IN THE UNITED STATES BANKRUPTCY COURT FOR THE EASTERN DISTRICT OF TENNESSEE

In re

Case No. 03-33350

BRENDA STARRITT
RONALD STARRITT

Debtors

MEMORANDUM ON MOTION TO TERMINATE STAY AND AUTHORIZE FORECLOSURE

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RICHARD STAIR, JR.
UNITED STATES BANKRUPTCY JUDGE

This contested matter is before the court on the Motion to Terminate Stay and Authorize Foreclosure filed by CitiFinancial, Inc. (CitiFinancial) on August 12, 2003, requesting relief from the automatic stay provisions of 11 U.S.C.A. § 362(a) (West 1993 & Supp. 2003), to allow CitiFinancial to proceed with foreclosure against real property owned by the Debtors. The Debtors oppose the Motion, arguing that CitiFinancial's lien is subject to being "stripped off" because the second mortgage upon which CitiFinancial is relying has no economic value.

This is a core proceeding. 28 U.S.C.A. § 157(b)(2)(G) (West 1993).

I

The Debtors filed the Voluntary Petition commencing their Chapter 7 bankruptcy case on June 17, 2003. The Notice of Commencement of Case instructed secured creditors only to file claims, as there were no assets to be distributed to unsecured creditors. The Debtors listed CitiFinancial as a secured creditor on their Schedule D, holding a second mortgage on their residence, known as 8296 Vonore Road, Loudon, Tennessee. The Debtors listed $12,056.41 as the balance of the debt owed to CitiFinancial, stating that the entire amount was unsecured because the house was valued at $41,500.00,[1] and the first mortgage was $69,999.32.[2] On their Statement of Intention, the Debtors evidenced their intention to avoid CitiFinancial's lien. CitiFinancial filed a Proof of Claim on July 21, 2003, in the amount of $12,750.35 plus costs.

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[1] The Debtors listed their residence on Schedule C, but under the exempted amount, they scheduled "0.00."

[2] The Debtors reaffirmed their debt to the first mortgage-holder, National City Home Loan Services, Inc., on July 17, 2003. The Reaffirmation Agreement, filed on August 25, 2003, lists the indebtedness being reaffirmed as $71,639.67.

The meeting of creditors was held on July 21, 2003, and on July 31, 2003, the Chapter 7 Trustee, Michael H. Fitzpatrick, filed the Trustee's Report of No Distribution and Abandonment of Property by which he "abandon[ed] all property of the estate as burdensome or of inconsequential value to the estate pursuant to 11 U.S.C. §544 and Fed. R. Bankr. P. 6007." On August 12, 2003, CitiFinancial filed the Motion presently before the court. In support of the Motion, CitiFinancial argues that the Debtors have refused to reaffirm the $12,750.35 balance due it on the second mortgage and avers that a good faith valuation of the property is approximately $80,000.00 instead of the $41,500.00 stated in the Debtors' statements and schedules. Finally, CitiFinancial argues that the Debtors cannot "strip off" a junior lien in a Chapter 7 case.[3]

On August 25, 2003, the Debtors filed their Response to CitiFinancial, Inc.'s Motion to Lift Stay and Authorize Foreclosure, arguing that CitiFinancial's lien should be avoided. The Debtors assert that their home is valued at approximately $60,000.00, that the first mortgage has an outstanding balance of approximately $71,639.67, and that because CitiFinancial's lien is wholly unsecured, it should be treated as an unsecured claim under § 506(a) (West 1993) and "stripped off" under § 506(d) (West 1993).[4] At the hearing on CitiFinancial's Motion, held on September 11, 2003, all parties agreed that this issue was clearly a matter of law to be determined by the court, and the matter was taken under advisement.

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[3] In its Motion, CitiFinancial also asked that the Chapter 7 Trustee be ordered to abandon any interest in the real property pursuant to 11 U.S.C.A. § 554 (West 1993); however, as already stated, the Trustee abandoned any interest in all property of the estate on July 31, 2003.

[4] The Debtors have not taken any affirmative action, such as filing an adversary proceeding or motion, to avoid CitiFinancial's lien.

