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Lawrence Ponoroff

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# HEY, THE SUN IS HOT AND THE WATER'S FINE: WHY NOT STRIP OFF THAT LIEN?

Lawrence Ponoroff\*

## ABSTRACT

*In this article, the author maintains that avoidance of wholly unsecured liens (“strip off”) in chapter 7 is permissible and desirable notwithstanding the Supreme Court’s controversial 1992 decision in Dewsnup v. Timm, which refused to permit avoidance of the unsecured portion of a partially secured lien (“strip down”). The argument flows from a broader analysis of the proper characterization of secured claims in bankruptcy. Specifically, contrary to the state law ideation of “secured” that focuses on the identity of the claimant, the author urges that in bankruptcy the concept of “secured” should focus on that creditor’s claim or claims as defined by the Bankruptcy Code. He argues not only that bankruptcy courts have the authority to develop a uniform federal rule in this area, but that to do so would limit Dewsnup to its narrowest possible construction, and perhaps provide the impetus for reexamination of a decision that is out-of-step with core bankruptcy policy and the Court’s own bankruptcy jurisprudence.*

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\* Samuel M. Fetgly Chair in Commercial Law, The University of Arizona James E. Rogers College of Law.

## INTRODUCTION

The 1990's witnessed a vigorous debate over the efficiency of secured credit<sup>1</sup> and the distributive impact of the "full priority" rule for secured creditors enshrined, following some debate,<sup>2</sup> in the revision of Article 9 of the Uniform Commercial Code ("UCC").<sup>3</sup> The new century saw an ebbing of the controversy; most likely a consequence of the dramatic shift in commercial financing patterns from conventional asset-based lending to various forms of securitization.<sup>4</sup> The squabble, however, over the potential moral hazard created

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<sup>1</sup> While most of the activity occurred in the 1990's, the debate itself dates back to at least 1979. See Thomas H. Jackson & Anthony T. Kronman, *Secured Financing and Priorities Among Creditors*, 88 YALE L.J. 1143 (1979). Other important contributions along the way include: Robert E. Scott, *The Truth About Secured Financing*, 82 CORNELL L. REV. 1436 (1997); Lucian Arye Bebchuk & Jesse M. Fried, *The Uneasy Case for the Priority of Secured Claims in Bankruptcy*, 105 YALE L.J. 857 (1996); John Hudson, *The Case Against Secured Lending*, 15 INT'L REV. L. & ECON. 47 (1995); Lynn M. LoPucki, *The Unsecured Creditor's Bargain*, 80 VA. L. REV. 1887 (1994); Alan Schwartz, *The Continuing Puzzle of Secured Debt*, 37 VAND. L. REV. 1051 (1984); Alan Schwartz, *Security Interests and Bankruptcy Priorities: A Review of Current Theories*, 10 J. LEGAL STUD. 1 (1981).

<sup>2</sup> In 1996, then-Professor (now Senator) Elizabeth Warren submitted a proposal to the American Law Institute and the Drafting Committee working on the revision of Article 9 providing for a carve-out of 20% percent of a prior perfected secured creditor's collateral in order to benefit tort claimants, employees, environmental-pollution claimants and other so-called "non-adjusting" (involuntary) creditors. See Kenneth N. Klee, *Barbarians at the Trough: Riposte in Defense of the Warren Carve-Out Proposal*, 82 CORNELL L. REV. 1466, 1476-77 (1997); Elizabeth Warren, *Making Policy with Imperfect Information: The Article 9 Full Priority Debates*, 82 CORNELL L. REV. 1373, 1379 (1997); William J. Woodward, Jr., *The Realist and Secured Credit: Grant Gilmore, Common-Law Courts, and the Article 9 Reform Process*, 82 CORNELL L. REV. 1511 (1997) (questioning the distributive fairness of rules that afford full priority to secured creditors). While the Warren proposal created a great deal of academic angst, the Drafting Committee ignored it, sharing the attitude of Professor White insofar as its necessity was concerned. See James J. White, *The Slippery Slope to Bankruptcy: Should Some Claimants Get a 'Carve-out' From Secured Credit?*, BUS. L. TODAY, Jan./Feb. 1998, at 33.

<sup>3</sup> Revised Article 9 was approved by its sponsoring agencies, the American Law Institute and the National Commission on Uniform State Laws, in 1998, but with a delayed effective date of July 1, 2001, in order to allow adequate time for enactment by the states. U.C.C. § 9-701 (2001).

<sup>4</sup> The use of limited-liability special-purpose entities to isolate assets has become ubiquitous in commercial finance. In 2001, Professor Lupica observed that, "[s]ince the first public asset-backed security issuance, the volume of ABS [asset-backed securities] issuances has grown from \$1 billion in 1985 to \$185 billion in 1999. There are over \$2.5 trillion asset-backed securities currently outstanding, and it has been estimated that a typical business day sees \$700 million in new ABS issuances." Lois R. Lupica, *Revised Article 9, Securitization Transactions and the Bankruptcy Dynamic*, 9 AM. BANKR. INST. L. REV. 287, 291-92 (2001). This trend only continued after 2001 facilitated by the revision of Article 9, an important goal of which was to expand protection for and facilitate securitization transactions. See also Edward J. Janger, *The Death of Secured Lending*, 25 CARDOZO L. REV. 1759, 1760-61 (2004) (citing recently-adopted state statutes that "gerrymander state property law to provide a safe harbor for securitization transactions" and an effective opt-out from Article 9). See generally Steven L. Schwarcz, *The Impact on Securitization of Revised UCC Article 9*, 74 CHI.-KENT L. REV. 947 (1999). The Enron debacle and the financial crisis in 2008 have combined to, if not

by the effective judgment proofing of debtors through all-encompassing security interests<sup>5</sup> continues unresolved to date.<sup>6</sup>

The issue is exacerbated in the context of a bankruptcy case where the unique rehabilitative fresh start and equality policies of the federal bankruptcy law enter into the fray, policies that find doctrinal instantiation in certain key provisions of the Bankruptcy Code (“Code”).<sup>7</sup> Chief among these is § 506(a) of the Code, which calls for the bifurcation of partially secured (“undersecured”) claims into two parts: (1) a secured claim equal to the value of the collateral, and (2) an unsecured claim for the balance of the debt supporting the claim.<sup>8</sup> This distinction, which ties the concept of “secured claim” to specific economic value, has no corollary under state law.<sup>9</sup> Largely, it derives from the necessity in bankruptcy to cleave a wide chasm between the debtor’s pre- and postpetition lives.<sup>10</sup> Whether in liquidation or reorganization

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abate the trend somewhat, at least attract greater regulatory scrutiny. *See* Dov Solomon, *The Rise of a Giant: Securitization and the Global Financial Crisis*, 49 AM. BUS. L.J. 859 (2012); Steven L. Schwarcz, *Securitization Post-Enron*, 25 CARDOZO L. REV. 1539 (2004); *cf.* Jonathan C. Lipson, *Re: Defining Securitization*, 85 S. CAL. L. REV. 1229 (2012) (distinguishing between “true” securitization transactions and other forms of structured financing).

<sup>5</sup> *See generally* Lynn M. LoPucki, *The Death of Liability*, 106 YALE L.J. 1 (1996).

<sup>6</sup> Two more contemporary forays into the arena include: Yair Listokin, *Is Secured Debt Used to Redistribute Value from Tort Claimants in Bankruptcy? An Empirical Analysis*, 57 DUKE L.J. 1037 (2008) (finding that firms with high tort risk do not issue more secured debt than other firms, negating the redistribution theory of secured credit); Richard Squire, *The Case for Symmetry in Creditors’ Rights*, 118 YALE L.J. 806 (2009) (calling for the subordination of secured creditor deficiency claims in order to produce “symmetry” in the portioning of the debtor’s assets). Also worth examining is a comparative law piece that juxtaposes the U.S. system, which affords the security interest priority over virtually all creditors, with the English system, which prescribes a “carve-out” for certain types of claims and expenses. Lynn M. LoPucki, Arvin I. Abraham & Bernd P. Delahaye, *Optimizing English and American Security Interests*, 88 NOTRE DAME L. REV. 1785 (2013).

<sup>7</sup> The current law of bankruptcy is found in Title 11 of the United States Code. 11 U.S.C. §§ 101–1530 (2012), *amended by* Pub. L. No. 112-106 (2012). It was enacted on November 6, 1978 as the Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549, and governs all cases filed on or after October 1, 1979. In this Article, except where otherwise indicated, all references to the “Code” or the “Bankruptcy Code” are to Title 11 of the United States Code as amended through January 1, 2013.

The clearest examples of provisions that promote these goals are the provisions for cramdown of the claims of nonconsenting creditors in chapters 11, 12, and 13. *See* 11 U.S.C. §§ 1129(b)(2), 1222(b)(2), 1322(b)(2) (2012). In chapter 7, the discharge injunction of § 524(d), the protection of exempt assets in § 522, and the prohibitions on discrimination based on the bankruptcy filing in § 525, loom large.

<sup>8</sup> 11 U.S.C. § 506(a).

<sup>9</sup> *See Lane v. W. Interstate Bancorp (In re Lane)*, 280 F.3d 663, 665 (6th Cir. 2002) (“Lawyers [and laypersons] often think of any claim for repayment of a mortgage loan as a ‘secured claim’ whether or not the mortgagee could actually realize anything at a foreclosure sale.”).

<sup>10</sup> *See infra* text accompanying notes 247–50, 266–67.

mode, bankruptcy at its core entails a fundamental and mandatory realignment of existing contractual and property relationships and obligations so as to achieve the debtor's fresh start or rehabilitation, as the case may be.<sup>11</sup> On the face of it, then, it would seem that being "secured" for bankruptcy purposes means simply the right to a priority claim in the present value (net of prior liens) of the creditor's collateral as of the date of filing—no more and no less.<sup>12</sup> The controversy and disagreement, however, over how to properly conceptualize security interests in bankruptcy demonstrates that, in fact, understanding the ontological meaning of and entailments associated with a "secured claim" has been anything but simple.

In 1992 the Supreme Court of the United States set the stage for the current debacle with its controversial decision in *Dewsnup v. Timm*.<sup>13</sup> The narrow holding of the case was that "strip down"<sup>14</sup> of an undersecured claim is not permitted under § 506(d) in a chapter 7 case.<sup>15</sup> The broader implications of the holding were that, in ways yet unarticulated, being secured in bankruptcy might entail rights beyond simply the right to the property pledged to secure the claim, or its value. In 1997, Professor Knippenberg and I published a law review article rather critical of the Court's decision in *Dewsnup*<sup>16</sup> based primarily on our view of a security interest as representing a *claim to property*,

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<sup>11</sup> The importance of this "closing of the books" with regard to all prebankruptcy transactions, regardless of character, is reflected in the Code's broad definition of what constitutes a "claim" in § 101(5) and in the procedures in § 502(c) for estimating claims, the precise determination of which might unduly delay the administration of the case.

<sup>12</sup> This view is consistent with a prediction expressed at the birth of the Code. See Peter F. Coogan, *Article 9—An Agenda for the Next Decade*, 87 YALE L.J. 1012, 1028–30 (1978) (indicating that the Code had moved away from an approach that viewed the secured party's interest as "property rights" to one that recognized the interest as a prior claim against specific assets). Unfortunately, Professor Coogan's prediction proved a bit too optimistic, as the property-based understanding of security has become enconced in Revised Article 9. See Lawrence Ponoroff & F. Stephen Knippenberg, *Having One's Property and Eating It Too: When the Article 9 Security Interest Becomes a Nuisance*, 82 NOTRE DAME L. REV. 373, 379–84 (2006); Steven L. Harris & Charles W. Mooney, *A Property-Based Theory of Security Interests: Taking Debtors' Choices Seriously*, 80 VA. L. REV. 2021, 2047–53 (1994) (Professors Harris and Mooney were the reporters to the Article 9 revision process).

<sup>13</sup> *Dewsnup v. Timm*, 502 U.S. 410 (1992).

<sup>14</sup> "Strip down" occurs when an undersecured lien is bifurcated and the unsecured portion is avoided and should be distinguished from "strip off," which entails avoiding a lien that is unsupported by any collateral value. See generally Lam v. Investors Thrift (*In re Lam*), 211 B.R. 36, 37 n.2 (B.A.P. 9th Cir. 1997).

<sup>15</sup> *Dewsnup*, 502 U.S. at 417.

<sup>16</sup> In this, we were hardly alone. For a representative sample of cases and commentary critical of *Dewsnup*, see Woolsey v. Citibank, N.A. (*In re Woolsey*), 696 F.3d 1266, 1274 n.1 (10th Cir. 2012).

but not an indefeasible *right in* property.<sup>17</sup> In attempting to demonstrate the futility of the holding in *Dewsnup*, we stated that by resorting to a device known as “chapter 20”<sup>18</sup> a debtor could do in two steps what *Dewsnup* now forbids doing in one; namely, strip down an undersecured lien, at least as against nonresidential real property.<sup>19</sup>

Later that same year, Judge Robert D. Martin, in a case titled *In re Kirchner*,<sup>20</sup> faced with a chapter 20 scenario similar, but by no means identical, to the one Professor Knippenberg and I hypothesized,<sup>21</sup> opined: “How the chapter 7 discharge affects what can be done in a subsequent chapter 13 case is not as obvious to me as it was to Professors Ponoroff and Knippenberg.”<sup>22</sup> Sixteen years after that, in *Branigan v. Davis*,<sup>23</sup> the U.S. Fourth Circuit faced an attempt by debtors to “strip off” wholly underwater liens against their personal residences in a chapter 20 case. In a two-to-one decision, the court held that lien stripping in chapter 20 is permissible notwithstanding: (1) the fact that it created an “end run” around *Dewsnup*, and (2) the amendments to chapter 13 accomplished under the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (“BAPCPA”)<sup>24</sup> intended to tip “the bankruptcy scales back in the direction of creditors.”<sup>25</sup>

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<sup>17</sup> 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 (1997).

<sup>18</sup> There is, of course, no “chapter 20” in the Bankruptcy Code. Rather, the term refers to the successive filing of a chapter 7 bankruptcy to discharge personal liability on debt and then a chapter 13 in order to restructure secured debt or deal with non-dischargeable debt. *See also infra* note 118 and accompanying text.

<sup>19</sup> Ponoroff & Knippenberg, *supra* note 17, at 2299. Our point was that a debtor might still strip down an undersecured lien by first filing a chapter 7 case to discharge personal liability, and then file a chapter 13 petition to re-impose the stay and satisfy the claim by proposing under § 1325(b)(5) a plan in which the creditor would receive payments equal to the present value of the secured portion of its claim. *Id.*

<sup>20</sup> *In re Kirchner*, 216 B.R. 417 (Bankr. W.D. Wis. 1997).

