

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF WISCONSIN

In re

LARRY M. WATTS,

Debtor.

Case No. 01-21368-MDM

Chapter 7

LARRY M. WATTS,

Plaintiff,

v.

Adversary No. 01-2583

J.D. GRIFFITHS CO., INC.,

Defendant.

MEMORANDUM DECISION ON DEFENDANT'S MOTION FOR SUMMARY JUDGMENT

Procedural Background

The debtor filed a voluntary petition for relief under chapter 7 on February 12, 2001, and filed a motion on February 16, 2001, to declare the lien of J.D. Griffiths Company, Inc., void pursuant to § 506(d). After the motion was denied on procedural grounds, the debtor filed an adversary proceeding on May 15, 2001, to "determine the purported lien void pursuant to 11 U.S.C. § 506(d)." J.D. Griffiths Co. moved for summary judgment on the matter, and the parties filed written responses supplementing their original briefs and arguments made in relation to the debtor's previous motion.

This decision constitutes the court's findings of fact and conclusions of law pursuant to Fed. R. Bankr. P. 7052. For the reason stated herein, the court determines the defendant/creditor's judgment lien is not void and dismisses the complaint.

Undisputed Facts

The schedules list the value of the property on the petition date at \$71,200. The city assessor, as of March 26, 2001, indicated that the fair market value of the property was \$72,000, a difference that the court and apparently the parties consider insignificant. Property taxes for the year 2000 were due in the amount of \$1,570.47, and the outstanding balance on the first mortgage was approximately \$18,000. The second mortgage on the property secures indebtedness of over \$88,000 as of April 11, 2001, which completely eliminated any equity the debtor might have in the property.

The lien in question arose when the debtor engaged J.D. Griffiths Co., Inc., to tear down and replace his garage on April 18, 2000. After the debtor failed to pay for the work performed, J.D. Griffiths obtained a prepetition non-consensual construction lien, filed pursuant to § 779.06,

Wis. Stats., in the amount of \$5,980, plus interest.¹ The creditor does not contest that its claim is wholly unsecured.

Discussion

May the Debtor Use Section 506(d) to Void the Non-consensual Wholly Unsecured Lien?

In a nutshell, the debtor argues that he is not seeking avoidance of the lien, merely that the court declare that the lien is void as a matter of law, and that such a determination in chapter 7 is not contrary to *Dewsnup v. Timm*, 502 U.S. 410 (1992). The creditor contends that the lien passes through bankruptcy unaffected.

Section 506(d) provides:

To the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void, unless --

- (1) such claim was disallowed only under section 502(b)(5) or 502(e) of this title; or
- (2) such claim is not an allowed secured claim due only to the failure of any entity to file a proof of such claim under section 501 of this title.

11 U.S.C. § 506(d). The debtor contends that J.D. Griffiths' lien is wholly unsecured under § 506(a) and therefore, under § 506(d), it is "not an allowed secured claim" and is void. Section 506(a) provides in relevant part:

¹The debtor interprets 11 U.S.C. § 506(d) to mean that a lien never existed in this case because the debtor had no equity in the property when the purported lien arose:

At no time did [J.D. Griffiths] have a charge or an interest in the property. "Property" suggests value and there was never any value for the lien to attach to since its purported inception. All that [J.D. Griffiths] ever had was its self-drafted paper with the term "lien" on it. [J.D. Griffiths'] purported lien is not reduced by the bankruptcy, the lien never existed.

Debtor's Supplemental Brief, p. 2.

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 or on a plan affecting such creditor's interest.

11 U.S.C. § 506(a).

The Supreme Court's Ruling in Dewsnup v. Timm.

In *Dewsnup v. Timm*, 502 U.S. 410, 112 S.Ct. 773 (1992), the chapter 7 debtor filed an adversary proceeding seeking, pursuant to § 506(d), to "strip down" a \$120,000 undersecured consensual lien on property she owned to the \$39,000 judicially determined fair market value of the property. Before filing bankruptcy, the debtor had granted the lien on the property through a deed of trust in return for a \$119,000 loan from the creditor. The debtor had argued that § 506(a) and (d) compelled both a reduction of the value of the creditor's lien in the property and an avoidance of the creditor's lien to the value of the creditor's interest in the property. *Dewsnup*, 502 U.S. at 413.

