somehow *Dewsnup* does *not* apply if used in a chapter 13 adversary proceeding. Victorio v. Billingslea, 470 B.R. 545 (S.D. Cal. 2012); *see also* David Gray Carlson, *Cars and Homes in Chapter 13 Under the 2005 Bankruptcy Amendments*, 14 AM. BANKR. INST. L. REV. 301, 385-88 (2006) (arguing that such a position completely undermines the notorious "hanging paragraph" that applies to newly bought vehicles).

[154] 508 U.S. 324 (1993).

> retains $23,500 of value as collateral. The portion of the bank's claim that exceeds $23,500 is an "unsecured claim component" under § 506(a)⟦.⟧[155]

This passage says that § 506(a) supplies the definition of "allowed secured claim."[156] Under that definition, ML_2 is not a secured creditor.

Yet at another point in his opinion, Justice Thomas implies that the *Dewsnup* meaning applies, so that ML_2 is fully entitled to § 1322(b) protection. In this passage, Justice Thomas ponders the relation of "secured claim" to "claim secured," as that phrase appears in § 1322(b)(2):

> Petitioners urge us to apply the so-called "rule of the last antecedent" … According to this argument, the operative clause "other than a claim secured only by a security interest in … the debtor's principal residence" must be read to refer to and modify its immediate antecedent, "secured claims." Thus, § 1322(b)(2)'s protection would then apply only to that subset of allowed "secured claims," determined by application of § 506(a), that are secured by a lien on the debtor's home … We acknowledge that this reading of the clause is quite sensible as a matter of grammar. But it is not compelled. Congress chose to use the phrase "claim secured … by" in § 1322(b)(2)'s exception, rather than repeating the term of art "secured claim." The unqualified word "claim" is broadly defined under the Code to encompass any "right to payment, whether … secure⟦d⟧ or unsecured" … . It is also plausible, therefore, to read "a claim secured only by a ⟦homestead lien⟧" *as referring to the lienholder's entire claim*, including *both the secured and the unsecured components of the claim*. Indeed, § 506(a) itself uses the phrase "claim … secured by a lien" to encompass both portions of an undersecured claim.
>
> This latter interpretation is the more reasonable one … .[157]

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[155] *Id.* at 328-29.

[156] The "zero" theory survives *Caulkett* because the Supreme Court in *Nobelman v. American Savings Bank* issued a "directive" that, in chapter 13, the debtor should look "to § 506(a) for a judicial valuation of the collateral to determine the status of the bank's secured claim." Larson v. Morningstar Mortgage LLC (*In re* Larson), 544 B.R. 883, 884-885. (Bankr. W.D. Wis. 2016) (quoting *Nobelman*, 508 U.S. at 328); *see also* Branigan v. Davis (*In re* Davis), 716 F.3d 331, 338 (4th Cir. 2013) (*Nobelman* "valued the claim in that case under section 506 before analyzing whether section 1322 barred its modification. If, as the Trustee insists, it were not necessary to first value the claim pursuant to section 506(a), the analysis in *Nobelman* would be superfluous. Rather, the Court could have simply held that, because the lien was secured by a primary residence, it falls within the anti-modification provision of section 1322(b), regardless of the value of the collateral").

[157] *Nobleman*, 508 U.S. at 330-31 (emphasis added).

This part of the *Nobleman* opinion suggests that the *Dewsnup* definition applies in chapter 13. *ML_2* has a *claim* and it is *secured,* meaning that *Dewsnup* and *Caulkett* apply after all![158]

It is therefore impossible to tell from Supreme Court opinions whether § 506(a)(1) defines "secured claim" or not.[159] A great many courts cite the first part of *Nobelman* to justify stripping off *ML_2*.[160] They mostly ignore the second part, which implies that *ML_2* is protected by § 1322(b)(2).[161]

In *Zimmer v. PSB Lending Corp. (In re Zimmer),*[162] the court noted the contradiction in *Nobelman* and reasoned that the first remark (§ 506(a) definitions apply) outranks the second remark (§ 1322(b)(2) refers to the lien for both *ML_1*'s secured *and* unsecured claims). First, *ML_1* had to qualify for secured claim status under § 506(a).

> Finally, and only after determining that the creditor was the holder of a secured claim is a secured claim and thus eligible for anti-modification protection, the Court proceeded to the question of exactly what was entitled to such protection. The Court found that the rights of such a creditor were protected and, therefore, in order to protect such rights interpreted the antimodification clause to encompass the entire claim of such a creditor so long as it was secured by a homestead lien.[163]

Any attempt to *Dewsnup ML_2*'s out-of-the-money lien

> attempts to jump forward to the last step in this analysis—determining what is entitled to protection from modification—without considering whether the creditor even qualifies for such protection in the first place. While it is clear that the term "claim secured only by" in the antimodification clause is not limited to "secured claims," it is equally clear that "holders of secured claims" does refer to the term of art as defined by § 506(a). The *Nobelman* Court recognized this when it pointed out that Congress

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158 "And, thus, did the cancer of *Dewsnup v. Timm* spread to a vital part of Chapter 13." David Gray Carlson, *Bifurcation of Undersecured Claims in Bankruptcy*, 70 AM. BANKR. L.J. 1, 15-16 (1996).

159 *See* Newborn, *supra* note 74, at 589-90.

160 Woolsey v. Citibank, N.A. (*In re* Woolsey), 696 F.3d 1266, 1273 (10th Cir. 2012) (citing cases).

161 For an exception, *see* American General Fin., Inc. v. Dickerson, 229 B.R. 539, 542 (M.D. Ga. 1999), *rev'd,* 222 F.3d 924 (11th Cir. 2000). Judge Lundin in his treatise emphasized the second proposition in *Nobelman* and favored *Dewsnupping ML_2*. KEITH M. LUNDIN, CHAPTER 13 BANKRUPTCY § 4.46 (2d ed. 1994), (cited with disapproval in *In re* Hoskins, 262 B.R. 693, 703 (Bankr. E.D. Mich. 2001).