II

The issue before the court is whether a wholly unsecured consensual junior lien can be "stripped off"[5] in a Chapter 7 case pursuant to 11 U.S.C.A. § 506(d). Section 506 provides, in material part:

> (a) An allowed claim of a creditor secured by a lien on property in which the estate has an interest . . . is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property . . . and is an unsecured claim to the extent that the value of such creditor's interest . . . is less than the amount of such allowed claim. Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use[.]
>
> . . . .
>
> (d) To the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void[.[6]]

11 U.S.C.A. § 506.

The Supreme Court, in *Dewsnup v. Timm*, 112 S. Ct. 773 (1992), held that the allowance of a claim must come prior to avoidance. The Court reasoned that

> [G]iven the ambiguity in the text, we are not convinced that Congress intended to depart from the pre-Code rule that liens pass through bankruptcy unaffected.
>
> 1. The practical effect of petitioner's argument is to freeze the creditor's secured interest at the judicially determined valuation. By this approach, the creditor would lose the benefit of any increase in the value of the property by the time of the foreclosure sale. The increase would accrue to the benefit of the debtor, a result some of the parties describe as a "windfall."

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[5] "The term 'strip down' is used in the situation where the inferior mortgage is partially secured whereas 'strip off' is used where the junior mortgage is totally unsecured." *In re Davenport*, 266 B.R. 787, 790 (Bankr. W.D. Ky. 2001).

[6] Exceptions not applicable in this case.

> We think, however, that the creditor's lien stays with the real property until the foreclosure. That is what was bargained for by the mortgagor and the mortgagee. The voidness language sensibly applies only to the security aspect of the lien and then only to the real deficiency in the security. 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.
>
> Such surely would be the result had the lienholder stayed aloof from the bankruptcy proceeding (subject, of course, to the power of other persons or entities to pull him into the proceeding pursuant to § 501), and we see no reason why his acquiescence in that proceeding should cause him to experience a forfeiture of the kind the debtor proposes. It is true that his participation in the bankruptcy results in his having the benefit of an allowed unsecured claim as well as his allowed secured claim, but that does not strike us as proper recompense for what petitioner proposes by way of the elimination of the remainder of the lien.
>
> 2. This result appears to have been clearly established before the passage of the 1978 Act. Under the Bankruptcy Act of 1898, a lien on real property passed through bankruptcy unaffected.

Dewsnup, 112 S. Ct. at 778. Accordingly, the Court held that a debtor cannot "strip down" a creditor's lien if the creditor has an allowed claim. *Dewsnup*, 112 S. Ct. at 778. Under the Bankruptcy Code, a proof of claim is deemed allowed unless it is objected to by a party in interest. *See* 11 U.S.C.A. § 502(a) (West 1993).

Clearly, these two subsections of § 506 do not address the same process. Subsection (a) concerns treatment of allowed claims, while subsection (d) discusses treatment of disallowed claims. Subsection (a) provides that a creditor holding an allowed claim that is secured by a lien shall be treated as secured to the extent of the value of the collateral and unsecured to the extent that the amount of the claim exceeds the value of the collateral. On the other hand, subsection (d) does not discuss value at all, nor does it address secured and unsecured amounts of a claim.

Finally, subsection (d) does not even apply unless a claim has actually been disallowed. Nevertheless, despite the Court's ruling in *Dewsnup* and a careful reading of the statute itself, there is a split of authority as to whether § 506(d) allows a "strip off" of a lien in a Chapter 7 case.[7]

There are a hand-full of cases holding that a fully unsecured lien can be "stripped off" because a wholly unsecured claim is "essentially disallowed." *Farha v. First Am. Title Ins. (In re Farha)*, 246 B.R. 547, 549-50 (Bankr. E.D. Mich. 2000)[8] (distinguishing *Dewsnup* because the lien therein was not wholly unsecured); *see also Yi v. Citibank (Md.), N.A. (In re Yi)*, 219 B.R. 394, 399 (E.D. Va. 1998) ("Because Citibank's lien is wholly unsecured, by definition it cannot be an 'allowed secured claim.'");[9] *Zempel v. Household Fin. Corp. (In re Zempel)*, 244 B.R. 625 (Bankr. W.D. Ky. 1999) ("[*Dewsnup*] does not . . . preclude the 'stripping off' of a lien when there is no collateral to which the lien may attach[.]").[10] These cases also found that *Dewsnup* was "strictly limited to the facts before [the Court]." *Farha*, 246 B.R. at 549.