The Supreme Court found that the "avoidance powers" under § 506(d) do not come into play when a claim has been allowed as a secured claim under § 502(a). *Id.* at 414-15. The Court reasoned that because the creditor's claim had been allowed as a secured claim under § 506(a), the lien could not be avoided as to the value of the property under § 506(d) because the claim was allowed as fully secured. *Id.* Moreover, the Court had previously held that because liens pass through bankruptcy unaffected and are subject to removal only by payment, an allowed

secured claim under § 502(a) could not be stripped down to its secured and unsecured components. *Id.* at 417-18 (citing *Farrey v. Sanderfoot*, 500 U.S. 291 (1991)).

The *Dewsnup* majority opined that the secured party, not the debtors or the general creditors, deserved all appreciation in value:

Any increase over the judicially determined valuation during bankruptcy rightfully 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.

Id. at 417.

In this case, the debtor points out that there never was a secured component of the creditor's claim; it was completely unsecured from the time the lien attached. Also, it is not a consensual mortgage; it is a nonconsensual statutory lien. Finally, *Dewsnup* is to be limited to its facts and holding, and appreciation in the property *after* bankruptcy should be the debtor's after the lien is declared void. The commentary in bankruptcy circles following *Dewsnup* has been spirited, and not surprisingly, lower courts are split on whether a chapter 7 debtor may "strip off" a valueless lien.

The Non-consensual Nature of the Lien.

A mortgagor-mortgagee bargain is not present in this case, although J.D. Griffiths points out that the parties' contract expressly provided that the creditor was entitled to the lien rights. Even though a consensual lien was the subject of the *Dewsnup* case, subsequent cases have applied the holding to nonconsensual liens, as well. *E.g.*, *Crossroads of Hillsville v. Payne*, 179 B.R. 486, 490 (W.D. Va. 1995); *In re Swiatek*, 231 B.R. 26, 30 (Bankr. D. Del. 1999); *In re Esler*, 165 B.R. 583, 584 (Bankr. D. Md. 1994). Other courts have limited *Dewsnup* to consensual liens only. *E.g.*, *In re Smith*, 247 B.R. 191, 195 (W.D. Va. 2000) (holding that debtor could void nonconsensual, wholly unsecured judgment liens on his real property on the ground that the liens were nonconsensual and unsecured); *In re Howard*, 184 B.R. 644, 647 (Bankr. E.D.N.Y. 1995) (finding that benefit of the bargain concept could not be applied to nonconsensual lien).

This court is satisfied that the central holding of *Dewsnup* applies equally to consensual and statutory liens. The better reasoning is that the "*in rem* aspect of a judgment is equally as viable in the context of a nonconsensual lien as in that of a consensual one." *In re Virello*, 236 B.R. 199, 202 (Bankr. D.S.C. 1999) (citing *Dewsnup*, 502 U.S. at 418). If the creditor is entitled to appreciation in the collateral during bankruptcy, if the lien passes through bankruptcy unaffected, and if a lien can be removed only by payment, then the creditor is entitled to appreciation after bankruptcy as well.

The Debtor's Standing.

The creditor contends that the debtor lacks standing to strip its lien because a chapter 7 case does not provide any mechanism for the debtor's participation in the claims allowance process. The court rejects this argument as the debtor still has an interest in the property. The debtor is requesting relief with respect to his property, and any statute that grants relief must grant a procedure to give it effect.

Cases Allowing Strip-off of Wholly Unsecured Liens.

Many subsequent cases have attempted to dilute *Dewsnup's* import. This is understandable since at one point, the Court itself invites a narrow reading of the opinion:

The foregoing recital of the contrasting positions of the respective parties and their amicus demonstrates that § 506 of the Bankruptcy Code and its relationship to other provisions of that Code do embrace some ambiguities. 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.

Dewsnup, 502 U.S. at 416-17 (citation omitted).

The district court in *In re Yi*, 219 B.R. 394 (E.D. Va. 1998), held that a creditor's wholly unsecured third deed of trust on the chapter 7 debtors' real property could not be an "allowed secured claim" under § 506(d). The court explained why § 506(d) directed a different treatment of wholly unsecured claims: "'When there is no value underlying the claim, there is not a secured claim, despite the existence of a document to the contrary.'" *Id.* at 397 (quoting *Wright v. Commercial Credit Corp.*, 178 BR. 703, 707 (E.D. Va. 1995)). Thus, the lien was void and could be "stripped off." The *Yi* court further found that, because appraisal is an inexact process,

the determination of a lien's status as secured or unsecured should not depend on the inherently imprecise valuation affixed by the bankruptcy court. Although "the distinction between a secured an unsecured lien can hinge on one dollar," such a possibility was "not a reason for failing to give § 506(d) its plain meaning." *Id.* at 400. Just as the bankruptcy court in *In re Howard*, 184 B.R. 644 (Bankr. E.D.N.Y. 1995), had previously come to the same conclusion, the courts in *In re Zempel*, 244 B.R. 625 (Bankr. W.D. Ky. 1999), and *In re Farha*, 246 B.R. 547 (Bankr. E.D. Mich. 2000), concluded that the lack of equity in the subject property was sufficient to strip off the junior lien.