162 313 F.3d 1220 (9th Cir. 2002).

163 *Id.* at 1225 (internal citations omitted).

> used a different phrase in the antimodification clause "rather than *repeating* the term of art 'secured claim.'"[164]

On this reading, *Nobelman* blesses strip-off of ML_2. The *Dewsnup* afterthought may be disregarded.

b. The Role of § 506(d) in Chapter 13

I have said that § 506(d) has no role to play in bifurcating undersecured claims in chapter 13. When bifurcation is appropriate, it is enough that the secured claim is entitled to cram down protection under § 1325(a)(5). Cram down requires that *ML* receive the value of the collateral. The unsecured portion of *ML*'s claim deserves no cram down rights and is entitled to equal treatment with other nonpriority claims.[165] This treatment requires distributions at least equal to what the unsecured claim would have received in a chapter 7 liquidation,[166] and (if someone objects to plan confirmation) a plan that compels *D* to pay projected disposable income over the applicable commitment period.[167]

This raises the question: why did the drafters of the Bankruptcy Code bother writing §506(d) in the first place? This is rather hard to say. Being a chapter 5 provision, § 506(d) applies in chapter 7 *and* in chapter 13.[168] But it isn't needed in chapter 13 or in the other reorganization chapters. It was clearly intended to apply in chapter 7, which certainly suggests *Dewsnup* was wrongly decided (as is very widely believed).

One view of *Dewsnup* is that it stands for the proposition that § 506(d) means *one* thing in the reorganization chapter and *another* thing in chapter 7. The general meaning of § 506(d) is that *ML*'s lien on a nonresidential property does not secure the allowed unsecured claim. But, says the *Dewsnup* majority, this meaning is suspended in chapter 7 cases because its application there would disrupt prepetition practice. Therefore, § 506(d), as interpreted by the *Dewsnup* dissenters, is alive and well in chapter 13.[169]

In *In re Victorio*,[170] Judge Peter W. Bowie opines that *Dewsnup* implies that § 506(d) means one thing in chapter 7 and another thing in chapter 11 or 13 because Justice Blackmun thought Congress did not intend to upset existing practice. Strip-downs were never recognized in chapter VII cases under the Bankruptcy Act of 1898, but could be accomplished in the

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[164] *Id.* at 1225-26 (emphasis original; internal citations omitted).

[165] § 1322(b)(3).

[166] § 1325(a)(4).

[167] § 1325(b).

[168] § 103(a).

[169] *See* Hall v. Brendan Fin. Inc. (*In re* Hall), 495 B.R. 393 (Bankr. N.D. Ill. 2013); Lam v. Investors Thrift (*In re* Lam), 211 B.R. 36 (B.A.P. 9th 1997) (upholding D's right to a declaratory judgment that ML_2 has no lien without citation to § 506(d)).

[170] 454 B.R. 759 (Bankr. S.D. Cal. 2011), *aff'd*, 470 B.R. 545 (S.D. Cal. 2012),

reorganization chapters. Judge Bowie drew this from two cases cited by Justice Blackman: *Long v. Bullard*,[171] for chapter 7 cases, and *Louisville Joint Stock Land Bank v. Radford*,[172] for reorganization cases. *Bullard* stands for the proposition that there could be no strip-down in liquidations.[173] *Radford* stands for the proposition that strip-down can be achieved in reorganizations.[174] Thus the "true" definition of § 506(d) favors strip-down. But this definition is to be suppressed in chapter 7 cases.[175]

In *Woolsey v. Citibank, N.A. (In re Woolsey)*[176] the court held that under § 506(d) *D* could not strip off *ML_2* in a chapter 13 case because the *Dewsnup* definition carried over to chapter 13 cases. *D* had claimed that:

> *Dewsnup* controls the meaning of the term "secured" under § 506(d) only in Chapter 7 cases. The very same term in § 506(d), they contend, should be given an entirely different meaning when it comes to handling Chapter 13 cases—requiring proof of value to avoid lien removal, just as the plain language of § 506(a) suggest.[177]
>
> The Woolseys invite us to hand *Dewsnup* a loss even on its home court, within § 506(d) itself . . . The Woolseys say, we should go now a step further and read the term "secured claim" to mean two different things *even within § 506(d) itself*. When a Chapter 7 case comes along, they say, the term should mean what *Dewsnup* says it means: any claim secured under state property law is protected from removal, even if backed by no value. But when a case is faced with a Chapter 13 case, they argue, the term should be read to require proof of value before a lien is protected from removal in accord with § 506(a). [178]

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[171] 117 U.S. 617 (1886).

[172] 295 U.S. 555 (1935).

[173] *Bullard*, 117 U.S. at 620. To be precise, *Bullard* actually holds that *D*'s discharge in a chapter 7 case does not affect *ML_1*'s post-bankruptcy foreclosure of the mortgage. Presumably, *ML_1*'s non-recourse claim against *D* is the full prepetition amount.

[174] *Radford* actually struck down the Frazier-Lemke Act as unconstitutional. For details, see John D. Ayer, *Rethinking Absolute Priority After Ahlers,* 87 MICH. L. REV. 963, 980-85 (1989).