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[7] In Chapter 13 cases, wholly unsecured junior liens may be "stripped off" under § 506(d). *See, e.g., In re Gray*, 285 B.R. 379 (Bankr. N.D. Tex. 2002); *In re Fuller*, 255 B.R. 300 (Bankr. W.D. Mich. 2000); *In re Kressler*, 252 B.R. 632 (Bankr. E.D. Pa. 2000); *In re Young*, 199 B.R. 643 (Bankr. E.D. Tenn. 1996).

[8] This bankruptcy court has since held that § 506(d) may not be used to "strip off" wholly unsecured liens, without actually overruling the *Farha* decision. *See Bessette v. Bank One, Mich. (In re Bessette)*, 269 B.R. 644 (Bankr. E.D. Mich. 2001).

[9] This case was also "effectively overruled" by a later case. *See Ryan v. Homecomings Fin. Network (In re Ryan)*, 253 F.3d 778, 783 (4th Cir. 2001).

[10] This bankruptcy court has also since held otherwise. *See In re Davenport*, 266 B.R. 787 (Bankr. W.D. Ky. 2001) (criticizing the *Zempel* decision).

On the other hand, a majority of courts have held that *Dewsnup* applies, regardless of the value of the lien, and does not allow a debtor to "strip off" a consensual junior lien. *See, e.g., Cater v. Am. Gen. Fin. (In re Cater)*, 240 B.R. 420, 423 (M.D. Ala. 1999) ("The Supreme Court made clear in *Dewsnup*, that as long as the claim is 'allowed' under § 502 and the claim is 'secured' by a valid lien, regardless of the lien's present value . . . subsection (d) does not apply. . . . The fact that the value of the property is insufficient to cover the debt does not warrant a different result."); *Webster v. Key Bank (In re Webster)*, 287 B.R. 703, 706-09 (Bankr. N.D. Ohio 2002); *Bessette v. Bank One, Mich. (In re Bessette)*, 269 B.R. 644, 648-52 (Bankr. E.D. Mich. 2001); *In re Davenport*, 266 B.R. 787, 789-91 (Bankr. W.D. Ky. 2001); *Keltz v. Homeq (In re Keltz)*, 261 B.R. 845, 846 (Bankr. W.D. Pa. 2001); *Cunningham v. Homecomings Fin. Network (In re Cunningham)*, 246 B.R. 241, 243-47 (Bankr. D. Md. 2000).

Many of these courts offered very persuasive reasoning, in addition to the Supreme Court's holding in *Dewsnup*, for not allowing Chapter 7 debtors to "strip off" junior liens. One such case is *In re Fitzmaurice*, 248 B.R. 356 (Bankr. W.D. Mo. 2000). Taking its cue from the Eighth Circuit's analysis of the issue under Chapter 12 in *Harmon v. Farmers Home Admin.*, 101 F.3d 574 (8th Cir. 1996), the *Fitzmaurice* court agreed that "*Dewsnup* does not hold that § 506(d) prohibits lien-stripping in Chapter 7—it holds only that § 506(d) does not itself provide the authority for a debtor to strip down liens. . . . [N]either § 506(d) nor any other provision of the Code applicable in Chapter 7 gave the debtor the power to strip down the lien." *Fitzmaurice*, 248 B.R. at 361 (quoting *Harmon*, 101 F.3d at 581). Additionally, the *Fitzmaurice* court agreed that § 506(d) alone "does not operate to void a lien but . . . it must be used in connection with another

statue[.] Without more . . ., a Chapter 7 debtor does not have standing to use § 506(d) to void a lien on real property which is abandoned . . . and therefore of no benefit to the estate." *Fitzmaurice*, 248 B.R. at 363 (quoting *In re Virello*, 236 B.R. 199, 204 (Bankr. D.S.C. 1999)).

In another case, *Laskin v. First Nat'l Bank of Keystone (In re Laskin)*, 222 B.R. 872 (B.A.P. 9th Cir. 1998), the Ninth Circuit Bankruptcy Appellate Panel offered the following similar analysis:

> In contrast to Chapter 13, where claims must be allowed or disallowed to determine what gets paid through the plan, and the would-be secured creditor whose claim is allowed only as unsecured gets paid as an unsecured creditor, the allowance of a secured claim, or determination of secured status is meaningless in a Chapter 7 where the trustee is not disposing of the putative collateral.
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> . . . .
>
> *Dewsnup* teaches that, unless and until there is a claims allowance process, there is no predicate for voiding a lien under § 506(d). Absent either a disposition of the putative collateral or valuation of the secured claim for plan confirmation in Chapter 11, 12 or 13, there is simply no basis on which to avoid a lien under § 506(d).
>
> Further, whether the lien is wholly unsecured or merely undersecured, the reasons articulated by the Supreme Court for its holding in *Dewsnup*,—that liens pass through bankruptcy unaffected, that mortgagee and mortgagor bargained for a consensual lien which would stay with real property until foreclosure, and that any increase in value of the real property should accrue to the benefit of the creditor, not the debtor or other unsecured creditors—are equally pertinent.
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> . . . .
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> Section 506 was intended to facilitate valuation and disposition of property in the reorganization chapters of the Code, not to confer an additional avoiding power on a Chapter 7 debtor. In contrast to Chapter 13 debtors, who may use § 506 to determine the amount to be paid to a creditor as a secured claim in return for at least a chance of being paid as an unsecured creditor, [the debtor] seeks to use § 506(d) to expand the rights afforded Chapter 7 debtors by removing an

> encumbrance from his real property, which he intends to retain. This result is not authorized by the Bankruptcy Code, and is clearly prohibited by *Dewsnup*.

Laskin, 222 B.R. at 876 (internal citations omitted).[11]

Additionally, in *Ryan v. Homecomings Fin. Network (In re Ryan)*, 253 F.3d 778 (4th Cir. 2001), the Fourth Circuit stated that "[t]he reasoning in *Dewsnup* is not ambiguous." *Ryan*, 253 F.3d at 781. Relying upon this "unambiguous" authority and finding the reasoning of *Laskin* and *Fitzmaurice* persuasive, the court held that

> Following the Supreme Court's teachings in *Dewsnup*, as we must, we discern no principled distinction to be made between the case *sub judice* and that decided in *Dewsnup*. The Court's reasoning in *Dewsnup* is equally relevant and convincing in a case like ours where a debtor attempts to strip off, rather than merely strip down, an approved but unsecured lien.
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> . . . .
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> Other courts have concluded, as do we, that a Chapter 7 debtor may not use § 506(d) to strip off an allowed, wholly unsecured consensual junior lien from real property.
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> . . . .
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> We accept the fact that in many cases junior lien holders may have little or no opportunity to recover all or even a part of their unsecured claims. Nevertheless, the parties bargained for their positions with knowledge that a superior lien existed. Under this Chapter 7 proceeding, they are entitled to their lien position until foreclosure or other permissible final disposition is had.

Ryan, 253 F.3d at 782-83.

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[11] The *Laskin* court also found that the debtors lacked standing to assert a claim under § 506, which does not confer standing on any party. *Laskin*, 222 B.R. at 876; *see also Warthen v. Smith (In re Smith)*, 247 B.R. 191, 194 (W.D. Va. 2000).

In the Sixth Circuit, recent bankruptcy cases, including *Talbert v. City Mortgage Servs. (In re Talbert)*, 268 B.R. 811 (Bankr. W.D. Mich. 2001), have adopted the reasoning of the *Laskin* and *Ryan* courts and agreed that, based upon the statutory language and *Dewsnup*, "the Bankruptcy Code does not permit such a practice." *Talbert*, 268 B.R. at 812. The Talbert decision was affirmed in an unpublished opinion by the district court, which held that it was "bound to follow what it [felt was] the inevitable result of the *Dewsnup* holding" and ultimately deciding that

> An unsecured lien operates in the same manner as the undersecured lien in *Dewsnup*, in that the lender's claim is secured by a lien, even if without sufficient recourse to value in the property. The *Dewsnup* Court said § 506(d) did not give debtors an avoidance remedy "to the extent that [claims] become 'unsecured' for purposes of § 506(a)." The Court is unconvinced by the cases . . . which argue that *Dewsnup* is inapplicable simply because *Dewsnup* purports to be inapplicable to any other facts or because of the undersecured/unsecured distinction. All that has changed in the instant case is the extent to which the claim has become unsecured, so under the Supreme Court's reading of the statute, Plaintiffs cannot avoid the lien at issue.

Talbert v. City Mortgage Servs., No. 1:01-CV-795, 2002 U.S. Dist. LEXIS 10464, at *5-6 (W.D. Mich. June 6, 2002) (internal citations and footnote omitted).

