

LIEN STRIPPING OF MORTGAGES IN CHAPTER 13 BANKRUPTCY

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- I. Lien Stripping--Now
 - A. Issue.
 1. Homeowner has a first and second mortgage on a primary residence (Home).
 2. The real estate markets fall and the fair market value (FMV) of Home falls below the mortgages.
 - B. Definitions.
 1. The process of reducing or avoiding a secured lien to the value of the underlying collateral.
 2. Secured Lien vs Secured Claim: The lien is what attaches to the property under state law and the allowed secured claim is the value of the creditors interest in the collateral. An allowed secured claim cannot be greater than the value of the collateral.
 - C. Code Sections.
 1. 11 U.S.C. § 506(a).
 2. 11 U.S.C. § 506(d).
 3. §506(a) & (d) are used to bifurcate the lien into secured and unsecured.
 4. §1322 (b)(2) to allow modifying the rights of secured creditors.
 5. The secured claim is allowed in the amount up to the FMV of the property at the time of the stripping (confirmation/judgment).
 6. The balance of the claim, which exceeds the FMV of the property is now deemed unsecured and thereby effecting the rights of the lien holder.
 7. The most common form of lien stripping is with car loans purchased over 910 days prior to the filing of bankruptcy.
 - D. Principle Residence.
 1. The Bankruptcy Code prohibits a Ch 13 plan to modify a claim secured only by a security interest in real property that is the debtor's principal residence. [See, §1322 (b)(2)].
 2. Lien stripping is available against second or third (or fourth, fifth etc) lien holders on a principle residence if the first mortgage balance equals or exceeds the value of the Home.
 3. The lien stripping renders such second and third liens as totally unsecured claims as there is no equity to attach to and thus is not an allowed secured claim.

4. It should be noted that modifying of non-homestead property is available, but the modified terms must be satisfied during the term of the plan.

E. Procedure

1. Conflict: Motion vs Confirmed Plan vs Adversary.
 - a. Motion. It is procedurally unnecessary to file an adversary solely to strip off an allegedly wholly unsecured lien pursuant to §1322(b)(2). *Millspaugh*, 302 B.R. 90 (Bankr. D. Idaho 2003); *In re Pereira*, 08-03059-B13 (Bankr.S.D. Cal. 8/25/2008).; see also *March, Ahart & Tchaikovsky, Cal Prac. Suide: Bankruptcy*, 18:110-113 at 18-10-11 (The Rutter Group 2007).
 - i. Motion under FRBP 3012 (valuation) and 9014 (Contested Matters).
 - b. Confirmed Plan.
 - i. Does the confirmation of a plan that contains the provisions to avoid or strip a wholly unsecured mortgage meet the notice requirements?
 - ii. Valuation? (evidence?)
 - iii. What about “cram down” of vehicles??
 - c. Adversary.
 - i. FRBP 7001(2) requires an adversary “to determine the validity, priority, or extent of a lien”
 - ii. File Summons and Complaint under FRBP 7001. Serve creditor, and if FDIC serve principal of corporation via certified mail.
 - iii. Requires evidence! (ie appraisal, affidavits, etc).
 - iv. If no answer, file motion for default judgment with affidavit.
 - v. If creditor responds, issue will be valuation thus your valuation must be solid and provable.

F. Effective Date.

1. Confirmation of plan?
2. Discharge?
3. What if case is converted or discharged? §§ 348, 349 and 1325(a)(5)(B)(i)(II)?
4. What if NO discharge or conversion?
5. Need to record order in Recorder of Deeds office. When?

- II. Lien Stripper - Later
 - A. Proposed Bankruptcy Law Change
 - 1. Allow for lien stripping of primary residence.
 - 2. Current requirements:
 - a. "Subject to notice of foreclosure";
 - b. Existing loan;
 - c. And, attempt to negotiate with lender first.
 - 3. Modification to include:
 - a. Loan to be modified as allowed under 506(a)(1);
 - b. Adjustable interest rates on such modification to be prohibited, reduced or delayed;
 - c. The term and conditions of the loan to be no longer than 40 years with a fixed rate;
 - d. Waiving early prepayment penalties.
 - e. Payments made directly to lender, NOT through trustee.
 - f. TILA rights excluded???
 - B. Potential issues.
 - 1. Obligation to tell existing Ch 13 clients of change in law? How fast, if at all?
 - 2. What is "subject to notice" of foreclosure?
 - 3. What if notice of foreclosure was 4 years ago, does that meet the requirement?
 - C. What to tell your clients while we wait for the "change" they voted for?
 - 1. File motions to strip liens?
 - 2. Wait?
 - 3. Request a loan modification?
 - 4. What if client is current with an adjustable loan?