[175] Some cases permit *D* in chapter 13 to get a declaration in advance of plan confirmation that *ML_2*'s lien is dead. Zimmer v. PSB Lending Corp. (*In re* Zimmer), 313 F.3d 1220 (9th Cir. 2002); Lam v. Investors Thrift (*In re* Lam), 211 B.R. 36 (B.A.P. 9th Cir. 1997). It seems to me that such cases speak of avoidance and have to be read as § 506(d) cases. Section 1322(b) is not an avoidance provision but a description of what a chapter 13 plan may or may not do. *Cf. In re* Okosisi, 451 B.R. 90, 95 (Bankr. D. Nev. 2011) (only the plan can kill *ML*'s lien; any earlier declaration is merely provisional).

[176] Woolsey v. Citibank, N.A. (*In re* Woolsey), 696 F.3d 1266 (10th Cir. 2012).

[177] *Id.* at 1274-75.

[178] *Id.* at 1276 (emphasis original) (internal citation omitted)

Distressed with the methodology of *Dewsnup*, Judge Gorsuch proclaimed himself tempted by *D*'s argument,[179] but in the end he concluded that it supposedly conflicted with the rule that a court must not give the same words a different meaning for each category of cases to which they apply.[180] This is an not effective argument. We are trying to figure out what chapter 13 means for ML_2. This is not a case of a statute meaning one thing for one fact pattern and another thing for another fact pattern. We are not changing the meaning of chapter 13 when the case involves bungalows v. split-levels. We're just trying to apply § 506(d) in chapter 13 *generally*.

Disturbingly, *Woolsey* pretty much endorsed the view that strip off does not require § 506(d), but *D* did not argue for this. In his brief, *D* stood on the § 506(d) argument. Although *D* deserved to win, he did not deserve to win on the meaning of § 506(d). Apparently, *D* was being graded on the quality of their lawyer's brief, not on whether justice was done when the bankruptcy court refused to strip off ML_2.

In the end there is no reason to think that bifurcation of ML_2 down to zero is barred by *Dewsnup*, because § 506(d) is not necessary for cram down in chapter 13.

c. Theater of the Absurd

If ML_2 is not protected by § 1322(b)(2), absurdity ensues. ML_2 still has a lien.[181] ML_2 can foreclose on this lien under state law, dispossessing *D* in favor of some buyer (perhaps ML_2 who may bid in for a dollar). Under state law, ML_2 is a creditor with a security interest. Yet in bankruptcy, ML_2 is not a secured creditor. But as *Woolsey* reminds us, in the world of definition, the author is king. Section 506(a):

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[179] *Id.* For more scornful treatment:

> In a transparent attempt to avoid that straightforward application, [[*D*]] asserts that the Supreme Court in *Dewsnup* was not really interpreting the term "allowed secured claim" differently in § 506(d) than § 506(a), but rather was simply adding an anti-modification provision in § 506(d) for Chapter 7 cases. That argument is so at odds with the plain language of *Dewsnup* as to be created from whole cloth. Nothing in *Dewsnup* indicated that the Court was adding an anti-modification provision to § 506(d) that would apply to chapter 7 cases along, and in fact, it would be beyond remarkable for the Supreme Court to simply fabricate its own statutory provision.

Ryan v. United States (*In re* Ryan), 725 F.3d 623, 625-26 (7th Cir. 2013).

[180] *Id.* at 1277.

[181] *In re* Sadowski, 473 B.R. 12, 19 (Bankr. D. Conn. 2011); *In re* Okosisi, 451 B.R. 90, 93 (Bankr. D. Nev. 2011); American General Fin., Inc. v. Dickerson, 229 B.R. 539, 542 (M.D. Ga. 1999), *rev'd,* 222 F.3d 924 (11th Cir. 2000). In Lam v. Investors Thrift (*In re* Lam), 211 B.R. 36, 40 (B.A.P. 9th 1997) the court held that "[[a]] forced sale of the property would not result in any financial return to [[ML2]], even if a forced sale could be accomplished where the lien attaches to nothing." This is a contradiction. The lien attaches to something—D's house and that is why, outside of bankruptcy, ML2 can foreclose, resulting in D's loss of title.

> explains that for purposes of federal bankruptcy law a 'secured claim' requires something more than a security interest recognized by state law. A claim, even if secured by a valid state law lien on property, qualifies as "secured" for purposes of § 506(a) … only to the extent it is support by *value* in the collateral."[182]

"Secured claim" is a term of art,[183] quite divorced from ordinary usage. Similarly, in marginal cases, ML_2's mortgage exists, or does not exist, according to the whim of the valuer. To borrow a point from Justice Thomas in *Caulkett*,[184] suppose the property is worth $400,001 and ML_1 claims $400,000. ML_2 has a secured claim to the extent of a dollar. The rights of ML_2 cannot be modified. Suppose on the morning of the confirmation hearing, *D* throws a brick through her basement window, which costs $25 to repair. A buyer would reduce her bid by $25 cover the cost of repair and so would pay $399,976, ML_2 has just lost her mortgage—an absurdity not absolutely compelled by the § 506(a) definition. Thus, if absurdity is a reason to guard ML_2 from 506(d) avoidance in chapter 7 cases, it becomes a reason to think that ML_2 is entitled to § 1322(b)(2) protection, which also stamps out the absurdity.[185] In any case, recall that if we conceive value as a probability distribution, ML_2's interest always has *some* positive value.[186]

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[182] Woolsey v. Citibank, N.A. (*In re* Woolsey), 696 F.3d 1266, 1272 (10th Cir. 2012) (emphasis in original).

[183] Nobelman v. American Savings Bank, 508 U.S. 324, 331 (1993).

[184] Bank of America, N.A. v. Caulkett, 575 U.S. 790, 797 (2015) ("If a court valued the collateral at one dollar more than the amount of a senior lien, the debtor could not strip down a junior lien under *Dewsnup*, but if it valued the property at one dollar less, the debtor could strip off the entire junior lien"). *See* Lam v. Investors Thrift (*In re* Lam, 211 B.R. 36, 41 (B.A.P. 9th 1997) ("We believe this concern ⟦as set forth in *Caulkett*⟧ to be unfounded⟦.⟧").

