

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF WISCONSIN

Court Minutes

CHAPTER: 13
DATE: October 25, 2010
JUDGE: Pamela Pepper
CASE NO.: 2009-31552
2010-27094
DEBTOR: Stephen and Jodie MacDonald
Sandra Lee Fair
ADV. NO.: 10-2287
10-2362
ADV.: Stephen and Jodie MacDonald vs. HSBC Mortgage Services, Inc.
Sandra Lee Fair vs. GMAC Mortgage, LLC
NATURE OF HEARING: Pretrial
APPEARANCES: Joseph Reback - Attorney for plaintiffs Stephen and Jodie McDonald
Rollie Hanson - Attorney for Sandra Lee Fair
Jennifer Marquisee - Chapter 13 trustee, Sandra Lee Fair
COURTROOM DEPUTY: Kristine Wrobel
TIME: 10:30 a.m. - 10:49 a.m.
ADJOURNED DATE:

The Court indicated that it had adjourned the pretrial conferences in both of the above-captioned cases to give the plaintiffs' attorneys an opportunity to brief the following issue: whether debtors who are not entitled to receive a Chapter 13 discharge could strip a wholly-unsecured junior mortgage lien through the Chapter 13. (The debtors in both cases had received Chapter 7 discharges within four years of filing the present Chapter 13 petitions, and thus were not eligible for a Chapter 13 discharge under §1328(f)(1).) The Court noted that it had raised this issue *sua sponte*, because the Supreme Court in United Student Aid Funds v. Espinosa, ___ U.S. ___, 130 S.Ct. 1367 (March 23, 2010) had implied that bankruptcy courts had an affirmative duty to review Chapter 13 plans for provisions that do not comply with the requirements of the Code.

The Court noted that several bankruptcy courts in the Seventh Circuit had ruled that a debtor could not use Chapter 13 to strip a wholly-unsecured junior mortgage lien when that debtor was not entitled to receive a Chapter 13 discharge. Counsel for the debtors also had cited cases from courts that had decided the other way. The Court observed that many of the judges who had concluded that non-discharge-eligible debtors could not strip the unsecured liens had relied on Judge Mary Gorman's decision in In re Jarvis, 390 B.R. 600 (Bankr. C.D. Ill. 2008), including Judge Kelley in her decision in Blosser v. KLC Financial, Inc. (In re Blosser), ___ B.R. ___, 2009 WL 1064455 (Bankr. E.D. Wis., April 15, 2009). Counsel for plaintiff Fair, however, had argued in his brief that the reasoning in the

Jarvis case was flawed. Counsel argued that Jarvis and its progeny assumed that lien avoidance was conditioned upon both completion of a Chapter 13 plan and discharge, while nothing in the Bankruptcy Code conditioned lien avoidance on the receipt of a discharge. The Court agreed with counsel that there was no specific provision in the Code that conditioned lien avoidance upon the receipt of a discharge.

The Court further agreed with those judges who had concluded that the anti-cramdown and anti-modification provisions of §1322(b)(2) did not apply to a wholly-unsecured junior mortgage, because the provisions of §1322(b)(2) prohibit modification only of the rights of holders of secured claims, and an unsecured junior mortgage claim is not a secured claim. Thus, the Court agreed with Judge Perkins' decision in In re King, 290 B.R. 641 (Bankr. C.D. Ill. 2003) that a debtor who is eligible for a Chapter 13 discharge can use the Chapter 13 process to avoid a wholly-unsecured mortgage lien. The Court also agreed with Judge Perkins' decision in In re Lilly, 378 B.R. 232 (Bankr. C.D. Ill. 2007), in which he held that a debtor who is not eligible for a Chapter 13 discharge can use the Chapter 13 process to cram down the interest rate on a non-§1322(b)(2) secured claim, but only for the duration of the plan.

The Court stated that it was not certain that it agreed with those judges who had concluded that the Supreme Court's decision in Dewsnup v. Timm, 502 U.S. 410 (1992) precluded non-discharge-eligible debtors from avoiding a wholly-unsecured junior lien. The Court noted that the Dewsnup Court had held that a Chapter 7 debtor could not strip off a lien that was partially secured and partially unsecured. Justice Scalia had dissented, arguing that because the lien was partially unsecured, the debtor should have been allowed to strip the unsecured portion. The Court noted that some bankruptcy courts had concluded that if a debtor could not strip a partially unsecured lien in the Chapter 7 context, it must follow that the debtor could not strip a wholly-unsecured lien in the Chapter 13 context. The Court stated that it was not certain that this conclusion was correct, and wondered what the Supreme Court might have done if the lien involved in Dewsnup had been entirely unsecured.

In spite of all of the above, however, the Court concluded that a Chapter 13 debtor who is not eligible to receive a Chapter 13 discharge cannot use the Chapter 13 proceeding to strip an unsecured junior mortgage lien. The Court based its decision on §1328(f)(1), added to the Code via BAPCPA. Section 1328(f)(1) prohibits courts from granting a Chapter 13 discharge to a debtor who received a Chapter 7 discharge within the four-year period preceding the Chapter 13 petition date. The Court read that provision as a clear indication that Congress did not intend a debtor who had received a Chapter 7 discharge to be able to obtain a Chapter 13 discharge within the following four years. The Court found that avoiding the lien on the

unsecured mortgage—and thus, avoiding the debtor’s *in rem* liability and stripping away the creditor’s state-law rights and remedies—was the functional equivalent of granting the debtor a complete discharge of the unsecured mortgage debt, which was exactly what Congress said courts could not do for debtors who had file their Chapter 13 petitions within four years of receiving a Chapter 7 discharge. The Court indicated that if it were to allow a debtor to obtain a complete discharge of all aspects of the unsecured mortgage debt through the Chapter 13, it essentially would have create a separate class of unsecured creditors—junior mortgage creditors—for whom the four-year waiting period in §1328(f)(1) did not apply. The Court opined that there was nothing in the limited legislative history of BAPCPA to show that Congress intended such a result. The Court held that a Chapter 13 debtor who is not eligible for a Chapter 13 discharge due to having obtained a Chapter 7 discharge within the previous four years cannot use the Chapter 13 proceeding to avoid a wholly-unsecured junior mortgage lien.

In the MacDonald case, the Court denied the motion for default judgment, and stated that it would issue an order dismissing the adversary. The Court stated that it would issue an order dismissing the adversary in the Fair case. The Court indicated that it would allow the debtors in both underlying Chapter 13 cases to file amended plans. Counsel for the debtor in the Fair case reminded the Court that it had signed an order confirming the plan in that case, and that the confirmed plan proposed to strip the unsecured mortgage lien. The Court responded that it would vacate that order.