<sup>21</sup> In our hypothetical, we acknowledged that the chapter 20 technique for stripping down an undersecured lien would not include circumstances where the claim was secured by a lien on property that was the debtor’s principal residence. *See* Ponoroff & Knippenberg, *supra* note 17, at 2299 n.251.

<sup>22</sup> In light of the fact that Judge Martin is a long-serving, smart, conscientious judge, with a stellar reputation on the bench (not to mention a friend), I felt a bit unnerved on first reading this statement.

<sup>23</sup> *Branigan v. Davis (In re Davis)*, 716 F.3d 331 (4th Cir. 2013).

<sup>24</sup> Pub. L. No. 109-8, 119 Stat. 23 (2005) (codified as amended in scattered sections of 11 U.S.C.). BAPCPA became fully effective for cases filed on or after Oct. 17, 2005.

<sup>25</sup> *Ransom v. FIA Card Servs., N.A.*, 131 S. Ct. 716, 721 (2011). The late Senator Paul Wellstone, the lone senator to vote against the bill, summed up the view of many in the bankruptcy field when he offered this comment with respect to an earlier iteration of the bill that eventually was passed as BAPCPA.

In short, notwithstanding the passage of more than 16 years, the spilling of much ink on the subject, and a comprehensive overhaul of the federal bankruptcy law, we have gone exactly nowhere in advancing our collective understanding of what it means to be “secured” in bankruptcy. So, it seems timely to tilt yet once more at that windmill where divergent state and federal law schema have uncomfortably co-existed for so long. I begin this redux with a brief overview of the relevant Supreme Court jurisprudence relating to this topic, and then consider some of the questions that remained unanswered after those cases, including the dilemma faced by Judge Martin in *Kirchner* and the differing treatment to be accorded to *strip off* as opposed to *strip down*.<sup>26</sup> Next, I turn to a detailed discussion of the *Branigan* case and its implications. Following that, I attempt to pull together some of the disparate threads by focusing, ironically, on the technique employed by Congress under BAPCPA to expand the scope of non-modifiable claims in chapter 13. I then propose what I submit represents a way to conceive of security in bankruptcy, as distinct from state law, that fairly balances the contractual entitlements of secured creditors with the specific equality and rehabilitation objectives implicated in any bankruptcy proceeding. Lastly, relying on recent scholarship analyzing the role of the bankruptcy courts in the development of the law, I conclude that the courts inherently possess the means to allow strip off in chapter 7, and, in so doing, to confine the Court’s definition of “secured claim” in *Dewsnup* to its narrowest (and least damaging) possible sphere of operation.

## I. THE SUPREME COURT TRILOGY (OR HOW WE GOT TO WHERE WE ARE TODAY)

### A. Dewsnup

In *Dewsnup*, the chapter 7 debtors owed \$120,000 on land worth only \$39,000.<sup>27</sup> The debtors sought to keep the land by bifurcating the undersecured claim under § 506(a) and then relying on what appeared to be the plain

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You are hard pressed to find a bankruptcy judge that supports this legislation. You are hard pressed to find a bankruptcy law professor, a bankruptcy expert of any kind, anywhere, any place in the U.S.A. that backs this bill. This bill was written for the lender. It is that simple.

<sup>147</sup> CONG. REC. 13129, 13140 (2001) (statement of Sen. Paul Wellstone).

<sup>26</sup> See *supra* note 14.

<sup>27</sup> *Dewsnup v. Timm*, 502 U.S. 410, 413 (1992).

language of § 506(d)<sup>28</sup> to void (“strip down”) the portion of the lien (\$81,000) unsupported by the land’s value.<sup>29</sup> The Court, in Justice Blackmun’s majority decision, found that the relationship between subsections (a) and (d) of § 506, as well as their relationship with other parts of the Code, was sufficiently ambiguous<sup>30</sup> to allow the Court to overlook its own rules of statutory construction regarding the meaning to be attached to identical terms as used in different parts of a statute.<sup>31</sup> Thus freed to make its own interpretation of § 506, the Court concluded that the better reading of the phrase “allowed secured claim,” as used in § 506(d), was to assign it a different meaning from the defined meaning of the identical phrase in § 506(a); i.e., that portion of the total claim that is supported by value in the collateral.<sup>32</sup> Specifically, Justice Blackmun concluded that the phrase “allowed secured claim” in § 506(d) “should be read term-by-term” so as to refer only to a claim that is both “not allowed” and “not secured.”<sup>33</sup> In this case, because the creditors’ claim had been allowed under § 502, and was secured,<sup>34</sup> this construction of § 506(d) meant that the lien could not be stripped down.

It becomes important later to pay some attention to the rationales that the majority opinion offered in support of its holding that strip down of an undersecured claim is not permitted in chapter 7. First, the Court opined that a different conclusion would, of necessity, “freeze the creditor’s security interest at the judicial valuation,” and, thus, deprive the creditor of the any later appreciation in the property.<sup>35</sup> Second, noting the doctrine that holds the Code

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<sup>28</sup> Section 506(d) provides that: “To the extent that a lien secured a claim against the debtor that is not an allowed secured claim, such lien is void . . . .” 11 U.S.C. § 506(d) (2012).

<sup>29</sup> *Dewsnup*, 502 U.S. at 413. For an extensive review of the facts of the case and its treatment in the lower courts, see Margaret Howard, *Dewsnupping the Bankruptcy Code*, 1 J. BANKR. L. & PRAC. 513 (1992).

<sup>30</sup> *Dewsnup*, 502 U.S. at 416–17.

<sup>31</sup> *Sullivan v. Stroop*, 496 U.S. 474, 484 (1990) (“[I]dentical words used in different parts of [a statute] are [presumed] to have the same meaning.”). It is also notable that the “ambiguity” seems, as pointed out by the dissent, based merely on the fact that the litigants ascribed different meanings to the statute. *Dewsnup*, 502 U.S. at 420–21 (Scalia, J., dissenting); see also *infra* text accompanying note 41.

<sup>32</sup> *Dewsnup*, 502 U.S. at 417.

<sup>33</sup> *Id.* (referring to respondents’ arguments at 415). Justice Blackmun did acknowledge that if “writing on a clean slate, we might be inclined to agree with petitioner that the words ‘allowed secured claim’ must take the same meaning in § 506(d) as in § 506(a).” *Id.*

<sup>34</sup> In this context, “secured” is being used in the state law sense, of the debt being supported by an interest in property of the debtor, unrelated to value (if any) artificially prescribed by the Code in § 506(a). See *infra* note 222.

<sup>35</sup> *Dewsnup*, 502 U.S. at 417 (“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

should be read not to change pre-Code practices without some indication in the legislative history,<sup>36</sup> the Court pointed to the pre-Code principles that liens passed through bankruptcy unaffected, and that debtors were only permitted to reduce an unwilling creditor's lien by either paying it in full or filing for reorganization.<sup>37</sup> Ironically, the majority missed the one obvious opportunity to mitigate its butchery of the usual canons of statutory interpretation in construing the language of § 506(d).<sup>38</sup> That is, the debtors' interpretation of § 506(d) could be seen as rendering the redemption provision in § 722 largely superfluous,<sup>39</sup> in contravention of the general judicial reluctance to avoid construing a statute in a manner that produces that result.<sup>40</sup>

The majority opinion drew a splenetic dissent from Justice Scalia for ignoring the "normal and sensible principle that a term (and especially an artfully defined term such as 'allowed secured claim') bears the same meaning throughout the statute."<sup>41</sup> Among other salvos leveled at the majority

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unsecured creditors whose claims have been allowed and who had nothing to do with the mortgagor-mortgagee bargain.").

<sup>36</sup> *Id.* at 419. The pre-Code practices doctrine has been developed by the Supreme Court in a string of cases dating back to *Midlantic Nat'l Bank v. N.J. Dep't of Envtl. Prot.*, 474 U.S. 494, 501 (1986), which refused to hold that the power of abandonment under § 554(a) is no longer subject to certain judicially-created exceptions developed under the prior bankruptcy law.

<sup>37</sup> *Dewsnup*, 502 U.S. at 418. The problem, however, as Professor Howard has shown, is that the Court's understanding of the pre-Code practice in relation to both lien stripping and the inviolability of liens was incorrect. *See* Howard, *supra* note 29, at 526–30; *see also infra* note 225.

<sup>38</sup> *See infra* text accompanying note 161.

<sup>39</sup> That is because, under the debtor's interpretation of § 506(d), liens securing both personal and real property collateral could be stripped. That result is more expansive than the collateral—tangible personality used for consumer purposes—subject to redemption under § 722 for the secured portion of the lender's claim as determined under § 506(a). The point was not lost on the dissent. *See infra* note 41.

<sup>40</sup> *See, e.g., United States v. Jicarillo Apache Nation*, 131 S. Ct. 2313, 2330 (2011) (quoting *Mackey v. Lanier Collection Agency & Serv., Inc.*, 486 U.S. 825, 837 (1988)) ("As our cases have noted in the past, we are hesitant to adopt an interpretation of a congressional enactment which renders superfluous another portion of that same law."); *see also Cohen v. de la Cruz*, 523 U.S. 213, 220 (1998) (noting that the Code must, when possible, be interpreted such that "equivalent words have equivalent meaning"); *Ratzlaf v. United States*, 510 U.S. 135, 143 (1994) ("A term appearing in several places in a statutory text is generally read the same way each time it appears.").

<sup>41</sup> *Dewsnup*, 502 U.S. at 423 (Scalia, J., dissenting). It is important to bear in mind that, four years earlier, Justice Scalia authored the Court's most recent attempt to define the character of secured claims in bankruptcy. *See United Savs. Ass'n of Tex. v. Timbers of Inwood Forest Assocs., Inc.*, 484 U.S. 365 (1988). In that case, an undersecured creditor with a deed of trust on the debtor's apartment complex sought relief from stay on the ground that its interest lacked adequate protection as required by § 362(d)(1). *Id.* at 368. Specifically, the creditor urged that even if the property were not declining in value, it was losing the opportunity (as it surely was) to reinvest the value of the property; a right with unquestioned economic value that is also part of the creditor's bargain with the debtor. *Id.* at 370–71. The Court rejected the argument,

opinion,<sup>42</sup> the dissent also derided the Court's deference to "pre-[C]ode behavior" as inappropriate where, as here, the specific language of the statute clearly revealed Congress's intent as to the matter.<sup>43</sup> Noting that the majority opinion's approach to construing the statute was the "methodological antithesis" of the approach taken by the Court just three years earlier in a case involving the interpretation of yet another subsection of § 506,<sup>44</sup> Justice Scalia closed with a sardonic expression of sympathy for the courts of appeal that would be forced now to speculate on the approach to statutory construction the Court would choose next in connection with its interpretation of the Code.<sup>45</sup>

## B. Johnson

A year prior to *Dewsnup*, the Court decided another case that would also end up influencing the treatment of secured claims in bankruptcy. In *Johnson v. Home State Bank*, the Court implicitly placed its imprimatur on a practice that had been in some doubt; that is, rescheduling in chapter 13 of a debt as to which personal liability had been discharged in an earlier chapter 7.<sup>46</sup> In *Johnson*, the mortgage lender opposed use of the "chapter 20" technique by urging that once the debtor's personal liability on the obligation had been discharged, the remaining lien no longer represented a "claim," and therefore,

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holding that an undersecured creditor is not entitled to what would amount to postpetition income to compensate for the delay associated with realizing on its collateral. *Id.* at 373. To hold otherwise, the Court observed, would allow one group of creditors (undersecured) to realize on unencumbered assets at the expense of another group of creditors (unsecured) contrary to the Code's allocation of the costs of bankruptcy. *Id.* Clearly, at its essence, *Timbers* stood for the proposition that, for bankruptcy purposes, a secured creditor's claim represents an entitlement to the value of its collateral as of the time of filing and no more. *See id.* *Dewsnup*, by contrast, seems to accord a secured claim rights in post-filing appreciation. Thus, Justice Scalia's dissent in *Dewsnup* was demanded by his opinion in *Timbers*, though he did not expressly make that connection.

<sup>42</sup> For instance, the dissent suggested that the "inconsistency" that § 722 (the redemption provision) would supposedly create, if avoidance were permitted under § 506(d), was "greatly overstated," because § 506(d) is *not* a redemption provision. *Dewsnup*, 502 U.S. at 428–29 (Scalia, J., dissenting).

<sup>43</sup> *Id.* at 433. The dissent also pointed to the absence of any prior Bankruptcy Act provision or practice for the interpretation of § 506(d) that would invalidate across the board liens securing disallowed claims. *Id.* at 434.

<sup>44</sup> *Id.* at 435. That case was *United States v. Ron Pair Enters., Inc.*, 489 U.S. 235 (1989), concerning the entitlement under § 506(b) of postpetition interest to oversecured creditors whose liens are nonconsensual.

<sup>45</sup> *Dewsnup*, 502 U.S. at 435 (Scalia, J., dissenting). Justice Scalia also noted: "The greater and more enduring damage of today's opinion consists in its destruction of predictability, in the Bankruptcy Code and elsewhere. By disregarding well-established and oft-repeated principles of statutory construction, it renders those principles less secure and the certainty they are designed to achieve less attainable." *Id.*

<sup>46</sup> *Johnson v. Home State Bank*, 501 U.S. 78 (1991).

could not be restructured in a chapter 13 plan.<sup>47</sup> The Court disagreed, reasoning that the mortgagee still had a “right to payment” through foreclosure of the mortgaged property, and thus, possessed a “claim” within the meaning of § 101(5).<sup>48</sup> The Court also refused to hold that the serial filing was per se invalid, concluding instead that each case must stand or fall on its own under the crucible of good faith.<sup>49</sup>

Surely unbeknownst at the time, the Court’s ruling in *Johnson*, combined with the anti-modification stipulation in § 1322(b)(2), set the stage for what later would prove to be the principal battleground between the bankruptcy system’s foundational pro rata rule and the traditional hierarchical norms of secured credit. At the time, however, *Johnson* could be seen as perfectly consistent with Congress’s decision in the 1978 Code to give the term “claim” the “broadest possible definition” in order to enhance the scope of debtor relief in bankruptcy beyond what had been the practice under the prior law.<sup>50</sup>

### C. Nobelman

The final Supreme Court case of import for current purposes, *Nobelman v. American Savings Bank*, arose just a year after *Dewsnup* and also addressed the issue of strip down of an undersecured lien, but this time in chapter 13.<sup>51</sup> The debtors had unsuccessfully argued below that the antimodification language of § 1322(b)(2), pertaining to claims secured by the debtors’ principal residence,<sup>52</sup> applied only to the *postbifurcation* secured claim.<sup>53</sup> In this case,

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<sup>47</sup> *Id.* at 81.