[185] Absurdity, however, was embraced by the Supreme Court in *Ransom v. FIA Card Servs., N.A.*, 562 U.S. 61 (2011). There, under the means test for chapters 7 and 13, *D* sought to take the deduction for car ownership expense under the local standard set by the Internal Revenue Service. § 707(b)(2)(A)(ii)(I). But *D* had made his last payment on the car and so the IRS-endorsed expense was not "applicable" to him:

> ⟦*D*⟧ first points out a troubling anomaly: Under our interpretation, "⟦d⟧ebtors can time their bankruptcy filing to take place while they still have a few car payments left, thus retaining an ownership deduction which they would lose if they filed just after making their last payment." Indeed, a debtor with only a single car payment remaining, Ransom notes, is eligible to claim a monthly ownership deduction.
>
> But this kind of oddity is the inevitable result of a standardized formula like the means test, even more under Ransom's reading than under ours. Such formulas are by their nature over- and under-inclusive. In eliminating the pre-BAPCPA case-by-case adjudication of above-median-income debtors' expenses, on the ground that it leant itself to abuse, Congress chose to tolerate the occasional peculiarity that a brighter-line test produces.

Id. at 78 (internal citation omitted).

[186] *See* supra text accompanying notes 83-84.

Mathematics teaches that *ML_2*'s claim is an option. It *always* has positive value.

Absurd it may be. But so far all courts of appeal agree that *ML_2* gets no protection, and no court has concluded that *Caulkett* changes the chapter 13 rule.[187]

B. CHAPTER 20 CASES

A strange theory, ultimately incorrect, has emerged in chapter 20 cases that saves *ML_2*. In a chapter 20 case, *D* has filed for chapter 7, has obtained a discharge and then promptly (often one day later)[188] files in chapter 13. According to this theory, *ML_2* is admittedly subject to strip-off where *D* is entitled to a chapter 13 discharge. But *ML_2* is immune to strip-off where *D* is *not* entitled to a chapter 13 discharge.[189] At first blush, this is surprising. Since 1886, it has been understood that bankruptcy discharge does not affect a mortgage lien.[190] The only thing a discharge implies is that *ML* is a nonrecourse creditor.[191] How can a discharge affect *ML_2*'s lien (if it exists)?

Prior to BAPCPA, *any D* who completed a chapter 13 plan was entitled to discharge. In contrast, chapter 7 heavily restricts discharges. If *D* misbehaves by hiding assets or destroying financial records, *D* loses the discharge.[192] Not being an *honest* unfortunate debtor means a debtor does not deserve it in chapter 7. But apparently in chapter 13 the issue of a debtor's dishonesty is not relevant to obtaining a discharge.[193]

Since BAPCA, this is not exactly true. According to § 1328(f) (added by BAPCPA):

> the court shall not grant a discharge of all debts provided for in the plan or disallowed under section 502, if the debtor has received a discharge-

[187] Professor Ponoroff has recently declared the strip off of out-of-the-money second mortgages to be the product of "ineluctable logic." Ponoroff, *Dance*, *supra* note 2, at 211. But to my eye, the logic is very luctable indeed.

[188] *See* HSBC Bank USA, N.A. v. Blendheim (*In re* Blendheim), 803 F.3d 477 (9th Cir. 2015).

[189] This theory is adopted in Lindskog v. L&I Bank, 480 B.R. 916 (E.D. Wis. 2012); *In re* Gerardin, 447 B.R. 342 (Bankr. S.D. Fla. 2011) *as amended* (Mar. 28, 2011), and *abrogated by In re* Scantling, 754 F.3d 1323 (11th Cir. 2014); Orkwis v. MERS (*In re* Orkwis), 457 B.R. 243 (Bankr. E.D.N.Y. 2011); *In re* Fenn, 428 B.R. 494, 500 (Bankr. N.D. Ill. 2010); *In re* Jarvis, 390 B.R. 600, 605-06 (Bankr. C.D. Ill. 2008).

[190] Long v, Bullard, 117 U.S. 617 (1886).

[191] Johnson v. Home State Bank, 501 US 78, 82-84 (1991).

[192] § 727(a)(2) *et seq.*

[193] Judge Elizabeth Brown asks, "Did Congress not realize that it was creating this wide window of opportunity for mischief?" *In re* Frank, 683 B.R. 463, 468 (Bankr. D. Colo. 2022).

> (1) in a case filed under chapter 7 … during the 4-year period preceding the date of the order for relief under this chapter, or
>
> (2) in a case filed under chapter 13 of this title during the 2-year period preceding the date of such order.[194]

Suppose *D* filed for chapter 7 on July 1, 2018, and received a discharge on November 1, 2019. In any chapter 13 case commenced before July 1, 2022, *D* may not obtain a chapter 13 discharge.[195] Of course, in a chapter 20 case,[196] *D* arrives in chapter 13[197] already discharged in chapter 7 from any *in personam* rights ML_2 might have. In chapter 7, *D*'s *in personam* obligation to ML_2 is discharged but, under *Caulkett*[198], ML_2's mortgage lien still lives and reigns. Only when that lien is gone can *D* count his gains.

Continuing with the chapter 20 theory, ML_2 may be stripped off in a chapter 13 plan because ML_2 has no secured claim for the purpose of § 1322(b)(2). But, says our theory, ML_2 is nevertheless entitled to cram down protection. Cram down protection applies to "each allowed secured claim provided for by the plan …."[199] Here is the weak point of the theory. The theory concedes that "secured claim" is defined so as to deny ML_2 the protection of § 1322(b)(2). For § 1322(b)(2) purposes, ML_2 is not a secured creditor. But for § 1325(a)(5) purposes, ML_2 *is* the holder of a secured claim.