The district court in *In re Smith*, 247 B.R. 191 (W.D. Va. 2000), also held that the debtor could void nonconsensual, wholly unsecured judgment liens on his real property and distinguished *Dewsnup* on the ground that the liens were nonconsensual and unsecured. The court determined that, unlike a mortgagee who enters into a consensual arrangement, a judgment creditor takes its chances when attempting to secure the judgment. If there is no property to secured the debt, the judgment remains unsecured. The debtor asserts that this court can and should find that stripping off the lien is required, in accordance with the analysis of the courts discussed above, because it is not an "allowed secured claim" under § 506(d).

One of the debtor's arguments focused on the difference between the words "void" and "avoid." According to the debtor, when Congress used the term "void" in § 506(d) it meant to remove judicial discretion in determining whether a lien exists. Thus, when there is no allowed secured claim, the statute automatically determines that the lien is void without a court proceeding. Accordingly, all chapter 7 § 506(d) actions are actions for declaratory relief. The debtor asserts that although he does not have to bring an action to void the lien, such an action

will allow the court to restate the law in an order so that the creditor will deliver and record a satisfaction clearing future title. The court finds this reasoning unpersuasive. Even applying the debtor's reasoning, court determination of value is necessary, and the use of "void" or "avoid" in this context is a distinction without a difference.

Cases Not Allowing Strip-off of Wholly Unsecured Liens.

Notwithstanding the analysis of the above cases, several courts have concluded that debtors may not strip off wholly unsecured liens.

In *In re Laskin*, 222 B.R. 872 (B.A.P. 9th Cir. 1998), the bankruptcy appellate panel concluded that § 506(d) conferred no independent authority upon the debtor or the trustee to avoid either an under-valued or valueless lien. It determined that the lien avoidance resulting from the operation of § 506(d) was simply a consequence of the claim allowance process. As such, if the claim is allowed as secured in a particular amount, then the lien securing that claim is simultaneously adjusted by § 506(d) to correspond with the allowed amount. The panel observed that the allowance or disallowance of a secured claim was meaningless in a chapter 7 proceeding unless the trustee was actually disposing of the collateral. *Id.* at 876.

The panel further took issue with the holdings in *In re Howard*, 184 B.R. 644 (Bankr. E.D. N.Y. 1995), and *In re Yi*, 219 B.R. 394 (E.D. Va. 1998), opining that those courts' analyses reversed the statutory process. The *Howard* and *Yi* courts concluded that since there was no equity to which the lien at issue could attach and there could be no secured claim under § 506(a), the lien could therefore be avoided under § 506(d). The *Laskin* panel, on the other hand, construed *Dewsnup* to mean that, unless and until there was a claims allowance process, there

was 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)." *Laskin*, 222 B.R. at 876.

The bankruptcy court in *In re Talbert*, 268 B.R. 811, 815 (Bankr. W.D. Mich. 2001), admittedly went one step further than *Laskin* and held that the claims allowance procedure was meaningless² in a chapter 7 proceeding *even if* the trustee was disposing of property which was subject to a creditor's lien:

[A] Chapter 7 trustee's duty is not to administer all of the assets in which the debtor has a legal or equitable interest for the benefit of all parties who may have an interest in these assets. Rather, the Chapter 7 trustee's duty is to reduce to money the legal or equitable interests owned by the debtor in these various assets so that the proceeds may be distributed to unsecured creditors in accordance with Section 726. A third party's interest or lien in the same asset does not constitute property of the estate and the Chapter 7 trustee has no duty to liquidate that interest other than when it is necessary to liquidate the estate's own interest in the property. As such, it is not accurate to characterize the Chapter 7 trustee's distribution of proceeds from the sale of an asset in which the estate claims an interest in payment on account of an allowed secured claim which the lien holder holds against the estate. Rather, the distribution represents nothing more than the Chapter 7 trustee's accounting to the lien holder for the share of the proceeds realized from the Chapter 7 trustee's sale of both the estate's interest in the subject asset and the lien holder's interest.