<sup>48</sup> *Id.* at 84 (quoting 11 U.S.C. § 101(5) (2012)). The Court relied on § 524(a)(1), which it referred to as “codifying” the rule established more than a century earlier in *Long v. Bullard*, 117 U.S. 617 (1886), that the discharge only extinguishes the personal liability of the debtor and does not affect an action against the debtor *in rem*. *Id.* at 83–85.

<sup>49</sup> *Id.* at 87–88. On the actual issue of good faith (and, for that matter, feasibility under § 1325(a)(6)), which the bankruptcy court had found to be satisfied, the Court declined to rule inasmuch as both the district court and the court of appeals had chosen to resolve the case on the question of whether the bank’s interest was a “claim” for purposes of the debtor’s chapter 13 plan. Thus, the ultimate disposition was to reverse and remand. *Id.* at 88.

<sup>50</sup> S. REP. NO. 95-989, at 21–22 (1978); H.R. REP. NO. 95-595, at 309 (1977); *see also infra* notes 248–249 and accompanying text.

<sup>51</sup> *Nobelman v. Am. Savs. Bank*, 508 U.S. 324 (1993).

<sup>52</sup> 11 U.S.C. § 1322(b)(2) (allowing a plan, subject to §§ 1322(a) and (c), to “modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor’s principal residence, or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims”).

that amount was \$23,500, or roughly \$47,855 less than the amount owed under the terms of the mortgage loan.<sup>54</sup> Clearing up a split in the circuits, the Supreme Court rejected the debtors' argument.<sup>55</sup> Significantly, though, the Court agreed with the premise that it is necessary to "look first to 506(a) to determine" if the lender has a secured claim at all.<sup>56</sup> Beyond that, however, the Court noted that § 1322(b)(2) focuses on "rights," rather than "claims."<sup>57</sup> Thus, the fact that the lender had only a \$23,500 "secured claim" under § 506(a) did not mean that its rights as the holder of such a claim were necessarily limited to that amount.<sup>58</sup> Rather, the Court opined that, as determined under state law, the lender's "rights" include the right to retain the lien until the debt is paid off, the right to accelerate the loan upon default, and the right to recover any deficiency still outstanding after foreclosure.<sup>59</sup> Those are rights that, the Court concluded, bankruptcy might modify to an extent, but that ultimately may not be abrogated because of § 1322(b)(2)'s prohibition on modification.<sup>60</sup>

The debtor in *Nobelman* had urged the Court to apply the "last antecedent rule"<sup>61</sup> in construing § 1322(b)(2), which is to say that the "other than" language in the statute should be interpreted as modifying the phrase "secured

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<sup>53</sup> *Nobleman v. Am. Savs. Bank (In re Nobleman)*, 968 F.2d 483, 489 (5th Cir. 1992). The debtors' name, "Nobelman," was misspelled in the caption of the Fifth Circuit case and throughout that opinion.

<sup>54</sup> In chapter 13, strip down is accomplished under § 1322(b)(2), except as to home mortgage loans, making § 506(d), and thus the analysis in *Dewsnup*, inapposite in this case. See, e.g., *Bartee v. Tara Colony Homeowners Ass'n (In re Bartee)*, 212 F.3d 277, 291 n.21 (5th Cir. 2000) (holding that *Dewsnup* is inapplicable to the bankruptcy reorganization chapters); see also *infra* notes 99, 112 and accompanying text.

<sup>55</sup> *Nobelman*, 508 U.S. at 327–29.

<sup>56</sup> *Id.* at 328–29. This is precisely the point that the majority in *Dewsnup* ignored; i.e., the need to use § 506(a) to determine the status of the claim as secured or unsecured.

<sup>57</sup> *Id.* Justice Thomas also explained that Congress consciously chose the unqualified term "claim" rather than the term of art "secured claim" when crafting the antimodification provision in § 1322(b)(2). *Id.* Because "claim" is broadly defined under the Code, the conclusion to be drawn from its use is clear. Essentially, Congress employed the broader term specifically to capture the entire claim—including both its secured and unsecured portions—put forward by the bank. Thus, the reasoning goes that it is the "rights of a holder" of a claim secured by the debtor's residence, and not the mortgagee's secured claim in the debtor's residence, that may not be modified. *Id.* at 330–31.

<sup>58</sup> *Id.* at 324.

<sup>59</sup> *Id.* at 329 (citing *Butner v. United States*, 440 U.S. 48, 54–55 (1979)) ("In the absence of a controlling federal rule, we generally assume that Congress has 'left the determination of property rights in the assets of a bankrupt's estate to state law,' since such '[p]roperty interests are created and defined by state law.'"); see also *infra* notes 243–44 and accompanying text.

<sup>60</sup> *Id.* at 329. This would include the automatic stay against enforcement under § 362(a) and the right to cure a prepetition default under § 1322(b)(5).

<sup>61</sup> See generally Jeremy L. Ross, *A Rule of Last Resort: A History of the Doctrine of the Last Antecedent in the United States Supreme Court*, 39 SW. U. L. REV. 325 (2009).

claim,” with the result that only the portion of the mortgagee’s debt supported by value would be immune from modification.<sup>62</sup> The Court conceded that this reading was plausible, but not required.<sup>63</sup> Pointing out that the phrase used in the statute is “claim secured . . . by,” rather than the term of art for § 506(a) purposes, “secured claim,” the Court decided that the better reading was to construe the term “claim” as broad enough for purposes of the exemption from modification to include the lender’s *entire* claim, the unsecured as well as the secured portion.<sup>64</sup>

## II. UNANSWERED QUESTIONS

### A. *Strip Down in Chapters 13 and 20*

Despite some early uncertainty about the applicability of *Dewsnup* beyond chapter 7,<sup>65</sup>—a truly frightening possibility—a consensus quickly emerged that strip down remained available in all forms of reorganization proceedings for undersecured claims not statutorily protected from modification, such as by § 1322(b)(2) in chapter 13 cases.<sup>66</sup> The rationale for this conclusion, beyond being necessary to save rehabilitation from being consigned to oblivion, was the existence of specific cramdown provisions in each of the reorganization chapters.<sup>67</sup> This obviates the need in those cases to rely on § 506(d) for strip down authority and, when coupled with the language in Justice Blackmun’s opinion limiting the reach of the holding in *Dewsnup*,<sup>68</sup> provides a more than

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<sup>62</sup> *Nobelman*, 508 U.S. at 330.

<sup>63</sup> *Id.* at 331.

<sup>64</sup> *Id.*

<sup>65</sup> See, e.g., *Blue Pac. Car Wash, Inc. v. St. Croix Cnty. (In re Blue Pac. Car Wash, Inc.)*, 150 B.R. 434 (W.D. Wis. 1992).

<sup>66</sup> See, e.g., *Wade v. Bradford*, 39 F.3d 1126, 1128–29 (10th Cir. 1994) (holding strip down of liens on real property is permitted in chapter 11); *Sapos v. Provident Inst. of Sav.*, 967 F.2d 918, 920–21 (3d Cir. 1992) (involving strip down in chapter 13); *Okla. ex rel. Comm’rs of the Land Office v. Crook (In re Crook)*, 966 F.2d 539, 539 & n.1 (10th Cir. 1992) (involving a chapter 12 case); see also Margaret Howard, *Secured Claims in Bankruptcy: An Essay on Missing the Point*, 23 CAP. U. L. REV. 313, 319–20 (1994) (explaining why *Dewsnup* has little relevance in rehabilitative proceedings); *supra* note 54. The types of claims statutorily immune from modification were expanded in 2005. See *supra* text accompanying note 53.

<sup>67</sup> In chapter 11, for instance, under § 1141(b), confirmation of a plan vests all estate property in the debtor, and, thereafter, the property is held free of all liens except those provided for in the plan. See *In re Penrod*, 50 F.3d 459, 463 (7th Cir. 1995) (holding that a lien not provided for in the plan was extinguished upon confirmation); see also 11 U.S.C. §§ 1222(b), 1322(b) (2012).

<sup>68</sup> *Dewsnup v. Timm*, 502 U.S. 410, 417 n.3 (1992) (“[W]e express no opinion as to whether the words ‘allowed secured claim’ have different meaning in other provisions of the Bankruptcy Code.”). The Court also

sufficient justification for preserving the debtor's ability to strip down undersecured claims in reorganization proceedings to the value of the underlying collateral.<sup>69</sup>

As noted earlier, in *In re Kirchner*, Judge Martin described the difficulty in harmonizing these three Supreme Court cases in the context of a chapter 20 case.<sup>70</sup> In the case before him, the debtors sought to sell their principal residence under their chapter 13 plan and pay the lender the agreed-upon value of the property from the sales proceeds.<sup>71</sup> Contrary to the result of a hypothetical that Professor Knippenberg and I had posed,<sup>72</sup> Judge Martin concluded that the "rights" enjoyed by a mortgagee, and protected from modification by § 1322(b)(2), included the right to payment of the full amount of the underlying debt owed, as a condition to the release of its lien.<sup>73</sup> Consistent with *Johnson*, this would be true even after the debtor has received a discharge of personal liability.<sup>74</sup> Thus, the court upheld the lender's objection to confirmation of the debtors' plan.<sup>75</sup>

Although Judge Martin acknowledged that the lender had no discernible or genuine economic motive for not agreeing to release its lien in return for the proceeds from the sale of the property, and indeed might actually benefit,<sup>76</sup> he

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stated that its holding was limited to the facts presented and that it would "allow other facts to await their legal resolution on another day." *Id.* at 416.

<sup>69</sup> As will be seen, thanks to *Dewsnup*, the question is in far more doubt if the creditor relies on § 506(d), which is fully applicable in all types of bankruptcy proceedings as a basis for strip down or strip off, rather than one of the chapter-specific modification provisions. *See infra* Part II.C.2.

<sup>70</sup> The "question . . . all of this begs," Judge Martin lamented, is exactly what are these "rights" that may not be modified by the debtors' plan? *In re Kirchner*, 216 B.R. 417, 421 (Bankr. W.D. Wis. 1997).

<sup>71</sup> *Id.* at 419 n.2. Significantly, the value had been stipulated by the parties, so there was no issue of potential inaccuracy in the judicial valuation as might occur when the value is disputed. *See infra* notes 209, 282 and accompanying text.

<sup>72</sup> *See supra* note 19. We observed specifically that the strategy would only be assured of working with respect to nonresidential real property. Ponoroff & Knippenberg, *supra* note 17, at 2299–300 & n.251. Moreover, unlike in *Kirchner*, our hypothetical did *not* contemplate a proposed sale of the debtors' home.

<sup>73</sup> *Kirchner*, 216 B.R. at 421–22.

<sup>74</sup> *Id.* at 422–23 (noting that under Wisconsin law, an *in rem* foreclosure judgment may exceed the value of the foreclosed property if the amount due on the underlying note exceeds that market value of the property).

<sup>75</sup> *Id.* at 425.

<sup>76</sup> *Id.* at 423–24 & n.18. The point made by Judge Martin was that, even if able to credit bid a foreclosure judgment equal to the value of the underlying debt, as a regulated financial institution, the lender in this case would be required to dispose promptly of the foreclosed property (generally considered a "toxic" asset—expensive to maintain and considered nonearning assets for balance sheet purposes). *Id.* Thus, in the end, the lender would receive no more than the current value of the property that the debtors' proposed to pay from the sales proceeds, and perhaps less, given the tendency of forced sales to produce lower prices. *Id.*

reasoned that, to compel the mortgagee to accept that result would deprive it of the right assured by *Nobelman* to foreclose in the manner prescribed by state (in this case Wisconsin) law.<sup>77</sup> Due to the mortgagee's state law right to "credit bid" the full amount of its judgment at a foreclosure sale, this would include the right to receive the full amount of the underlying debt if the debtors' sought to redeem the property.<sup>78</sup> Judge Martin conceded, however, that there was no indication that debtors "presently have or ever will have the ability to redeem the property."<sup>79</sup> Thus, the debtors' proposal to sell the residence and turnover the stipulated current value to the bank was truly the economic equivalent of the bank's protected right to foreclose, but nonetheless determined to be a prohibited modification.<sup>80</sup>

### B. Strip Off in Chapter 7

Left unanswered by both *Dewsnup* and *Nobelman*, which prohibited strip down of chapter 7 and residential mortgage loans in chapter 13, respectively,<sup>81</sup> is the question of strip off of liens with no economic stake in the collateral (i.e., wholly underwater, or unsecured, liens). While some courts initially concluded that strip off of valueless liens in chapter 7 was not precluded by *Dewsnup*,<sup>82</sup> the overwhelming weight of authority in appellate decisions, including three

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<sup>77</sup> *Id.* at 422.

<sup>78</sup> *Supra* note 76.

<sup>79</sup> *Kirchner*, 216 B.R. at 423. For this reason, Judge Martin quite accurately noted that "the right to foreclose property possessed by Union would appear to give it an economic right that is realistically equal only to the intrinsic value of the property." *Id.*

<sup>80</sup> The court speculated on possible non-economic motives for objecting to the plan, such as the desire to avoid any precedent establishing the ability of strip down in a chapter 20 case or even personal animus toward the debtors, but concluded such motive was unclear. *Id.* at 424.

<sup>81</sup> *See supra* Part I.