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[194] Another reason *D* may not obtain a chapter 13 discharge after completing the plan is *D*'s failure to complete an instructional course concerning personal finance management. *See* § 1328(g). Also, the court may not grant a discharge if there is reasonable cause to believe that Bankruptcy Code § 522(q)(1) applies to *D* and if there is reasonable cause to believe that *D* is subject to criminal charges that could result in a felony conviction relating to bankruptcy fraud. *Id.* § 1328(h). The court may not grant a discharge if *D* has defaulted on domestic support obligations. *Id.* § 1328(a) (preamble).

[195] "Note that the four-year bar is measured from the filing of the prior case, not by the date upon which a discharge was previously granted." William Houston Brown, *Taking Exception to a Debtor's Discharge: The 2005 Bankruptcy Amendments Make It Easier*, 79 AM. BANKR. LJ. 419, 448 (2005); *see* Caroll v. Sanders (*In re* Sanders), 551 F.3d 397 (6th Cir. 2008) (same).

[196] As most readers will know, there is no chapter 20 of the Bankruptcy Code. "It is a colloquialism used by bankruptcy practitioners." Wells Fargo Bank, N.A. v. Scantling (*In re* Scantling), 754 F.3d 1323, 1326 n.2 (11th Cir. 2014). What's the point of a chapter 20? Not much, in the present context. If *D* has too much debt to qualify for chapter 13, (*see* § 109(e)), the chapter 7 discharge serves to clear away most of it, making *D* eligible for chapter 13, where *D* may preserve the right to possess her home. Free v. Malaier (*In re* Free), 542 B.R. 492, 497 (B.A.P. 9th Cir. 2015). Other than that, *D* may as well skip chapter 7 and go right to chapter 13, where ML_1 may not be crammed down as to a residential mortgage, but perhaps ML_2 can be stripped off. In the old days, *D* could get an expanded chapter 13 discharge, so that there was no reason to stop off in chapter 7 for a discharge there. BAPCPA has in any case substantially narrowed the difference between chapter 7 and chapter 13 discharges. *See generally* Ponoroff, *supra* note 2, at 216-20.

[197] § 1322(f) is not an eligibility provision. *D* may still file in chapter 13 even where no discharge is possible. Branigan v. Bateman, 515 F.3d 272 (4th Cir. 2008); Grandstaff v. Casey (*In re* Casey), 428 B.R. 519 (Bankr. S.D. Cal. 2010).

[198] Bank of American, N.A. v. Caulkett, 575 U.S. 790 (2015).

[199] § 1325(a)(5).

Carrying the day in the Tenth Circuit is the theory that maintains the meaning of "secured claim," a fickle changeling and poor discontent, capriciously dissembles from section to section in chapter 13.[200]

But we haven't yet articulated the full theory. Assuming we can hustle past the unsteady footing of this the weak point, ML_2 is supposedly a secured creditor for cram down purposes. Traditionally, this always included the right to receive future payments whose present value equal to the value of the secured claim. For ML_2, this is zero, and so far cram down protection is useless. Under BAPCPA, however, ML_2 is entitled to something else. The plan must provide that:

> the holder of such claim retain the lien securing such claim *until the earlier of*
>
> *(aa) the payment of the underlying debt determined under nonbankruptcy law; or*
>
> *(bb) discharge under section 1328* . . . ⟦.⟧[201]

In our hypothetical, ML_2's prebankruptcy claim is $75,000, and it will be receiving not a penny, because this liability was discharged in chapter 7. But *D* is disentitled to a discharge from claims held by other unsecured creditors. Therefore, ML_2's lien continues to exist—now and forever. The chapter 7 discharge never affected the enforcement of this lien against the property, it only served to relieve the debtor's personal liability for payment. Nor could a chapter 13 discharge (of unsecured creditors *other* than ML_2). But the inability of *D* to get a chapter 13 discharge *generally* signifies that ML_2 retains the lien until "payment of the underlying debt determined under nonbankruptcy law." ML_2 survives to recapture appreciation value after completion of the plan. In short, ML_2 regains all the protections under § 1325(a)(5) that were not available under § 1322(b)(2). Weirdly, this works only in those chapter 20 cases where § 1328(f) applies. In ordinary chapter 13 cases and even in some chapter 20 cases, ML_2 can be stripped off.

The theory just expressed should be rejected. Recall that chapter 13 bifurcations do not require an assist from § 506(d). Rather, a secured party's (*SP*s) prepetition security interest is displaced by the chapter 13 plan.[202] We know this from § 1327(a): "The provisions of a confirmed plan bind the debtor and each creditor . . . "The plan says that *SP* has a security interest for some bifurcated amount. Under the plan, *SP* must receive a present value of that amount. Once the plan is complete, *SP* has been paid and the security

[200] DaimlerChrysler Financial Services Americas LLC v. Ballard (*In re* Ballard), 526 F.3d 634, 641 (10th Cir. 2008).

[201] § 1325(a)(5)(B)(i)(I) (italicized words added under BAPCPA).

[202] White v. NewRez LLC (*In re* White), 641 B.R. 717, 724 (Bankr. S.D. Ga. 2022); *In re* Gloster, 459 B.R. 200 (Bankr. D.N.J. 2011); *In re* Frazier, 448 B.R. 803, 810 (Bankr. E.D. Cal. 2011).

interest is extinguished.[203] A similar point can be made about § 1327(c), which states:

> Except as otherwise provided in the plan or in the order confirming the plan, the property vesting in the debtor under subsection (b) of this section is free and clear of any claim *or interest* of any creditor provided for by the plan."[204]

As retired judge Professor Bruce A. Markell emphasized in *In re Okosisi*,[205] "interest" (undefined) must mean ML_2's mortgage lien. Therefore, once the plan is confirmed, ML_2's lien is dead.[206] Thus, prior to BAPCPA, the retirement of SP's lien had nothing to do with receiving a chapter 13 discharge.[207] The same conclusion follows *after* BAPCPA.