Only today, this decision was affirmed by the Sixth Circuit Court of Appeals. *See Talbert v. City Mortgage Servs. (In re Talbert)*, ___ F.3d ___, 2003 Fed. App. 0343P (6th Cir. Sept. 24, 2003). The Sixth Circuit noted the conflict of authority on this issue, but relied upon the Fourth Circuit's *Ryan* decision in affirming the district court, and holding that

> The Supreme Court's reasoning for not permitting "strip downs" in the Chapter 7 context applies with equal validity to a debtor's attempt to effectuate a Chapter 7 "strip off." In fact, one court has gone so far as to describe this conclusion as "flawless."

> As in the case of a "strip down," to permit a "strip off" would mark a departure from the pre-Code rule that real property liens emerge from bankruptcy unaffected. Also, as in the case of a "strip down," a "strip off" would rob the mortgagee of the bargain it struck with the mortgagor, i.e., that the consensual lien would remain with the property until foreclosure. . . . Finally, as was true in the context of "strip downs," Chapter 7 "strip offs" also carry the risk of a "windfall" to the debtors should the value of the encumbered property increase by the time of the foreclosure sale. . . . .
>
> It is true that the Court's opinion has not escaped scholarly criticism . . . and that some courts have been unwilling to extend *Dewsnup* to its logical conclusion[.] However, notwithstanding the dissatisfaction of some, we are not at liberty to ignore the Supreme Court's reasoning, which Congress has made no apparent attempt to modify or correct through legislative action.

Talbert v. City Mortgage Servs. (In re Talbert), ___ F.3d ___, 2003 Fed. App. 0343P, at 4-5 (6th Cir. Sept. 24, 2003) (internal citations omitted).

III

Together, these cases evidence that under the plain language of the statute, without more, § 506(d) alone does not provide the authority for a debtor to "strip down" or "strip off" partially or wholly unsecured liens. The Debtors in this case have not taken any steps to avoid CitiFinancial's lien under any other provision of the Bankruptcy Code. Additionally, CitiFinancial's claim was never disallowed. Based upon this authority and the clear language of the statute, the Debtors cannot simply "strip off" CitiFinancial's lien. The Debtors have not reaffirmed this debt, the property has been abandoned by the Trustee, and CitiFinancial is accordingly entitled to relief from the automatic stay so that it may proceed with foreclosure.[12]

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[12] Because the Debtors' residence has been abandoned by the Trustee, the property is no longer property of the estate and is thus not subject to the automatic stay of 11 U.S.C.A. § 362(a)(4) (West 1993 & Supp. 2003). See 11 U.S.C.A. § 362(c) (West 1993) ("(c) . . . (1) the stay of an act against property of the estate . . . continues until (continued…)

An order consistent with this Memorandum will be entered.

FILED: September 24, 2003

BY THE COURT

/s/ Richard Stair, Jr.

RICHARD STAIR, JR.
UNITED STATES BANKRUPTCY JUDGE

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[12](…continued)
such property is no longer property of the estate[.]"). Relief from the stay is still required, however, because the Debtors have not yet been granted their discharge, *see* 11 U.S.C.A. § 362(c)(2) (West 1993), and the property, therefore, remains subject to the stay afforded the Debtors under 11 U.S.C.A. § 362(a)(5) (West 1993 & Supp. 2003), which stays "any act to . . . enforce against property of the debtor any lien to the extent that such lien secures a claim that arose before the commencement of the case . . . ."

IN THE UNITED STATES BANKRUPTCY COURT FOR THE EASTERN DISTRICT OF TENNESSEE

In re

Case No. 03-33350

BRENDA STARRITT
RONALD STARRITT

Debtors

O R D E R

For the reasons stated in the Memorandum on Motion to Terminate Stay and Authorize Foreclosure filed this date, the court directs the following:

1. The Motion to Terminate Stay and Authorize Foreclosure filed by CitiFinancial, Inc. on August 12, 2003, is GRANTED.

2. The automatic stay of 11 U.S.C.A. § 362(a)(5) (West 1993) is modified to allow CitiFinancial, Inc. to foreclose its lien encumbering the Debtors' residence at 8296 Vonore Road, Loudon, Tennessee, under the terms of the Deed of Trust dated January 31, 2002, executed by the Debtors, as "Grantor," and R. Anderson, as "Trustee," and in accordance with the laws of the State of Tennessee.

SO ORDERED.

ENTER: September 24, 2003

BY THE COURT

/s/ Richard Stair, Jr.

RICHARD STAIR, JR.
UNITED STATES BANKRUPTCY JUDGE