<sup>82</sup> *See, e.g.,* Warthen v. Smith (*In re Smith*), 247 B.R. 191, 197 (W.D. Va. 2000); Yi v. Citibank (Md.), N.A. (*In re Yi*), 219 B.R. 394, 399 (E.D. Va. 1998); Farha v. First Am. Title Ins. (*In re Farha*), 246 B.R. 547, 550 (Bankr. E.D. Mich. 2000); Zempel v. Household Fin. Corp. (*In re Zempel*), 244 B.R. 625, 629–30 (Bankr. W.D. Ky. 1999). The analysis of the district court in *Yi* is representative of the approach taken by the courts in these cases. Specifically, the court in that case first distinguished *Dewsnup* based on the fact that two prior deeds of trust had "eaten up" any value in the property for the lien as to which avoidance was sought. *Yi*, 219 B.R. at 397. As for the argument regarding potential future appreciation, the court observed that the "argument proves too much, for if accepted it would mean that no claim could ever be deemed unsecured under the second part of § 506(a), given that there is always some theoretical potential for the value of the collateral to increase." *Id.* at 398. Lastly, the court noted that its decision was consistent with *Nobelman*, even though the Supreme Court established in that case that a creditor might be regarded as "secured" for some purpose beyond the value of its collateral. *Id.* Specifically, the *Yi* court relied on *Nobelman's* instruction that, in order for this to be the case, it is necessary in the first place to consult § 506(a) to determine that the creditor is the holder of a secured claim to at least some event. *Id.* at 399; *see also supra* note 56.

published circuit court opinions, draw no distinction between partially and totally unsecured liens in terms of the reach of the holding in *Dewsnup*.<sup>83</sup> The diverging analyses of the bankruptcy and district courts in *Wachovia Mortgage v. Smoot*, are illustrative.<sup>84</sup>

In *Smoot*, the chapter 7 debtor filed an adversary proceeding in the bankruptcy court to avoid a wholly unsecured second mortgage on her primary residence.<sup>85</sup> Applying § 506(a) to determine the status of the creditor's secured claim, and relying on the Second Circuit's decision in *In re Pond*—a decision holding that a wholly unsecured mortgage lien is not protected from modification under § 1322(b)(2)<sup>86</sup>—the bankruptcy court concluded that there was no basis for treating unsecured mortgage liens differently in chapter 7 than in chapter 13.<sup>87</sup> Thus, the court found the valueless lien “null and void” pursuant to § 506(d).<sup>88</sup>

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<sup>83</sup> See, e.g., *Palomar v. First American Bank*, 722 F.3d 992, 994–95 (7th Cir. 2013); *Talbert v. City Mort. Servs.* (*In re Talbert*), 344 F.3d 555, 562 (6th Cir. 2003) *superseding* *Farha v. First Am. Title Ins.* (*In re Farha*), 246 B.R. 547 (Bankr. E.D. Mich. 2000), *and Zempel v. Household Fin. Corp.* (*In re Zempel*), 244 B.R. 625 (Bankr. W.D. Ky. 1999); *Ryan v. Homecomings Fin. Network*, 253 F.3d 778, 783 (4th Cir. 2001) *superseding* *Smith*, 247 B.R. at 197, *and Yi*, 219 B.R. at 397; *see also* *Laskin v. First Nat'l Bank of Keystone* (*In re Laskin*), 222 B.R. 872, 876 (B.A.P. 9th Cir. 1998) (holding that the rationales articulated by the Supreme Court in *Dewsnup* apply with equal force whether the lien is wholly unsecured or merely undersecured). The *Laskin* court also based its holding on the fact that, “[s]ection 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 [c]hapter 7 debtor.” *Laskin*, 222 B.R. at 876 (citing *Oregon v. Lange* (*In re Lange*), 120 B.R. 132, 135 (B.A.P. 9th Cir. 1990)). The appropriateness of this statement is discussed *infra* notes 274–77, given that the provisions of chapter 5 of the Code apply in all types of debtor relief cases, including chapter 7.

<sup>84</sup> *Smoot v. Wachovia Mort.* (*In re Smoot*), 465 B.R. 730 (Bankr. E.D.N.Y. 2011), *rev'd sub nom.* *Wachovia Mort. v. Smoot*, 478 B.R. 555 (E.D.N.Y. 2012).

<sup>85</sup> *Id.* at 731.

<sup>86</sup> *Pond v. Farm Specialist Realty* (*In re Pond*), 252 F.3d 122, 125–26 (2d Cir. 2001) (ruling that antimodification is triggered only when there is sufficient equity in the collateral to cover some portion of the creditor's claim); *see also infra* text accompanying notes 109–10. In addition, Judge Eisenberg, who decided *Smoot*, had issued two earlier opinions permitting strip off in chapter 7. *In re Lavelle*, No. 09-72389-478, 2009 WL 4043089 (Bankr. E.D.N.Y. 2009); *Howard v. Nat'l Westminster Bank* (*In re Howard*), 184 B.R. 644 (Bankr. E.D.N.Y. 1995).

<sup>87</sup> *Smoot*, 465 B.R. at 730, 734–35 (stating that there is no statutory prohibition in the application of § 506(a) and (d) to chapter 7 cases).

<sup>88</sup> *Id.* at 736; *cf. Lam v. Investors Thrift* (*In re Lam*), 211 B.R. 36, 40 (B.A.P. 9th Cir. 1997) (making the point, albeit in the context of a chapter 13 proceeding, that, “if a lien has no ‘security’ interest in property of the debtor, its status as a lien is questionable”).

On appeal, the district court reversed.<sup>89</sup> After extensive review of the prior case law and applicable statutory edicts, the court reasoned that the Second Circuit's (and other court's) allowance of strip off of unsecured home mortgages hinged upon a "unique statutory predicate" in chapter 13 that has no analog in chapter 7; specifically, § 1322(b)(2).<sup>90</sup> Thus, *Pond* could not, the court reasoned, represent controlling precedent in chapter 7.<sup>91</sup> Likewise, the court found the statement in *Nobelman* that, in applying § 1322(b)(2), a court must first look to § 506(a) to determine if a claim is "secured only by a security interest in real property that is the debtor's residence,"<sup>92</sup> is inapposite in chapter 7.<sup>93</sup> Instead, the court found that *Dewsnup*'s interpretation of the relationship between § 506(a) and (d), and particularly its finding as to the irrelevance of valuation under the former in determining the scope of avoidance under the latter, constrained chapter 7 debtors from avoiding valueless unsecured liens with equal force and logic as in the case of undersecured liens.<sup>94</sup> By way of explanation, the court cited the Sixth Circuit's articulation of the three key analytical underpinnings of *Dewsnup*: (1) that post-filing appreciation belongs to the creditor; (2) that the parties bargain ex ante for the lien to remain with the property; and (3) that liens pass through bankruptcy unaffected, none of which depend on the lien having at least some value.<sup>95</sup>

At the same time, the district court in *Smoot* did throw a bouquet to the bankruptcy court, noting that the lower court's decision reflected "the more logical position, and the one supported by a large volume of legal commentary."<sup>96</sup> In addition, the court cited with approval Judge Wizmur's statement in *In re Cook*,<sup>97</sup> that reading § 506(a) and (d) together so as to allow

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<sup>89</sup> *Wachovia Mort. v. Smoot*, 478 B.R. 555 (E.D.N.Y. 2012). The decision actually involved two separate appeals that were consolidated since they involved the exact same issue—i.e., the permissibility of strip off in chapter 7.

<sup>90</sup> *Id.* at 564, 567.

<sup>91</sup> *Id.* at 564.

<sup>92</sup> *Supra* note 56 and accompanying text.

<sup>93</sup> *Smoot*, 478 B.R. at 568–69 (stating, as to the Supreme Court's interpretation of "secured" in *Dewsnup*, "although it is arguably an unusual reading of the statute, it plainly appears that the Supreme Court intended the concept of 'secured' to have a specific definition in the chapter 7 context, so that valuation of the underlying collateral is irrelevant").

<sup>94</sup> *Id.* at 564.

<sup>95</sup> *Id.* at 565 (citing *Talbert v. City Mort. Servs. (In re Talbert)*, 344 F.3d 555, 559 (6th Cir. 2003)).

<sup>96</sup> *Id.* at 569–70.

<sup>97</sup> *In re Cook*, 432 B.R. 519 (Bankr. D.N.J. 2010).

a junior lien with no value to be stripped off in chapter 7 is premised on sound principles of statutory construction that would be controlling were the court writing on a clean slate.<sup>98</sup> Yet, like Judge Wizmur, the district court in *Smoot* concluded that *Dewsnup* represented the “law of the land” and must be obeyed.<sup>99</sup>

The one outlier thus far among the circuit courts is the Eleventh Circuit, which, in an initially unpublished opinion in *In re McNeal*, permitted strip off of a wholly unsecured junior lien.<sup>100</sup> The panel’s decision, issued per curiam, is brief, noting simply that *Dewsnup* involved strip down, and not strip off. Therefore, the court concluded that it did not abrogate prior pre-*Dewsnup* circuit precedent permitting strip off of a subordinate lien unsupported by any value.<sup>101</sup> The lienholder adversely affected by the decision in *McNeal*, GMAC Mortgage L.L.C. (“GMAC”), filed a petition for rehearing en banc, but before the court could rule on that request, GMAC filed its own petition for relief under chapter 11, resulting in a considerable delay as the courts sought to ascertain the effect of the stay in GMAC’s case on the appellate proceeding in *McNeal*.<sup>102</sup> As this article goes to print, it appears the issue of rehearing vel non of the decision in *McNeal* in the Eleventh Circuit will be addressed by that court,<sup>103</sup> but the outcome of course is uncertain. In the meantime, because Eleventh Circuit Rules provide that, while not binding precedent, unpublished opinions can serve as persuasive authority, the lower courts in the Eleventh Circuit have, since the original decision was rendered, generally (although to a degree reluctantly) deferred to the panel’s decision in *McNeal* pending finality.<sup>104</sup>

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<sup>98</sup> *Id.* at 527.

<sup>99</sup> *Smoot*, 478 B.R. at 570 (citing *Cunningham v. Homecomings Fin. Network (In re Cunningham)*, 246 B.R. 241, 246 (Bankr. D. Md. 2000)).

<sup>100</sup> *McNeal v. GMAC Mortg., L.L.C. (In re McNeal)*, 735 F.3d 1263 (11th Cir. 2012) (originally 477 F. App’x 562).

<sup>101</sup> *Id.* at 564 (citing *Folendore v. Small Business Administration (In re Folendore)*, 862 F.2d 1537 (11th Cir. 1989)) (noting that *Dewsnup* was not “clearly” on point, and, thus, did not overrule the court’s decision in *Folendore*).

<sup>102</sup> The various machinations following the panel decision in *McNeal* are ably and carefully catalogued in *In re Alonso*, 495 B.R. 53 (Bankr. M.D. Fla. 2013). The situation was further complicated by the fact that the loan at issue in *McNeal* was no longer being serviced by GMAC, resulting in an additional motion for substitution of parties in *McNeal*, so that the petition for rehearing could go forward notwithstanding the stay in GMAC’s case. *Id.* at 54.

<sup>103</sup> *Id.* at 55.

<sup>104</sup> See, e.g., *Rogers-Dude v. J.P. Morgan Chase Bank, N.A.*, 498 B.R. 348, 352–53 (S.D. Fla. 2013); *Campbell v. Marshall & Ilsley Bank (In re Campbell)*, 498 B.R. 370, 373 (Bankr. N.D. Ga. 2013) (reluctantly

### C. Strip Off in Chapters 13 and 20

#### 1. Under § 1322(b)(2)

As discussed by the district court in *Smoot*,<sup>105</sup> the district and circuit courts have almost uniformly affirmed the ability to strip off unsecured liens in chapter 13, even as against the debtor's primary residence.<sup>106</sup> In *First Mariner Bank v. Johnson*, for example, the bankruptcy court was faced with the scenario where the first lien against the debtors' residence, with a fair market value of \$555,000, secured a debt with a balance of \$662,000.<sup>107</sup> While acknowledging the preclusion under § 1322(b)(2) from modifying that lien, the debtors nonetheless sought to strip off a second lien, securing a debt of \$82,000.<sup>108</sup> Referring specifically to precedent from other circuits,<sup>109</sup> the court held that the antimodification limitation in § 1322(b)(2) does not come into play unless and until the creditor can demonstrate that it has an allowed secured claim within the meaning of § 506(a).<sup>110</sup> By definition, the holder of a lien unsupported by any economic value cannot meet that burden. Its state law rights are, as the Ninth Circuit Bankruptcy Appellate Panel put it, "empty

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following *McNeal*); *Malone v. Citibank, N.A. (In re Malone)*, 489 B.R. 275 (Bankr. M.D. Ga. 2013) (wherein Judge Diehl, while expressing her skepticism that *Folendore* could be reconciled with *Dewsnup*, followed *McNeal* in allowing the chapter 7 debtor to strip off a junior lien unsupported by any equity in the underlying collateral).

<sup>105</sup> *Wachovia Mortg. v. Smoot (In re Smoot)*, 478 B.R. 555, 565 (E.D.N.Y. 2012). See *supra* text accompanying note 90.

<sup>106</sup> The one somewhat unusual exception is discussed in detail *infra* Part II.C.2.

<sup>107</sup> *First Mariner Bank v. Johnson*, 411 B.R. 221, 222 (D. Md. 2009), *aff'd mem. per curiam sub nom. First Mariner Bank v. Johnson (In re Johnson)*, 407 F. App'x 713 (4th Cir. 2011).

<sup>108</sup> *Id.*

<sup>109</sup> The court referred to authority from the 6th and 11th Circuits. *First Mariner*, 411 B.R. at 224 (citing *Lane v. W. Interstate Bancorp (In re Lane)*, 280 F.3d 663, 665 (6th Cir. 2002) and *Tanner v. FirstPlus Fin., Inc. (In re Tanner)*, 217 F.3d 1357, 1360 (11th Cir. 2000)). However, no less than four other circuits have also held that § 1322(b)(2) may be invoked to strip off a wholly unsecured lien in chapter 13, even though that lien encumbers that debtor's principal residence. See 11 U.S.C. § 1322(b)(2) (2012); *Zimmer v. PSB Lending Corp. (In re Zimmer)*, 313 F.3d 1220, 1221 (9th Cir. 2002); *Pond v. Farm Specialist Realty (In re Pond)*, 252 F.3d 122, 127 (2d Cir. 2001); *McDonald v. Master Fin., Inc. (In re McDonald)*, 205 F.3d 606, 615 (3d Cir. 2000); *Bartee v. Tara Colony Homeowners Ass'n (In re Bartee)*, 212 F.3d 277, 280 (5th Cir. 2000); see also *Minn. Hous. Fin. Agency v. Schmidt (In re Schmidt)*, No. 0:13-cv-00434, 2013 WL 2470218 (D. Minn. June 07, 2013).

<sup>110</sup> *First Mariner*, 411 B.R. at 223–24. The origins of this analysis trace their roots back, of course, to the Supreme Court's acknowledgment in *Nobelman* that the first step in determining if a claim is subject to modification under § 1322(b)(2) is to ascertain if that claim is secured within the meaning of § 506(a). See *supra* text accompanying notes 56, 82.

rights from a practical, if not a legal standpoint.”<sup>111</sup> The court in *First Mariner* also rejected the mortgagee’s policy-based argument concerning the importance of encouraging the flow of capital into the residential real estate market, noting this aim pertains only in the case of first or purchase-money mortgages.<sup>112</sup>

Although the bankruptcy filing in *First Mariner* postdated the effective date of BAPCPA, no mention was made of the changes to §§ 1325(a) and 1328 wrought by the 2005 amendments, most likely because *First Mariner* was not preceded by an earlier chapter 7 case. These provisions, however, figured prominently in *Branigan v. Davis*<sup>113</sup> and the discussion that follows.<sup>114</sup> Thus, they merit a quick review. As part and parcel of the implementation of BAPCPA’s paramount twin objectives of correcting perceived abuses of the bankruptcy system and ensuring that debtors who have the ability to pay more to their creditors do so,<sup>115</sup> BAPCPA made a number of changes to chapter 13, including several intended to bolster the stability of secured claims.<sup>116</sup> Among them were amendments to § 1325(a)(5), providing for retention of the lien securing an allowed secured claim (1) until the earlier of payment or discharge of the underlying debt, and (2) upon conversion or dismissal of the case without completion of the plan.<sup>117</sup> In addition, a new subsection (f) was added

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<sup>111</sup> *Lam v. Investors Thrift (In re Lam)*, 211 B.R. 36, 40 (B.A.P. 9th Cir. 1997).