In a pre-BAPCPA case, the Ninth Circuit in *In re Leavitt*[208] pondered a dismissal of a chapter 13 case for cause. In the course of its ruminations, the *Leavitt* court stated in passing, "A Chapter 13 case concludes in one of three ways: discharge pursuant to § 1328, conversion to chapter 7 case pursuant to § 1307(c) or dismissal of a Chapter 13 case 'for cause' under § 1307(c)."[209] This statement was entirely accurate in 1999. If the plan was completed, a discharge *had* to follow. But BAPCPA rendered the *Leavitt* trilemma inaccurate. Today, a chapter 13 case can be commenced with no hope of discharge. Yet the plan might be completed and *then* the case might be closed (without a discharge).[210] Closure without discharge was a *fourth* option for killing off ML_2's out-of-the-money lien.[211]

In *In re Victorio*,[212] vigorously disagreed with this fourth option and insisted the *Leavitt* dictum still held, even after BAPCPA. The Ninth Circuit would soon side with Judge Markell: there is indeed a fourth option for ending a chapter 13 case—closure without discharge.[213] Accordingly, ML_2 can be stripped off in chapter 20 cases.

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[203] *In re* Okosisi, 451 B.R. 90, 100 (Bankr. D. Nev. 2011).

[204] § 1327(c) (emphasis added).

[205] *Okosisi*, 451 B.R. at 100.

[206] *Id.* Judge Markell disagrees. He thinks that the lien is not dead until the plan is completed. *Id.* at 95. The lien resurrects itself in case of dismissal and conversion to chapter 7. I explain why this is not so *infra* in Part III.

[207] *In re* Cain, 513 B.R. 316, 321 (B.A.P. 6th Cir. 2014) ("[T]he mechanism that voids the lien is plan completion, and that chapter 20 cases end in administrative closing rather than dismissal.").

[208] 171 F.3d 1219 (9th Cir. 1999).

[209] *Id.* at 1223 (footnote omitted).

[210] HSBC Bank USA, N.A. v. Blendheim (*In re* Blendheim), 803 F.3d 477, 493 (9th Cir. 2015); see *Okosisi*, 451 B.R. at 99 (since BAPCPA, there is a fourth option).

[211] *Okosisi*, 451 B.R. at 100.

[212] 454 B.R. 759 (Bankr. S.D. Cal. 2011).

[213] *Blendheim*, 803 F.3d at 493 note 2. This case applied § 506(d) in chapter 13, but in a *Dewsnup* sort of way. In *Blendheim*, the court considered whether § 506(d) could avoid a mortgage entirely *within* the money. The various courts decided that it did, but this must be questioned. In the case, *D* (wife and

Why, then, did BAPCPA add a duration term (the italicized language above) to the retention term? This requires an *excursus* into automobile lending. Whereas the home mortgage industry was alert to cram down at the dawn of the Bankruptcy Code, the car lenders were asleep at the wheel. Car loans could be crammed down, and the unsecured deficit was to be treated as an unsecured claim.

That was bad enough. But chapter 13 practice heaped more indignities upon the house of car lenders. One "abuse" *D* used to perpetrate prior to BAPCPA was to sponsor a plan in which *D* front-loaded payment to a secured party (*SP*), so that *SP*s lien (for $10,000, say) disappeared through payment. The plan then required *SP* to release the lien on the car, so that *D* owned the car free and clear.[214] Once that was accomplished, *D* would convert the chapter 13 case to chapter 7, where *SP* was entirely unsecured.

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husband) filed a chapter 7 bankruptcy case and obtained a discharge. The very next day, even before the chapter 7 case was closed, *D* filed a chapter 13 case in order to prevent foreclosure on their home. The home was encumbered by first and second mortgage, both entirely within the money.

In the chapter 13 proceeding, ML_1 filed a proof of claim with a copy of the deed of trust, but failed to attach a copy of the promissory note. *D* claimed the promissory note was forged (which sounds fishy, to say the least). In any case, separately, the mortgage agreement was binding, and it independently would have obligated *D* to pay.

Be that as it may, *D* filed an adversary proceeding to avoid the mortgage and also objected to the allowance of the claim. ML_1 inexplicably failed to respond. *Id.* at 488 ("almost bizarre lack of diligence" by ML_1). The bankruptcy court therefore disallowed the proof of claim and voided the mortgage under § 506(d).

This action was fraught with ambiguity. Was the court saying that *D* owed nothing on the mortgage debt? If so, any reference to § 506(d) was superfluous. There simply wasn't a mortgage because there wasn't a debt. This is not a case of *avoidance* but a case of *nonexistence*. Yet clearly the court thought the mortgage *did* exist and had to be voided, since, the court surmised, the avoided mortgage would have been revived in a dismissal of the chapter 13 case. § 349(B)(1)(c).

After notice to ML_1, the bankruptcy court held a hearing to which ML_1 did not show up. The court issued a "disallowance order" and invited ML_1 to seek relief from it. Eighteen months later ML_1 moved for reconsideration. The court denied the motion. ML_1's claim was disallowed.

D then moved for summary judgment on its avoidance adversary proceeding. The court granted the motion. Once ML_1's claim had been disallowed, § 506(d) voidness had to follow. The mortgage was "hereby cancelled." *Id.* at 482.