Talbert, 268 B.R. at 819. Other courts that have also followed *Laskin*, include *In re Cunningham*, 246 B.R. 241, 247 (D. Md. 2000), *In re Davenport*, 266 B.R. 787, 791 (Bankr. W.D. Ky. 2001), *In re Fitzmaurice*, 248 B.R. 356, 361 (Bankr. W.D. Mo. 2000), and *In re*

²The court recognized that section 506 could be relevant in the context of a chapter 7 case when, for instance, the debtor wanted to redeem property which was subject to a lien for the amount of the allowed claim. Section 506(d) completed the redemption process by avoiding any residual lien the creditor might claim in the redeemed property once the creditor's allowed secured claim had been paid. *Talbert*, 268 B.R. at 819.

Virello, 236 B.R. 199, 204-05 (Bankr. D. S.C. 1999); *see also In re Bessette*, 269 B.R. 644 (Bankr. E.D. Mich. 2001) (adopting analysis of *Davenport* court).

In *In re Cunningham*, 246 B.R. 241 (Bankr. D. Md. 2000), the court concluded that the chapter 7 debtors could not "strip off" junior deed of trust liens on real property which they sought to retain, even though the value of property was less than the amount of senior deed of trust indebtedness, and despite the fact that the junior lien holders may have known, at the time of the credit transactions, that there was no equity in the property to support their liens, and may have had no expectation of having their liens satisfied through any potential foreclosure. Likewise, the bankruptcy court in *In re Swiatek*, 231 B.R. 26 (Bankr. D. Del. 1999), refused to limit the ruling in *Dewsnup* solely to consensual liens or to those for which there was at least some equity in the lien property.

In *Ryan v. Homecomings Fin. Network*, 253 F.3d 778 (4th Cir. 2001), *aff'g In re Cunningham*, 246 B.R. 241 (D. Md. 2000), the Fourth Circuit disagreed with the debtors' argument that *Dewsnup* controlled only a "strip down" situation, but not a "strip off." Discerning no principled distinction to be made between the case before it and that decided in *Dewsnup*, the appellate court found that the Supreme Court's reasoning was equally relevant and convincing in a case in which a debtor attempts to strip off, rather than merely strip down, an approved but unsecured lien.

Conclusion

Courts allowing the strip-off of wholly unsecured liens have set forth compelling analyses of § 506(a) and (d), and were we deciding this case in the absence of *Dewsnup*, we might arrive

at such a result. However, we cannot interpret that section in a vacuum. *Dewsnup* teaches that any increase in value during bankruptcy rightfully accrues to the benefit of the creditor, a lien passes through bankruptcy unaffected unless the code provides for modification in the context of a reorganization, and a lien exists until it is paid. These principles are equally applicable to the facts of this case as they were to the facts in *Dewsnup*. If a lien is not paid during the bankruptcy, it follows that the lien continues on the property after bankruptcy, and the creditor is entitled to whatever value it secures until it is paid or foreclosed. The lien may eventually acquire value because the senior interests are paid down or market forces cause the value to rise, and a bankruptcy that falls between the creation of the lien and the accrual of value does not affect the creditor's rights. *Dewsnup* held that § 506 deals with payment of claims in the bankruptcy context and does not create a stand alone right. That is still the law, and the debtor's action must fail. The defendant's motion for summary judgment is granted and the adversary proceeding is dismissed.

A separate order consistent with this decision will be entered.

Dated at Milwaukee, Wisconsin, December 20, 2001.

BY THE COURT

_____/s/_____
Honorable Margaret Dee McGarity
United States Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF WISCONSIN

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Adversary No. 01-2583

J.D. GRIFFITHS CO., INC.,

Defendant.

ORDER GRANTING DEFENDANT'S MOTION FOR SUMMARY JUDGMENT

For the reasons set forth in the court's memorandum decision entered on this date, IT IS ORDERED that summary judgment is granted in favor of the defendant.

IT IS FURTHER ORDERED that the adversary proceeding is dismissed with prejudice and without costs to either party.

Dated at Milwaukee, Wisconsin, December 20, 2001.

BY THE COURT

/s/
Honorable Margaret Dee McGarity
United States Bankruptcy Judge