<sup>112</sup> *First Mariner*, 411 B.R. at 224–25 (citing *McDonald*, 205 F.3d at 613, and *Bartee*, 212 F.3d at 293). The policy of encouraging the flow of capital into the home lending market as the justification of favored treatment for residential mortgages was also the basis for Justice Stevens’s concurrence in *Nobelman*. See *Nobelman v. Am. Sav. Bank*, 508 U.S. 324, 332 (1993) (Stevens, J., concurring).

<sup>113</sup> *Branigan v. Davis (In re Davis)*, 716 F.3d 331 (4th Cir. 2013).

<sup>114</sup> See *infra* text accompanying notes 119–44.

<sup>115</sup> See H.R. REP. NO. 109-31, at 2 (2005), reprinted in 2005 U.S.C.C.A.N. 88, 88–89. For an extensive description of the legislative history, see also Susan Jensen, *A Legislative History of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*, 79 AM. BANKR. L.J. 485 (2005). The extent to which the perception of consumer irresponsibility and abuse was accurate, and even if so, the effectiveness of BAPCPA in responding to it, is open to serious question. See generally David Gray Carlson, *Means Testing: The Failed Bankruptcy Revolution of 2005*, 15 AM. BANKR. INST. L. REV. 223, 227 (2007) (concluding the means test in § 707(b), perhaps the centerpiece of BAPCPA’s abuse prevention measures, has, at best, produced no effect, and may actually have encouraged greater bankruptcy abuse); Susan Block-Lieb & Edward J. Janger, *The Myth of the Rational Borrower: Rationality, Behavioralism, and the Misguided “Reform” of Bankruptcy Law*, 84 TEX. L. REV. 1481, 1488 (2006) (arguing that the credit industries—not opportunistic debtors who abuse the bankruptcy system—are responsible for the increase in bankruptcy filings).

<sup>116</sup> See generally Eugene Wedoff, *Major Consumer Bankruptcy Effects of BAPCPA*, 2007 U. ILL. L. REV. 31, 60–65.

<sup>117</sup> 11 U.S.C. § 1325(a)(5)(B)(i) (2012). Subject to the hardship discharge provisions in § 1328(b), a discharge in chapter 13 is entered after completion of final payment under the plan. See *id.* § 1328(a)–(b).

to § 1328 prohibiting a debtor from receiving a discharge in chapter 13 if the debtor received a discharge in a chapter 7 case filed within four years preceding the filing of the chapter 13 case.<sup>118</sup>

The Fourth Circuit's decision in *Branigan* involved two separate chapter 20 cases arising from the same district and that had been consolidated by the district court for purposes of the first-level appeal.<sup>119</sup> In both cases, the bankruptcy court had approved, and the district court affirmed, a plan calling for the strip off of a valueless junior lien on the debtors' respective residences.<sup>120</sup> The issue of good faith was not challenged in one of the cases, and was specifically found to exist in the other.<sup>121</sup> The chapter 13 trustee, who was the same in both cases, as well as the holder of the avoided junior lien in one of the cases, brought the appeal.<sup>122</sup> Initially, consistent with *First Mariner*, the majority observed the overwhelming weight of authority permitting the stripping off of wholly underwater liens against principal residences in chapter 13, *Nobelman* notwithstanding.<sup>123</sup> The court then turned to the main issue on appeal and one as to which the cases are split; that is, whether BAPCPA operated to preclude strip off of valueless liens in chapter 20 cases.<sup>124</sup>

The trustee contended that lien stripping is dependent upon the debtor's ability to receive a chapter 13 discharge, which neither of the debtors in this case would be entitled to because of the restriction in § 1328(f)(1).<sup>125</sup> The basis for this contention was the language added to § 1325(a)(5)(B) concerning a

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<sup>118</sup> *Id.* § 1328(f)(1). This restriction on the chapter 13 discharge implicitly puts, for the first time, a temporal boundary on what will be considered a chapter 20 case. Moreover, a debtor cannot avoid this bar on the chapter 13 discharge by seeking revocation of the earlier discharge in chapter 7. *See In re Ross*, No. 1:12-bk-19182, 2013 WL 3070906, at \*2 (Bankr. E.D. Cal. Feb. 20, 2013).

<sup>119</sup> The district court had consolidated the cases below, and affirmed the bankruptcy court's decisions without opinion. *Branigan v. Davis (In re Davis)*, 716 F.3d 331, 334 n.3 (4th Cir. 2013).

<sup>120</sup> In one of the two cases, that of Bryan and Carla Davis, the debtors' plan proposed to strip off two underwater junior liens against certain rental property, as well as a third priority lien against their home. *Id.* at 333–34. According to the facts, the second lien against their home was also entirely unsecured based on the value assigned to the property and the amount of the first lien, but there is no explanation of why strip off was not sought or granted with respect to that lien. *Id.*

<sup>121</sup> *Id.* at 334.

<sup>122</sup> The holder of the third lien against the Davises' home was also an appellant. *Id.* at 332, 334.

<sup>123</sup> *Id.* at 334–36. *See also supra* note 109.

<sup>124</sup> *Branigan*, 716 F.3d at 336 (comparing the opinions of multiple bankruptcy courts). Notably, however, *Branigan* is the first court of appeals to address the question. *See also In re Jennings*, 454 B.R. 252, 256–57 (Bankr. N.D. Ga. 2011) (reviewing what the court describes as three separate approaches to lien stripping in chapter 20 cases).

<sup>125</sup> *Branigan*, 716 F.3d at 337.

lienholder's retention of its lien pending either payment *or discharge*.<sup>126</sup> The trustee also urged that permitting strip off under these circumstances would inappropriately amount, as Professor Knippenberg and I pointed out in 1997,<sup>127</sup> to an "end run around" the Supreme Court's holding in *Dewsnup*, and further would be inconsistent with "BAPCPA's goal of rebalancing the scales in favor of creditors."<sup>128</sup>

While crediting the weight of the trustee's arguments, the court was ultimately not persuaded.<sup>129</sup> Initially, the majority opinion pointed to its earlier holding that, even when applicable, § 1328(f)(1) does not bar a debtor from filing under chapter 13, and that there may be good and sufficient reasons for doing so apart from the discharge.<sup>130</sup> Thus, the question became whether the Code provides a mechanism for stripping off worthless liens absent a discharge.<sup>131</sup> The majority answered the question in the affirmative, noting that modification of secured claims has always been permitted under the combination of §§ 506 and 1322(b).<sup>132</sup> The opinion continued that, "BAPCPA did not amend [§§] 506 or 1322(b), so the analysis permitting lien stripping in [c]hapter 20 cases is no different than in any other [c]hapter 13 case."<sup>133</sup> As for the new language in § 1325(a)(5)(B)(i) regarding retention of the lien, the court observed that this provision applies only to an "allowed secured claim" within

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<sup>126</sup> *Id.*

<sup>127</sup> See *supra* note 19 and accompanying text. Although, we did not regard this technique as "inappropriate."

<sup>128</sup> *Branigan*, 716 F.3d at 337; cf. *Lindskog v. M & I Bank (In re Lindskog)*, 451 B.R. 863, 866 (Bankr. E.D. Wisc. 2011) (reasoning that lien stripping in a chapter 20 case amounts to an impermissible "end run" around § 1328(f)(1)).

<sup>129</sup> *Branigan*, 716 F.3d at 337–38.

<sup>130</sup> *Id.* at 336 (citing *Branigan v. Bateman (In re Bateman)*, 515 F.3d 272, 283 (4th Cir. 2008)) (noting the protections or benefits available under chapter 13, other than discharge, that might be incentives for a debtor to file for relief even when § 1328(f) applies).

<sup>131</sup> *Id.* at 338.

<sup>132</sup> *Id.* Recall that what distinguishes *Nobelman* from *Dewsnup* is recognizing the need to first consult § 506(a) to determine if the creditor's claim is secured at all. See *supra* notes 56, 82 and accompanying text.

<sup>133</sup> *Branigan*, 716 F.3d at 338. The ability to strip off an unsecured lien under chapter 13, when uncomplicated by an earlier chapter 7 filing, is accepted almost without exception. See *supra* note 109 and accompanying text; cf. *infra* Part II.C.2 (examining the one notable, but distinguishable, exception). Subsequently, the Fourth Circuit limited its holding by ruling that in the case of property held in a tenancy by the entirety, strip off of a valueless lien would not be permitted when only one tenant spouse filed for bankruptcy. *Alvarez v. HSBC Bank USA, N.A. (In re Alvarez)*, No. 12–1156, 2013 WL 5737704 (4th Cir. Oct. 23, 2013).

the meaning of § 506(a).<sup>134</sup> Under the latter provision, of course, the mortgagees in these cases held wholly *unsecured* claims, so § 1325(a)(5) did not apply to them.<sup>135</sup> The *in rem* component of those claims could thus be stripped off despite the unavailability of a discharge in chapter 20, since the discharge, the majority noted, alters only *in personam* rights and not *in rem* liability.<sup>136</sup> Lastly, as far as end-running around *Dewsnup* was concerned, the majority declared that the Code was best viewed as leaving chapter 13's lien-stripping regime intact, and, as the Supreme Court first observed in *Johnson*,<sup>137</sup> pointed to the good faith requirement of § 1325(a)(3) to sift out uses of the chapter 20 device undertaken with improper ulterior motive.<sup>138</sup>

In her dissenting opinion, Judge Keenan expressed the view that the provisions of BAPCPA affecting secured claims in bankruptcy should be read to prohibit the elimination of valueless liens in chapter 20 cases where no discharge would be granted.<sup>139</sup> Specifically, Judge Keenan focused on § 1325(a)(5)(B)(i)(I), requiring the plan to provide that the holder of an allowed secured claim retain its lien until the earlier of full payment or

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<sup>134</sup> *Branigan*, 716 F.3d at 338. A few courts have adopted an intermediate approach between permitting and not permitting lien stripping in chapter 20, which makes little sense other than as a good faith attempt to apply the awkward and often ill-fitting provision of BAPCPA. These courts permit a debtor to confirm a plan that strips off a wholly unsecured junior mortgage, but then reinstates the lien under § 349(b)(1)(C) on the reasoning that the only way the case can be closed after completion of the plan is by *dismissal*, since there can be no discharge. *See, e.g., Grandstaff v. Casey (In re Casey)*, 428 B.R. 519, 522 (Bankr. S.D. Cal. 2010); *see also* 11 U.S.C. § 349(b)(1)(C) (2012).

<sup>135</sup> This is essentially the same exercise courts have used to distinguish the holding in *Nobelman* in chapter 13 cases involving wholly underwater liens; that is, both §§ 1322(b)(2) and 1325(a)(5) only apply to the "holder of a secured claim," which is to say a claim that is "secured," within the meaning of § 506(a), at least to *some* extent. *See* 11 U.S.C. §§ 1322(b)(2), 1325(a)(5); *Nobelman v. Am. Sav. Bank*, 508 U.S. 324, 331 (1993).

<sup>136</sup> *Branigan*, 716 F.3d at 339 ("We simply hold today that the bankruptcy court may strip the *in rem* component of a valueless lien."); *accord In re Dolinak*, No. 1:12-bk-13500, 2013 WL 3294277, at \*5 (D.N.H. June 28, 2013); *cf. Colbourne v. Ocwen (In re Colbourne)*, No. 12-14722, 2013 WL 5789159 (11th Cir. Oct. 29, 2013) (affirming the denial of cram down of partially secured liens in a Chapter 20 case because of the combination of §§ 1325(a)(5) and 1328(f)(1)).

<sup>137</sup> *Supra* note 48 and accompanying text.

<sup>138</sup> *Branigan*, 716 F.3d at 338-39 (observing that while BAPCPA may have tipped the scales back in favor of creditors, there is nothing in the Act that bars the strip off of worthless liens). The court also indicated that creditors are protected by § 349(b)(1)(C), presumably if the plan is not consummated and the case dismissed, but, as discussed *infra* note 153, this is not altogether clear. *Id.*; *see* § 349(b)(1)(C) (2012). For an example of a decision subsequent to *Branigan* where strip off was denied, and the case dismissed, based on lack of good faith, *see In re Mulhern*, No. 12-20857PM, 2013 WL 3992458 (Bankr. D. Md. Aug. 2, 2013) (finding that the sole purpose for the second filing was to enable the debtors to avoid a junior lien on their home).

<sup>139</sup> *Branigan*, 716 F.3d at 339 (Keenan, J., dissenting).

discharge, neither of which, of course, will occur in a chapter 20 case, as it has now come to be defined.<sup>140</sup> As for the analysis in the majority opinion that the claims at issue were not “allowed secured claims,” the dissent observed that a claim remains *secured* regardless of how it is valued under § 506(a).<sup>141</sup> Relying on the language from *Nobelman* concerning the relationship between §§ 506(a) and 1322(b)(2),<sup>142</sup> Judge Keenan maintained that a secured creditor’s protected *rights* under § 1325(a)(5)(B)(i) should not be affected by the valuation process in § 506(a).<sup>143</sup> The dissent, however, arguably missed the primary teaching of *Nobelman* that even if a secured creditor’s protected rights exceed the value of the collateral, there must in the first instance be at least some value (over and above the sum of prior liens) in order for the claim to be regarded as secured.<sup>144</sup> Thus, the majority seems to have the better of it in *Branigan*.

The court’s decision in *Branigan* is significant in an additional respect relating to the *timing* of strip off. Recall that § 1325(a)(5)(B)(i)(I) provides that the holder of an allowed secured claim retains its lien until the earlier of payment of the debt as determined under nonbankruptcy law or entry of discharge, and § 1325(a)(5)(B)(i)(II) provides for retention of the lien securing the claim in the event of conversion or dismissal.<sup>145</sup> In *In re Fisette*, the Bankruptcy Appellate Panel for the Eighth Circuit held, consistent with *First Mariner* and other circuit decisions, that a debtor could modify the rights of a creditor with a wholly unsecured lien against the debtor’s principal residence.<sup>146</sup> Unlike *First Mariner*, however, but similar to *Branigan*, the

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<sup>140</sup> *Id.* at 340–41.

<sup>141</sup> Judge Keenan reasoned that the term “allowed secured claim” for purposes of § 1325(a)(5) is not defined by § 506(a), but rather describes a claim that is “allowed” under § 502 and “secured” in a state law sense. *Id.* (citing 11 U.S.C. § 1325(a)(5)(B)(i)(I)(aa)–(bb)). In effect, this is a *Dewsnup*-like analysis of “allowed secured claim,” which has been discredited in every context outside of the narrow factual circumstances of *Dewsnup*. See *infra* note 161 and accompanying text.