Thereafter, *D* presented their eleventh amended chapter 13 plan. ML_1 objected to confirmation on the ground that its mortgage was not void after all! So far as it goes, ML_1 was correct. If the chapter 13 case were dismissed before the plan was completed, the void lien would be reinstated. *See* § 349(b)(1)(C). This "makes clear that lien avoidance under § 506(d) is intended to be provisional subject to reinstatement at least upon dismissal of the case." *In re* Victorio, 454 B.R. 759, 771 (Bankr. S.D. Cal. 2011). But ML_1 also insisted that it was impossible for § 506(d) avoidance ever to be final. In fact, § 506(d) was a contradiction and ML_1's mortgage was perfectly valid.

ML_1's relied on the *Leavitt* dictum that lien avoidance is never permanent until discharge. And discharge was impossible under § 1328(f). The court disagreed: "because bankruptcy discharge, by definition, affects only *in personam* liability, it has never served as the historical means for ensuring that the Bankruptcy Code's various mechanisms for modifying or voiding a creditor's *in rem* rights remained in place at the conclusion of the plan." 803 F.3d at 494.

[214] Carlson, *Cars and Homes*, *supra* note 153, at 383-84.

D would stop paying in wages for the benefit of unsecured creditors, and *SP* wound up in chapter 7 with no lien on the valuable car and, for the unsecured deficit, a pro rata claim to basically nothing.

Accordingly, BAPCPA cram-down requires that *SP* retain the lien *even after* the $10,000 was paid. BAPCPA added these extra words in § 1325(a)(5)(b)(i)(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.

This language shows that *SP*s $10,000 lien survives receipt of $10,000. But it *does* come to an end. The lien goes poof when the plan is completed. So, returning back to the mention of discharge in § 1325(a)(5)(b)(i)(I)(bb), this was just BAPCPA's way of saying *SP*s lien exists until the plan is completed. Prior to BAPCPA, completion of the plan *always* ended in discharge. There was no real desire to say that strip-off of ML_2 becomes impossible in chapter 20 cases.

In *Branigan v. Davis (In re Davis)*,[215] the Fourth Circuit, over a dissent, blew up the chapter 20 theory, not on the irrelevance of discharge, but at the weak point previously identified—second mortgages entirely out of the money are not secured claims within the meaning of § 1325(a)(5).[216] According to the Fourth Circuit, § 506(a) applies *universally* in chapter 13. This is what *Nobelman* supposedly holds. Therefore, ML_2 is not entitled to § 1322(b)(2) protection nor to cram-down protection. Section 1325(a)(5) does not apply.[217] The plan need not require that ML_2 retain her lien (even though she has one).

But the *Branigan* majority overlooks a series of cases that do indeed confirm that the *Dewsnup* definition applies to cram-down. According to the Tenth Circuit, § 1322(b)(2) follows § 506(a)(1).[218] The *Dewsnup* definition, however, applies to § 1325(a)(5) cram-down.[219]

To see why the Tenth Circuit resorted to *Dewsnup* for cram-down, we have to return to the grievances of car lenders. In the negotiations leading up to BAPCPA, car lenders complained that *D* was frequently buying a

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[215] 716 F.3d 331 (4th Cir. 2013).

[216] *Id.* at 337-38; *see also* Boukatch v. Midfirst Bank (*In re* Boukatch), 533 B.R. 292 (B.A.P. 9th Cir. 2015); *In re* Scotto-DiClemente, 459 B.R. 558, 566-67 (Bankr. D.N.J. 2011); *In re* Okosisi, 451 B.R. 90, 98-99 (Bankr. D. Nev. 2011).

[217] Wells Fargo Bank, N.A. v. Scantling (*In re* Scantling), 754 F.3d 1323, 1330 (11th Cir. 2014) ("Under such analysis, § 1325(a)(5) is not involved … "); *see generally* Lawrence Ponoroff, *Hey, the Sun is Hot and the Water's Fine: Why Not Strip Off That Lien?*, 30 EMORY BANKR. DEV. L. 13, 34 (2013).

[218] DamlerChrysler Fin. Servs. As. LLC v. Ballard (*In re* Ballard), 526 F.3d 634 (10th Cir. 2008).

[219] *See also In re* Sadowski, 473 B.R. 12, 19 (Bankr. D. Conn. 2011).

new car and then promptly driving it straight to chapter 13, where the car security interest was instantly underwater. There, *D* could write down the car debt to the value of the luxury car, which was typically far south of the purchase-price-minus-down-payment.

To combat this abuse, the car lenders wrote the notorious "hanging paragraph"—a free-floating paragraph that hangs like a spider at the bottom of § 1325(a). According to the last sentence in §1325(a):

> For purposes of paragraph (5), section 506 does not apply to a claim described in that paragraph if the creditor has a purchase money security interest securing the debt that is the subject of the claim, the debt was incurred within the 910-day ⟦sic⟧ preceding the date of the filing of the petition, and the collateral for that debt consists of a motor vehicle (as defined in section 30102 of title 49)[220] acquired for the personal use of the debtor, or if collateral for that debt consists of any other thing of value, if the debt was incurred during the 1-year period preceding that filing.[221]

This dumbfounding sentence basically means that car loans cannot be bifurcated. Rather, we are to pretend that the car is worth whatever the car debt is. For example, suppose the new car (bought less than 910 days before the bankruptcy petition) is worth $10,000 and the car debt is $40,000—plausible numbers if the car has been banged up in a collision. If *D* wants to keep the car, *D* will have to pay future wages with a present value of $40,000.[222] If § 506(a)(1) had applied, the car lender would be entitled to $10,000 only. The $30,000 deficit becomes an unsecured claim perhaps getting pennies on the dollar.