<sup>142</sup> Specifically, the dissent emphasized the point in *Nobelman* that valuation under § 506(a) did not automatically adjust downward the amount of a mortgage for treatment in a chapter 13 plan. *Branigan*, 716 F.3d at 340–41 (Keenan, J., dissenting) (citing *Nobelman v. Am. Sav. Bank*, 508 U.S. 324, 328–29 (1993)).

<sup>143</sup> *Id.* at 341 (“I would conclude that, like the creditor in *Nobelman*, the rights of the creditors in the present case are not altered by the valuation process of § 506(a) for allowed secured claims, because § 1325(a)(5)(B)(i) otherwise protects the rights of such holders . . . .”); see 11 U.S.C. § 1325(a)(5)(B)(i). This type of analysis is consistent with the creditor’s bargain model, emphasizing deference to a secured creditor’s state law rights, discussed briefly *infra* text accompanying notes 202–06.

<sup>144</sup> See *supra* notes 56, 109 and accompanying text.

<sup>145</sup> 11 U.S.C. § 1325(a)(5)(B)(i)(I)–(II).

<sup>146</sup> *Fisette v. Keller (In re Fisette)*, 455 B.R. 177, 182 & n.3 (B.A.P. 8th Cir. 2011). See *supra* notes 107–12 and accompanying text.

debtor was not eligible for a discharge in the chapter 13 case because of § 1328(f)(1).<sup>147</sup> The *Fisette* court decided that entitlement to a discharge was not a prerequisite for lien avoidance, but, because of the possibility that the plan could not be consummated leading to conversion or dismissal, the court specifically deferred the actual strip off of the lien until “completion of the debtor’s obligations under his plan . . . .”<sup>148</sup> Based on an analysis similar to the majority opinion in *Branigan*, the court’s reasoning that § 1325(a)(5) does *not* apply in the case of wholly unsecured liens,<sup>149</sup> the justification for seemingly conditioning strip off on successful completion of the plan, as required by § 1325(a)(5)(B)(i)(I), is altogether unclear.

By contrast to *Fisette*, in *Branigan* it appears from the majority opinion’s recitation of the facts that strip off of the underwater liens in each of the cases giving rise to the appeal occurred at the time of confirmation.<sup>150</sup> This assumption is buttressed by the majority’s later reference to § 349(b)(1)(C) as protecting creditors in circumstances where the debtor attempts to improperly use chapter 20 solely to strip off such creditor’s lien.<sup>151</sup> Under that provision, the majority noted, the lien “springs back” to life.<sup>152</sup> Obviously, a lien can neither spring back nor be “restored” unless it has first been eliminated.<sup>153</sup>

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<sup>147</sup> *Fisette*, 455 B.R. at 184.

<sup>148</sup> *Id.* at 185 (strip off of unsecured lien on debtor’s residence is effective upon completion of the debtor’s obligation under his plan). Two other bankruptcy courts have held that, in a chapter 20 situation, lien avoidance becomes “permanent” when the debtor completes all payments under the plan. *See In re Dolinak*, No. 1:12-bk-13500, 2013 WL 3294277, at \*8 (D.N.H. June 28, 2013); *In re Okosisi*, 451 B.R. 90, 100 (Bankr. D. Nev. 2011); *see also Bank of the Prairie v. Picht (In re Picht)*, 428 B.R. 885, 890 (B.A.P. 10th Cir. 2010) (overruling bankruptcy court’s confirmation of plan calling for release of lien against their residence upon payment under the plan of an amount equal to the equity in the property in excess of the first mortgage).

<sup>149</sup> *See supra* text accompanying note 135.

<sup>150</sup> *Branigan v. Davis (In re Davis)*, 716 F.3d 331, 334 (4th Cir. 2013). One such statement is, “Finding that the Davises had acted in good faith, Judge Lipp entered an order stripping off the third-priority lien on the Davises’ home.” *Id.* Other cases appear to allow strip off of valueless junior liens at plan confirmation. *See In re Tran*, 431 B.R. 230 (Bankr. N.D. Cal. 2010); *Grandstaff v. Casey (In re Casey)*, 428 B.R. 519 (Bankr. S.D. Cal. 2010); *see also In re Wapshare*, 492 B.R. 211, 217–18 (Bankr. S.D.N.Y. 2013) (holding that while the junior mortgagee’s claim, which was wholly unsupported by any equity, could be stripped off and would be reclassified as unsecured, the lien was nonetheless subject to being reinstated if the plan failed and the case was dismissed).

<sup>151</sup> *Branigan*, 716 F.3d at 338.

<sup>152</sup> *Id.*

<sup>153</sup> On the other hand, by its terms § 349(b)(1)(C) applies only to liens avoided under § 506(d), rather than under § 1322(b)(2), so its applicability is unclear, as is what would happen if the lien is stripped at the time of confirmation and the debtors fail to complete the plan. *See* 11 U.S.C. § 349(b)(1)(C) (2012); *supra* note 138; *see also Minn. Hous. Fin. Agency v. Schmidt (In re Schmidt)*, No. 0:13-cv-00434, 2013 WL 2470218, at \*8

Whether or not the lien (the *in rem* claim) continues as an encumbrance against the property until completion of the plan may not make much difference in some situations, but would seem to make a considerable difference in circumstances where the debtor, during the life of the plan, desires to sell the property, for whatever reason, or *needs* to sell the property in order to fund the plan. While the debtor's personal liability would have been discharged in the earlier chapter 7 case, the continued existence of the otherwise worthless lien obviously impairs the debtor's ability to supply merchantable title to a buyer, thus potentially conferring enormous unearned strategic leverage on the holder of the otherwise worthless lien.<sup>154</sup>

## 2. *Under § 506(d)*

In an extraordinary case and opinion, the Tenth Circuit affirmed the lower courts' denial of confirmation of a chapter 13 plan that proposed strip off of a wholly underwater lien against the debtor's personal residence.<sup>155</sup> What is remarkable about the case, which stands in opposition to the overwhelming weight of authority permitting a debtor to employ § 1322(b)(2) to strip off an unsecured lien even as against a personal residence,<sup>156</sup> is that the debtors deliberately based their argument on § 506(d), rather than § 1322(b)(2), and unequivocally maintained that position even when offered the opportunity by the court to file supplemental briefing on the applicability and effect of § 1322(b)(2) in the case.<sup>157</sup> It also bears specific mention that the debtors in this case had not filed an earlier chapter 7 in order to discharge personal

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(D. Minn. June 7, 2013) (affirming bankruptcy court's decision calling for avoidance of a creditor's wholly unsecured mortgage against debtors' residence upon debtors' completion of the plan).

<sup>154</sup> Consider a scenario where the debtor owns a home worth \$100,000 at the time of confirmation, subject to a first lien mortgage of \$110,000 and a second lien of \$25,000. If by sometime in year three of the plan the property has appreciated to \$120,000 and the debtor proposes to sell it to reach the equity, the holder of the second (to be avoided) lien, while presumably not entitled to that equity, can hold up the sale by refusing to release its lien, or, worse, can insist on receiving a portion of the sales proceeds as a condition to releasing the worthless lien.

<sup>155</sup> *Woolsey v. Citibank, N.A. (In re Woolsey)*, 696 F.3d 1266 (10th Cir. 2012).

<sup>156</sup> See *supra* note 109 and accompanying text.

<sup>157</sup> *Woolsey*, 696 F.3d at 1279 (relating that in response to the court's request for additional briefing on the application of § 1322(b)(2), "the Woolseys made plain they wanted no part of the argument."). As the appellants were represented on appeal by not only a Salt Lake City consumer debtors' bankruptcy lawyer, but also lawyers from Ballard Spahr, LLP, a firm that does not make a routine practice of representing debtors in chapter 13, one can only assume that the desire to "make law" was as much a motive in the appeal as the desire to remove the wholly underwater lien from the debtors' residence.

liability on the claim; instead, this was a simple chapter 13, uncomplicated by the issues which have split the courts in the chapter 20 scenario.<sup>158</sup>

The court began its analysis with a review of *Dewsnup*'s odd interpretation of § 506(d) as pertaining only when the lien is not allowed and not secured.<sup>159</sup> Although noting that the rationales offered by the Court in *Dewsnup* in support of its holding were dubious at best,<sup>160</sup> and indeed may have “warped the bankruptcy code’s seemingly straight path into a crooked one,” the court noted that it is the law and must be followed.<sup>161</sup> As for the debtors’ attempt to distinguish *Dewsnup* by limiting it to chapter 7 cases only, which the court clearly found compelling from a policy-based perspective,<sup>162</sup> the court was unable to bring itself to conclude that § 506(d) means different things in different kinds of bankruptcy cases.<sup>163</sup> In yet another stroke of irony, the determining factor for the court in declining the attractive invitation to “undo” (or at least further limit) *Dewsnup* in the fashion urged by the debtors was the Supreme Court’s more recent admonitions that giving the same words in a statute different meaning in different categories of cases is “methodologically incoherent and categorically prohibited . . . .”<sup>164</sup>

### III. RETURN FROM THE WILDERNESS (THE SECTION WITH NO NAME)

As has been seen, after reviewing and attempting to harmonize the Supreme Court’s decisions in *Johnson*, *Dewsnup*, and *Nobelman*, Judge

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<sup>158</sup> *Id.* at 1273–75. *See supra* note 124.

<sup>159</sup> *See supra* text accompanying note 33.

<sup>160</sup> *Woolsey*, 696 F.3d at 1274 (observing that pre-Code practice is of limited interpretative value in this context and that, ordinarily, the “windfall” resulting from subsequent appreciation in the property following strip down will be enjoyed by the remaining unsecured creditors, not the debtor).

<sup>161</sup> *Id.* at 1276 (observing, “[r]ight or wrong, the Dewsnupian departure from the statute’s plain language is the law,” but also commenting that “[*Dewsnup*’s] definition of ‘secured claim’ has been rejected time after time elsewhere in the [C]ode . . .”).

<sup>162</sup> *Id.* at 1274–75. The debtors noted that, of course, § 506(d) applies in all debtor relief chapters, but that very different considerations are at work in chapter 13 (and, for that matter, chapter 11) than in a straight liquidation. They also pointed out the potentially perverse impact on chapter choice that applying *Dewsnup* in the reorganization context would promote; i.e., compelling debtors facing the burden of full repayment under chapter 13 to throw in the towel and simply liquidate under chapter 7. Further, the debtors emphasized the Court’s own language in *Dewsnup* concerning the limited precedential value of the holding. *Id.* at 1276; *see supra* note 68; *see also* 11 U.S.C. § 506(d) (2012).

<sup>163</sup> *Woolsey*, 696 F.3d at 1277.

<sup>164</sup> *Id.* (citing *United States v. Santos*, 553 U.S. 507, 522–23 (2008); *Clark v. Martinez*, 543 U.S. 371, 378 (2005)).

Martin, in *In re Kirchner*,<sup>165</sup> decided that the attempted modification of the mortgagee's rights, even though not calculated to impair the lender's economic interests in any manner, was impermissible.<sup>166</sup> He lamented, however, that he hazarded this prediction with "little confidence" and considerable trepidation that the Supreme Court's next disquisition on the subject could well head in yet another direction.<sup>167</sup> While the Court has yet to seize that opportunity in the ensuing 16-plus years, the treatment of secured claims in bankruptcy generally, and chapter 13 or 20 in particular, has been further muddled by the provisions of BAPCPA,<sup>168</sup> as aptly demonstrated by the split opinion in *Branigan*.<sup>169</sup> But therein may also lay, doubtless without advertence,<sup>170</sup> a trail out of the thicket.

The path begins, unexpectedly enough, with yet another BAPCPA amendment to § 1325(a). It is an addition to the statute that appears as a new subparagraph following § 1325(a)(9), but it does not bear a separate letter or number.<sup>171</sup> Hence it has come to be termed the "hanging paragraph" or § 1325(a)(\*).<sup>172</sup> Whatever the sobriquet, in substance the new provision provides that for purposes of § 1325(a)(5)—concerning the permissible treatment of secured claims in a chapter 13 plan—"[§] 506(a) shall not apply" to a claim described in § 1325(a)(5) if the creditor has: (1) "a purchase money security interest securing the debt that is the subject of the claim, the debt was incurred within the 910-day period preceding the date of the filing of the petition, and the collateral for that debt consists of a motor vehicle" (sometimes referred to as "910 day vehicles" and "910 day vehicle loans"); or (2) "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."<sup>173</sup>

Doubtless, this provision was intended principally to benefit the financing subsidiaries of the major auto manufactures and other financial institutions

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<sup>165</sup> *In re Kirchner*, 216 B.R. 417 (Bankr. W.D. Wis. 1997) (discussed *supra* text accompanying notes 70–80).

<sup>166</sup> *Id.* at 425.

<sup>167</sup> *Id.*

<sup>168</sup> See *supra* text accompanying notes 116–18.

<sup>169</sup> *Supra* text accompanying notes 130–44.

<sup>170</sup> Congress' principal goal in BAPCPA was to increase payouts to creditors, surely not to offer guidance on the proper understanding of secured debt in bankruptcy. See Jensen, *supra* note 115.

<sup>171</sup> 11 U.S.C. § 1325(a) (2012).

<sup>172</sup> Hereinafter, I will refer to the hanging paragraph as "§ 1325(a)(\*)."

<sup>173</sup> *Id.* § 1325(a). Unquestionably, this provision was intended to curb perceived abuse by "spendthrift debtors" by eliminating their ability to reduce their secured obligations on 910 vehicles. See Wells Fargo Fin. Acceptance v. Rodriguez (*In re Rodriguez*), 375 B.R. 535, 548 (B.A.P. 9th Cir. 2007).

regularly engaged in secured auto lending by precluding strip down of purchase money 910 vehicle loans.<sup>174</sup> What is telling, however, is that in order to achieve that aim Congress found it either necessary or expedient to decommission the operation of § 506. The effect of doing so is that a claim, as defined in § 1325(a)(\*), is not bifurcated under § 506(a) and therefore must be treated as fully secured for purposes of § 1322(b)(2). Implicitly, it is also a congressional acknowledgement that an “allowed secured claim,” as used *throughout* the Code, derives fundamentally from the meaning assigned in § 506(a)—*Dewsnup* notwithstanding.<sup>175</sup> While other Code provisions may, in a specific context, determine what may or may not be done to such claims, these claims owe their existence in the first instance to § 506(a). This interpretation stands in substantiation of the majority opinion’s analysis in *Branigan*,<sup>176</sup> as well as the opinions of several other courts, that a creditor, though its debt be secured by a lien on the debtor’s property, is not the holder of an “allowed secured claim” for bankruptcy purposes unless it is deemed to be so under § 506(a); that is to say, the lien has some economic value as of the time of filing.<sup>177</sup>

From the perspective of core bankruptcy equality policy, this approach makes perfect sense. Under state law, a security interest has value, or at least the potential for value, beyond its current economic worth at a given moment. Once a bankruptcy petition is filed, however, the curtain has come down on the debtor’s prepetition life.<sup>178</sup> This needs to be so whether the aim of the case is a fresh start in chapter 7 or rehabilitation in chapter 11 or 13. Thus, the security interest’s only value is axiomatically its current value. Allowing appropriation of additional or future value runs directly counter to the twin bankruptcy goals of equitable distribution and returning debtors to economic viability.<sup>179</sup> The

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<sup>174</sup> See generally William C. Whitford, *A History of the Automobile Lender Provisions of BAPCPA*, 2007 U. ILL. L. REV. 143 (predicting that automobile lenders are likely to benefit more than any other group under BAPCPA).

<sup>175</sup> As noted by the *Woolsey* court, “*Dewsnup* has lost every game it has played: its definition . . . seems to hold sway only in § 506(d).” *Woolsey v. Citibank, N.A. (In re Woolsey)*, 696 F.3d 1266, 1276 (10th Cir. 2012).

<sup>176</sup> *Supra* text accompanying notes 130–38.

<sup>177</sup> See *infra* text accompanying notes 254–58 regarding the difference from state law in the Code’s approach to security.

<sup>178</sup> Hence, the broad definition of the term “claim” in the Code. See 11 U.S.C. § 101(5) (2012); *infra* notes 247–52 and accompanying text; see also *supra* note 34 and accompanying text.

<sup>179</sup> While it is open to some debate whether, because of § 551, the avoidance of underwater lien inures to the benefit of the debtor or other unsecured creditors, see *infra* note 220, it is abundantly clear that allowing

state law analog is a foreclosure sale, after which all that is left is an unsecured deficiency claim for the balance of the debt over and above the net foreclosure sale proceeds.<sup>180</sup> That is precisely the way in which § 506(a) operates.

What is the significance of taking § 506(a) out of the equation? One would presume the answer is a simple one, but it is not, as evidenced by the disagreement among courts over the impact of the hanging paragraph in circumstances where the debtor proposes to surrender rather than retain the 910 vehicle. Once more, perhaps because of a better-attuned sensitivity to the substantive goals of the bankruptcy system, many bankruptcy courts initially took a quite different view on this issue than the consensus view that eventually developed among appellate courts.<sup>181</sup> The origin of the controversy lies in the fact that § 1325(a)(5) offers three alternatives for satisfying a secured claim in a chapter 13 plan: (1) approval by the secured creditor of whatever the plan proposes, (2) payment to the secured creditor over the life of the plan of an amount equal to at least the present value of the allowed amount of the secured claim,<sup>182</sup> or (3) surrender of the collateral to the secured creditor. If the collateral falls within the definition of the hanging paragraph and is worth less than the total amount owed to the secured creditor on the debt, and the plan provides for surrender of the collateral, the issue then becomes, has the hanging paragraph's disabling of bifurcation under § 506(a) effectively converted the debt to a nonrecourse (i.e., fully secured) claim by negating any unsecured component?

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expansion of the secured claim based on value accruing postpetition runs afoul of bankruptcy's aim to separate the debtor's pre- and postpetition lives.

<sup>180</sup> Even the majority in *Dewsnup* recognized this point in noting that a lien stays with the collateral until the foreclosure. *Dewsnup v. Timm*, 502 U.S. 410, 417 (1992). In other words, the state law bargain is that, after foreclosure, the secured lender will recognize a deficiency, if at all, based on its *in personam* claim against the debtor.

<sup>181</sup> It will be recalled that, initially following *Dewsnup*, a number of bankruptcy (and a couple of district) courts concluded that the Court's holding did not apply to wholly underwater claims, but were overruled on appeal. *See supra* notes 66, 82 and accompanying text. The same phenomenon is observed frequently in bankruptcy, such as in connection with the test to be applied in determining whether a bad check prosecution is a "true" criminal proceeding exempt from the automatic stay or a disguised effort to collect a debt. *See generally* David A. Rice, *When Bankruptcy Courts Will Enjoin State "Bad Check" Proceedings: The Decline of the Primary Motivation Standard in Favor of the Younger Abstention Doctrine*, 93 COM. L.J. 111 (1988).

<sup>182</sup> It is in connection with this option that the aforementioned provisions of BAPCPA amended § 1325(a)(5)(B) to provide for lien retention, *supra* text accompanying notes 116–18, and also required that periodic payments be in equal monthly installments and sufficient to assure adequate protection to the holder of the claim during the life of the plan. *See* 11 U.S.C. § 1325(a)(5)(B)(iii) (2012).

The debtor's argument, based on the plain language of the statute, would be that if the claim is not bifurcated under § 506(a) because the hanging paragraph has rendered it inoperative, then there is no statutory basis for asserting entitlement to an unsecured claim for the deficiency.<sup>183</sup> In other words, there is nothing in the hanging paragraph or elsewhere in BAPCPA that says the treatment of the entire claim as secured is limited to circumstances where the debtor proposes to retain the collateral. In effect, § 1325(a)(\*) operates as a matter of law to accomplish de facto what an undersecured creditor has the right to elect to do in chapter 11; that is, have the total amount of its claim, and not just the portion supported by value in the collateral, treated as an allowed secured claim for plan confirmation purposes.<sup>184</sup>

When the chapter 13 debtor elects to retain the collateral subject to § 1325(a)(\*), there is no question that the allowed secured claim for plan purposes is the total owed on the underlying debt. Why, the argument goes, should the same not be true if the debtor elects (as she is fully entitled to do) a different option under § 1325(a)(5)? The argument makes perfect sense under traditional canons of statutory construction,<sup>185</sup> but the appellate courts have roundly rejected it, suggesting that the effect of knocking § 506 out of the equation is not to eliminate any unsecured claim under subsection (a), but rather to leave the parties with their state law contractual rights and

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<sup>183</sup> See *In re Pinti*, 363 B.R. 369 (Bankr. S.D.N.Y. 2007), for a thoughtful opinion based on this argument. As to § 1325(a)(\*) claims, a debtor who retains the collateral must make all principal and interest payments under the loan agreement as they become due, and the bankruptcy court cannot adjust the payment schedule or impose a cramdown interest rate on the lender. The creditor, therefore, has no unsecured claim under the plan because the hanging paragraph, by eliminating bifurcation, has made its claim fully secured. It therefore stands to reason that the same analysis should apply in the case of surrender, where permitting the secured creditor's deficiency claim would dilute the other unsecured claims against the bankruptcy estate. See 11 U.S.C. § 1325(a); *In re Ezell*, 338 B.R. 330 (Bankr. E.D. Tenn. 2006).

<sup>184</sup> The effect of the election is that the plan must provide for payments with a present value equal to the full amount of the debt. See Joel L. Tabas, *The § 1111(b) Election: A Decision-Making Framework*, 23 AM. BANKR INST. J. 36, 36–37 (2004). Notably, if the creditor does not make the election, and receives an unsecured claim under § 506(a) for the amount of the debt in excess of the value of the collateral, the creditor retains its lien only to the extent of the allowed amount of its secured claim. *Id.* at 37–38. This is arguably how § 1325(a)(\*) should operate, rather than as under *Dewsnup*, where the creditor is permitted to have its cake and eat it, too, i.e., retention of the lien for the full amount of the debt and an unsecured claim for the deficiency if the collateral (net of prior liens) is valued at less than the total amount owed. *Dewsnup*, 502 U.S. at 415, 417.

<sup>185</sup> *In re Pinti*, 363 B.R. 369, 380 (Bankr. S.D.N.Y. 2007) (“When an undersecured creditor seeks a deficiency claim against a debtor in bankruptcy, it should be emphasized that, however the deficiency might be calculated under state law, the creditor is seeking allowance of the deficiency as a bankruptcy claim. The Bankruptcy Code, and not state law, determines whether and to what extent such claim should be allowed in the bankruptcy estate.”).

entitlements, including the right to a deficiency judgment, unless the loan was expressly made nonrecourse.<sup>186</sup> Curiously, some of these courts, just like the courts that reached precisely the opposite conclusion, also base their determinations on a “plain reading” of § 1325(a)(\*),<sup>187</sup> but they rely as well on the tired aphorism that state law determines the rights and obligations of the parties unless the Code supplies an express federal rule.<sup>188</sup>

What are perhaps most salient for present purposes are the negative implications of these decisions that permit undersecured 910 vehicle lenders to maintain an unsecured deficiency claim in the event of surrender of the collateral. Accepting these decisions on their own terms—that elimination of § 506 from the equation means that the lender retains its full panoply of state law rights and remedies—implies ineluctably that when § 506 does apply (which is virtually in every other case) then its definition of when and to what extent a claim is secured supplants state law and controls. In the case of a lien unsupported by any value in the collateral beyond senior liens, § 506 defines the lien as an unsecured claim; thus supporting strip off in chapter 7, no less than in chapter 11 or 13, even in the face of *Dewsnup*.

#### IV. WHAT DOES BEING SECURED REALLY MEAN?

The foregoing points out that it is almost impossible to overstate the criticality of § 506(a) in accomplishing the policy aims of federal bankruptcy law. While the Supreme Court has been solicitous when it comes to treading

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<sup>186</sup> See, e.g., *AmeriCredit Fin. Servs. v. Tompkins*, 604 F.3d 753, 757–58 (2d Cir. 2010); *DaimlerChrysler Fin. Servs. Americas v. Miller (In re Miller)*, 570 F.3d 633, 640 (5th Cir. 2009) (citations omitted); *DaimlerChrysler Fin. Servs. Americas v. Ballard (In re Ballard)*, 526 F.3d 634, 638–39 (10th Cir. 2008) (citations omitted); *Capital One Auto Fin. v. Osborn*, 515 F.3d 817, 822–23 (8th Cir. 2008) (citations omitted); *In re Wright*, 492 F.3d 829, 832–33 (7th Cir. 2007) (citations omitted); cf. *Santander Consumer USA Inc. v. Brown*, 2013 WL 3198000, at \*8–9, \*11–12 (M.D. Ga. June 21, 2013) (rejecting lender’s argument that the bankruptcy court erred in valuing a non-910 vehicle at replacement cost under § 506(a) upon surrender by debtor).

<sup>187</sup> “Based on a plain reading of the hanging paragraph, there is no question that Congress has unambiguously eliminated the 910 creditor’s access to a federal remedy under § 506(a).” *Tidewater Fin. Co. v. Kenney*, 531 F.3d 312, 318 (4th Cir. 2008). *But see AmeriCredit Fin. Servs. v. Long (In re Long)*, 519 F.3d 288, 297 (6th Cir. 2008) (using the common law principle of interpretation known as “the equity of the statute” as a method of filling statutory gaps rather than resorting to non-bankruptcy law to preserve deficiency claims).

<sup>188</sup> See *In re Wright*, 492 F.3d at 832–33; see also *infra* Part IV.A.

upon secured creditors' state law rights,<sup>189</sup> even in a full priority regime, § 506(a) of the Code limits the extent to which consenting parties in a commercial transaction can transfer risk to nonadjusting creditors in a bankruptcy proceeding.<sup>190</sup> Instead, the undersecured creditor is assured a priority claim for the value of its collateral, but, as for the balance of the debt, unless the Code makes specific provision to the contrary,<sup>191</sup> the creditor must feed at the trough side-by-side with all the other unsecured creditors. Likewise, except in specified circumstances, § 506(a): (1) maximizes the prospects for a debtor to confirm (and complete) a chapter 13 plan; (2) promotes equity among creditors *inter se* by providing more favorable treatment for unsecured creditors as a group;<sup>192</sup> and (3) facilitates the debtor's fresh start in chapter 7.<sup>193</sup>

The bifurcation of partially secured claims is certainly consistent with a conceptualization of security as representing a contractual right to priority and not a property right *per se*, a view to which I subscribe.<sup>194</sup> But, one does not have to endorse that ideation to appreciate how the bifurcation of claims pursuant to § 506(a) advances the purposive goals underlying the bankruptcy

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<sup>189</sup> See Daniel Keating, *RadLAX Revisited: A Routine Case of Statutory Interpretation or a Sub Rosa Preservation of Bankruptcy Law's Great Compromise?*, 20 AM. BANKR. INST. L. REV. 465, 468–69 (2012) (citing *RadLAX Gateway Hotel v. Amalgamated Bank*, 132 S. Ct. 2065 (2012)).

<sup>190</sup> See Bebchuk & Fried, *supra* note 1, at 864 (describing nonadjusting creditors as creditors that do not adjust the terms of their loan to reflect the effect on them of the creation of security interests which, under full priority, completely subordinate the nonadjusting creditors' claims in bankruptcy). The classic example of a nonadjusting creditor is a party that has been injured by the borrower and that is unable to recover fully from the borrower's insurance carrier.

<sup>191</sup> See, e.g., 11 U.S.C. §§ 1111(b), 1322(b)(2), 1325(a)(\*) (2012). By prohibiting modification of home mortgage loans, the underwater mortgagee has a fully secured claim that must be paid according to the original terms of the contract between the parties.

<sup>192</sup> Even though bifurcation increases the amount of unsecured claims, the secured party takes *pro rata* with respect to its deficiency claim instead of enjoying priority over unsecured claims. This is also consistent with the core bankruptcy principle that equity is equality since, while secured in a state law sense, the portion of a claim not supported by value in collateral is much more akin in substance to an unsecured claim than a secured claim. See *Bank of Marin v. England*, 385 U.S. 99, 103 (1966) (citations omitted) (the "overriding consideration" in bankruptcy is that "equitable principles govern").

<sup>193</sup> It does so by limiting the amount of the secured claim to the value of the collateral. Section 506(a) permits a debtor to retain certain property through redemption under § 722 without having to pay the entire amount of the underlying debt. However, since the claim must be paid in full and in cash, empirical research has shown, not surprisingly, that this right is infrequently exercised. See, e.g., ELIZABETH WARREN & JAY LAWRENCE WESTBROOK, *THE LAW OF DEBTORS AND CREDITORS* 265 (6th ed. 2009) ("For most debtors, section 722 might as well base redemption on the debtor running a three-minute mile."); see also 11 U.S.C. §§ 506(a), 722.