Cram down has always given *D* a "surrender" option. According to § 1325(a)(5)(B), *D* can pay $40,000 for a 910-vehicle worth $10,000. Alternatively, under § 1325(a)(5)(B), *D* can surrender the car. Early on, *D* figured that, under the hanging paragraph, the car was deemed worth $40,000. So, surrendering the car was an "asset payment" extinguishing *SP*s $40,000 claim in full. The car lender has lost the unsecured claim of $30,000 in exchange for a car worth $10,000. The car lender has been outfoxed.

Car lenders argued against this turnabout, fair play though it seems to have been. In *DaimlerChrysler Financial Services Americas LLC v. Ballard (In re Ballard)*,[223] the Tenth Circuit ruled that, where *D* intends keep the

[220] This section defines "motor vehicle" as "a vehicle driven or drawn by mechanical power and manufactured primarily for use on public streets, roads, and highways, but does not include a vehicle operated only on a rail line." 49 U.S.C. § 30102.

[221] § 1325(a)(5).

[222] Ford Motor Credit Cp., LLC v. Dale *(In re* Dale), 582 F.3d 568, 572 (5th Cir. 2009).

[223] 526 F.3d 634 (10th Cir. 2008).

car, bifurcation is not allowed, but where *D* intends to surrender the car, the car claim must be bifurcated. *D* can surrender the car as an asset payment on the $10,000 secured claim. But *SP* retains the unsecured claim of $30,000. In so ruling, the court found itself saying:

> In addition, nothing in § 1325(a)(5) suggests that § 506(a) determines the meaning of the phrase "allowed secured claim in that section. In the absence of express language linking the meaning of "allowed secured claim" in § 1325(a)(5) to § 506(a), the most natural reading of the phrase is that it describes a claim that is both 'allowed' under the Bankruptcy Code and 'secured' by a lien . . . Thus, the phrase 'allowed secured claim" in § 1325(a)(5) simply means a claim that is allowed under § 502 and is secured by a lien under state law."[224]

Dewsnup thus supplies the definition of "secured claim" for § 1325(a)(5), according to the *Ballard* court.

We seem to have a circuit split. The chapter 20 theory requires the *Dewsnup* definition for cram-down.[225] In the Tenth Circuit the chapter 20 theory carries the day. Of course, we have rehearsed a theory under which ML_2 can be crammed down to zero, regardless of whether "secured claim" takes on the *Dewsnup* meaning in § 1325(a)(5). Even if the Tenth Circuit is right that ML_2 is a secured creditor for cram-down purposes, ML_2's lien waves farewell if the plan is completed, even where *D* in a chapter 20 case is entitled to no discharge. We do not presently need to know what "secured claim" means for cram-down purposes.

According to the court in *In re Tran*,[226] it is bad faith to strip off ML_2 in a chapter 20 case, because to do so is simply a subterfuge of *Dewsnup* in chapter 7.[227] In *Tran*, *D*'s plan had minor goals, such as paying *D*'s chapter 13 attorney and curing defaults on ML_1's mortgage. The main goal was to strip off ML_2.[228] Doing what the Bankruptcy Code expressly invites was

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[224] *Id.* at 641 (citations and footnote omitted); *Accord, In re* Sadowski, 473 B.R. 12 (Bankr. D. Conn. 2011),

[225] Curween v. Whiton, 557 B.R. 39, 42 (D.C. Conn. 2016) ("The crux of the dispute is whether the phrase 'allowed secured claim,' as set forth in section 1325(a)(5), should be defined using 11 U.S.C. § 506(a)'s definition of the phrase, or whether it should be defined as it was in ⟦*Dewsnup*⟧.").

[226] 431 B.R. 230 (Bankr. N.D. Cal. 2010), *aff'd*, 814 F. Supp. 2d 946 (N.D. Cal. 2011).

[227] *Tran* is contradicted by a later BAP opinion, Meyer v. Lepe (*In re* Lepe), 470 B.R. 851, 856 (B.A.P. 9th Cir. 2012), which implies that seeking a strip-off is not *per se* bad faith. *Lepe* is difficult to follow. It is said that *D* had assets of $364,000 and liabilities of $581,380 yet was somehow solvent. The mystery is solved if these purchase money debts were owed to ML_1 and ML_2 and were in fact nonrecourse mortgages. Cal Civ. Code § 580b.

[228] *Tran*, 431 B.R. at 237 ("Here, the totality of the circumstances shows that ⟦*D*⟧ filed this chapter 13 case solely for purposes of avoiding the second deed of trust under circumstances where such

found to be bad faith. Accordingly, some courts think that *D* must show *other* parts of the plan have significant utility, in which case the strip-off, otherwise in bad faith, will be tolerated.[229]

To summarize, in chapter 7 cases, ML_2 has a place in the appreciation value waterfall. In chapter 13 cases, however, ML_2 can be stripped off, thereby enriching *D* or perhaps the unsecured creditors. Which of these benefit from the strip-off? We now supply a most complicated answer.

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Part III will appear in the next issue of the American Bankruptcy Law Journal and will cover allocation of appreciation value in homesteads between the debtor and unsecured creditors in chapter 13 and in converted chapter 7 cases.

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avoidance was not available to her in chapter 7, and where no independent reasons exists for her subsequent chapter 13 filing").

[229] *In re* Gloster, 459 B.R. 200, 204 (Bankr. D.N.J. 2011); In re Scotto-DiClemente, 459 B.R. 558, 567-78 (Bankr. D.N.J. 2011); *In re* Okosisi, 451 B.R. 90, 101-02 (Bankr. D. Nev. 2011); *In re* Hill, 440 B.R. 176, 184 (Bankr. S.D. Cal. 2010).