<sup>194</sup> Ponoroff & Knippenberg, *supra* note 17, at 2289–92.

system. Except in those isolated circumstances where Congress has made the judgment to prohibit, or a creditor exercises its statutory option to avoid, bifurcation, a debt secured by collateral that is devoid of economic value cannot be regarded as secured in bankruptcy.<sup>195</sup> That is to say, once the debtor files for bankruptcy, the creditor that was a “secured creditor” under state law is now simply a creditor, the character of whose claim will be determined and then provided for under the Code. The distinction between types of claims, rather than types of creditors as under state law, is crucial to a proper understanding of what it means to be secured in bankruptcy. Under state law, the character of the claim derives from the status of the creditor, but under bankruptcy law and practice, the character of the claim is determinative of the status of the creditor.<sup>196</sup>

Concededly, *Dewsnup* cannot be fully reconciled with this view,<sup>197</sup> but *Johnson* and *Nobelman* easily can, at least as *Nobelman* has come to be construed (or tamed) by subsequent lower court decisions.<sup>198</sup> As the Tenth Circuit stated in *In re Woolsey*, “[*Dewsnup*’s] definition of ‘secured claim’ has been rejected time after time elsewhere in the [C]ode . . . .”<sup>199</sup> Moreover, the changes made to the Code under BAPCPA, and, just as importantly, the changes not made,<sup>200</sup> support this construction of security, and they also represent, quite frankly, a powerful argument for re-examination by the Supreme Court or Congress of the tortured interpretation of § 506 employed by the majority opinion in *Dewsnup*. In the meantime, there is ample basis for containing the damage and Congress has illuminated the path with the hanging paragraph by demonstrating—even if unwittingly—that § 506(a) has to be about *more* than just valuation of secured claims, in chapter 7 no less than in rehabilitative proceedings.

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<sup>195</sup> See *supra* notes 33, 185 and accompanying text; *infra* note 222 and accompanying text. Collateral is devoid of economic value where there is no value over and above the sum of senior liens, if any.

<sup>196</sup> Under the Code there are no “secured parties,” as creditors are not secured or unsecured; rather, it is *claims* that are secured or unsecured, by virtue of § 506, and creditors hold secured claims, which may be allowed or disallowed in accordance with § 502. See *infra* notes 255–58 and accompanying text.

<sup>197</sup> By ignoring the well-established principles of statutory construction, the *Dewsnup* majority concluded that, at least in one context, a secured claim might exist untethered to economic value. *Dewsnup v. Timm*, 502 U.S. 410, 415–17 (1992).

<sup>198</sup> Unlike in *Dewsnup*, the Court in *Nobelman* acknowledged that a party cannot be a secured party unless it possesses a secured claim within the meaning of § 506(a). See *supra* note 56 and accompanying text.

<sup>199</sup> *Woolsey v. Citibank (In re Woolsey)*, 696 F.2d 1266, 1276 (10th Cir. 2012).

<sup>200</sup> See, e.g., *Branigan v. Davis (In re Davis)*, 716 F.3d 331, 338 (4th Cir. 2013) (noting BAPCPA did not amend the Code’s lien-stripping regime).

Returning to *Dewsnup*, an important part of the majority's explanation for assigning the phrase "allowed secured claim" a different meaning in different subsections of § 506 was that the prebankruptcy bargain between the mortgagor and the mortgagee contemplated that the lien given to secure the debt—the *in rem* claim—would remain with the property until the debt was paid or the lien foreclosed, regardless of what happened with respect to the debtor's personal liability for the debt.<sup>201</sup> This approach is consistent with the standard law and economics account of bankruptcy, by now famously known as Thomas Jackson's "creditor's bargain model."<sup>202</sup> Ruthlessly devoted to ex ante efficiency, the model posits that bankruptcy should emulate the system that creditors would bargain for if they were afforded the opportunity to do so, sans transaction costs, in advance of bankruptcy. Jackson postulates that, among other attributes,<sup>203</sup> this bargain would almost obsessively respect prebankruptcy rights and entitlements.<sup>204</sup> It is a view that trivializes the idea of substantive goals in bankruptcy, separate and apart from state law.<sup>205</sup> It also is an approach that, in pursuit of wealth maximization, largely ignores questions of distributive justice. In sum, it is a grim outlook that enfeebles bankruptcy policy and regards the bankruptcy case as little more than a procedural apparatus, superior to be sure to state law, but devoid of any meaningful independent values.<sup>206</sup>

This account of bankruptcy has been subjected to serious criticism<sup>207</sup> and, in my own view, is deeply flawed in its iconoclastic and myopic commitment

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<sup>201</sup> *Dewsnup*, 502 U.S. at 417.

<sup>202</sup> See generally Thomas H. Jackson, *Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain*, 91 YALE L.J. 857 (1982). For a much more complete discussion, see Lawrence Ponoroff & F. Stephen Knippenberg, *The Implied Good Faith Filing Requirement: Sentinel of an Evolving Bankruptcy Policy*, 85 NW. U. L. REV. 919, 948–58 (1992).

<sup>203</sup> Central among these are increasing wealth, by maximizing the pool of assets available to creditors, and minimizing strategic costs, through security and administrative efficiencies. Jackson, *supra* note 202, at 861.

<sup>204</sup> A key assumption underlying Jackson's model is that "no [ex ante] meeting of the creditors can, realistically, take place." *Id.* at 866–67. It is a key assumption because, under Jackson's account, if such a meeting could occur, the parties could enter the optimal ex ante agreement in an actual bargain that would render bankruptcy law unnecessary.

<sup>205</sup> See *infra* notes 297–303 and accompanying text for a further description of the two traditional competing accounts of bankruptcy.

<sup>206</sup> See Adam J. Levitin, *Bankrupt Politics and the Politics of Bankruptcy*, 97 CORNELL L. REV. 1399, 1405 (2012) (pointing out that bankruptcy is ultimately "an expression of distributional norms," of which the wealth maximization goal of the creditors' bargain is just one).

<sup>207</sup> See, e.g., Susan Block-Lieb, *Congress' Temptation to Defect: A Political and Economic Theory of Legislative Resolutions to Financial Common Pool Problem*, 39 ARIZ. L. REV. 801, 804 n.15 (1997) (and authorities therein cited).

to a single goal,<sup>208</sup> but that is another story. The point to be made for present purposes is that even accepting the premise of the model, prohibiting strip off of liens unsupported by any equity over and above prior encumbrances materially re-writes the ex ante bargain in a manner that could produce a windfall for the lender, just as the majority in *Dewsnup* was concerned that freezing the creditor's secured claim at the judicially determined value would produce a potential windfall to the debtor.<sup>209</sup> Specifically, assume the debtor owns a home worth \$100,000 that is subject to a first mortgage in the amount of \$120,000, and a second lien securing a debt of \$25,000. Assume further that this debtor is able to either come up with financing to satisfy the holder of the first lien or work out some form of loan modification with that creditor that will allow the debtor to retain the property. For the strategy to work, the holder of the unsecured second lien must be willing to relinquish its *in rem* rights against the property. Even though those "rights" are unsupported by any value in the property itself, they now certainly have "hold-up" value with the desperate debtor.<sup>210</sup> Is the "right" to that shakedown payment properly considered a bargained-for part of the deal between mortgagee and mortgagor? What if the otherwise junior lien is nonconsensual?<sup>211</sup> Finally, any such payment from the debtor to secure the release of the lien would also seem certain to violate the spirit if not the letter of the discharge injunction.<sup>212</sup>

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<sup>208</sup> See Ponoroff & Knippenberg, *supra* note 202, at 966–70; Lawrence Ponoroff, *Enlarging the Bargaining Table: Some Implications of the Corporate Stakeholder Model for Federal Bankruptcy Proceedings*, 23 CAP. U. L. REV. 441, 451–53 (1994).

<sup>209</sup> *Dewsnup v. Timm*, 502 U.S. 410, 417 (1992). The windfall could result from subsequent appreciation, inaccurate value, or both; see Barry Adler, *Creditor Rights After Johnson and Dewsnup*, 10 BANKR. DEV. J. 1 (1993) (positing that undervaluation must be a persistent problem); see also Woolsey v. Citibank, N.A. (*In re Woolsey*), 696 F.3d 1266, 1274 (10th Cir. 2012) (questioning whether it would indeed be the debtor, rather than other unsecured creditors, who would reap the benefit of future appreciation); *infra* note 220.

<sup>210</sup> Even though it does not have, and may be unlikely to ever have, any value, the creditor has no incentive to release its lien unless adequately induced to do so. On the other hand, because of its lack of value, even a relatively small payment from the debtor, who needs to eliminate the lien if she is to keep the property, may be sufficient inducement. It should be pointed out that *Dewsnup* creates the same sort of opportunity for commercial terrorism with respect to a partially secured lien; *i.e.*, to extort a payment from the debtor equal to *N* plus the equity above the prior lien(s).

<sup>211</sup> In other words, there is no prior bargain that strip off would interfere with, and yet no such distinction has been generally made in the cases. *But see* *Howard v. Nat'l Westminster Bank (In re Howard)*, 184 B.R. 644, 647 (Bankr. E.D.N.Y. 1995) (stripping off wholly underwater judgment lien since the policy emphasized in *Dewsnup* of respecting the bargain struck by the mortgagor and the mortgagee plays no role in the case of a nonconsensual lien).

<sup>212</sup> Section 524(a)(2) of the Code contains the injunction against efforts to collect discharged debts. 11 U.S.C. § 524(a)(2) (2012). Payment on an *in rem* claim would presumably not run afoul of this provision. See *In re Kohler*, No. 10-51409-C, 2010 WL 2853893 (W.D. Tex. July 19, 2010). However, when the creditor's

While the prospect of a windfall for the creditor, as opposed to the debtor, may have seemed unlikely when *Dewsnup* was decided in 1992, and for a time thereafter, since 2008 that calculus would surely have to be handicapped a little differently.<sup>213</sup>

Finally, even to the extent there is subsequent appreciation, if the debtor is unable to salvage the property, the likelihood of the underwater lienor actually realizing on that appreciation is virtually nil, since the property will almost surely already have been the subject of foreclosure by a prior lienor who can realize some economic value from its disposition. And, by operation of state law, that foreclosure will do exactly what *Dewsnup* did not allow to be done: eliminate the unsecured lien.<sup>214</sup>

As a matter of state law, it is generally understood that the secured creditor has both an *in personam* claim against the debtor and an *in rem* claim against the collateral. Consistent with its pre-Code jurisprudence,<sup>215</sup> the Court in *Johnson* held that the discharge in chapter 7 only extinguished one of those claims, leaving intact the *in rem* claim—and thus opened the door for modification of a previously discharged debt in a chapter 20 scenario.<sup>216</sup> What *Johnson* failed to address, because it was not at issue, is whether the *in rem* claim persists in the absence of the very thing that constituted the “*rem*” to begin with.<sup>217</sup> *Nobelman*, though a difficult decision to parse, did hold that a court must first look to § 506(a) for judicial valuation of the collateral to

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lien has no value, but the creditor nonetheless extracts a payment as a condition to release that lien, the situation comes perilously close to the line. Cf. *In re Anderson*, 378 B.R. 296, 301 (W.D. Wash. 2007) (finding violation of the discharge injunction by postpetition payment on a judgment lien where the lien had not attached as of the date of the petition).

<sup>213</sup> One estimate pegged the percentage of homes underwater nationally in the last quarter of 2011 at 22.8%. Esther Cho, *Report: 22.8 Percent of U.S. Homes Are Underwater*, DS NEWS (Mar. 1, 2012), <http://www.dsnews.com/articles/percentage-of-homes-underwater-at-228-2012-03-01>.

<sup>214</sup> See *infra* note 253 and accompanying text.

<sup>215</sup> See *Long v. Bullard*, 117 U.S. 617, 619 (1886); see also *Cen-Pen Corp. v. Hanson*, 58 F.3d 89, 92 (4th Cir. 1995) (citations omitted) (holding that the discharge generally has no effect on an *in rem* claim against the debtor’s property).

<sup>216</sup> This, of course, is precisely what transpired in *Branigan v. Davis* (*In re Davis*), 716 F.3d 331, 338 (4th Cir. 2013). See *supra* text accompanying notes 130–38.

<sup>217</sup> See *supra* note 111 and accompanying text. Surely if the collateral is no longer in existence, the claim cannot be regarded as “secured” in any functional sense of the term. The situation may be different under state law if there is no current value to which the lien attaches because of the *possibility* that the value of the property might increase to the point where the junior lien is no longer underwater. However, in bankruptcy, the unique policies underlying the Code demand that these judgments be made today and not left wholly indeterminate into perpetuity. See *infra* text accompanying notes 261–67.

determine if the lender's claim is "secured."<sup>218</sup> In that case, of course, there was value to which the bank's lien attached. Nonetheless, this formed the premise for later decisions holding that a wholly underwater junior lien is not protected from modification under § 1322(b)(2), *Nobelman* notwithstanding, because there is no "secured claim."<sup>219</sup>

Thus, neither *Johnson* nor *Nobelman* are inconsistent with the view that ties the de jure meaning of secured with the de facto existence of value. Although § 506(d) is unquestionably applicable in all reorganization cases, the difference between chapter 7 and rehabilitation proceedings is, according to several courts,<sup>220</sup> the existence of a specific avoiding power—one they contend is absent in chapter 7 since *Dewsnup* removed § 506(d) from the table.<sup>221</sup> But phrasing the issue in this fashion misapprehends the point, as § 1322(b), and for that matter § 1123(b)(5), are not *avoiding* powers per se. They are provisions that define the permissible treatment of secured claims in,

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<sup>218</sup> See *supra* note 56 and accompanying text; see also *In re Williams*, 161 B.R. 27, 29–30 (Bankr. E.D. Ky. 1993) (stating that *Nobelman's* reference to § 506(a) is "meaningless unless some portion of the claim must be secured under § 506(a) analysis before the creditor is entitled to retain the rights it has under state law").

<sup>219</sup> See *supra* note 109 and accompanying text.

<sup>220</sup> E.g., *Laskin v. First Nat'l Bank of Keystone (In re Laskin)*, 222 B.R. 872, 876 (B.A.P. 9th Cir. 1998) (holding that in the absence of either a disposition of the collateral, or valuation to determine how the claim will be paid under chapter 11, 12, or 13, there is no basis to avoid a lien in chapter 7). The court in *Laskin* also questioned the debtor's standing to avoid a lien under § 506(a), even if such a power existed, since the only avoiding powers granted to debtors in the Code are under § 522(f) and (h). *Id.* at 874–75 (citing *Eakin v. Beneficial Idaho, Inc. (In re Eakin)*, 156 B.R. 132 (Bankr. D. Idaho 1993)). The court pointed out that this issue did not arise in *Dewsnup* because of the debtors' plan to redeem the property. *Id.* at 875. What this analysis overlooks, however, is that avoidance might also be used by the trustee for the benefit of the other unsecured creditors rather than the debtor, consistent with the strong equality norms that form the undergirding of the bankruptcy system. See David Gray Carlson, *Bifurcation of Undersecured Claims in Bankruptcy*, 70 AM. BANKR. L.J. 1, 10–11 (1996). It also ignores the fact that an exception to the trustee's exclusive standing to bring an avoidance action is recognized where the transferred property would have been exempt. See *James v. Planters Bank (In re James)*, 257 B.R. 673, 675 (B.A.P. 8th Cir. 2001); *Ealy v. Ford Motor Credit (In re Ealy)*, 355 B.R. 685, 687 (Bankr. N.D. Ill. 2006) (citing 11 U.S.C. § 522(h) (2012)).

<sup>221</sup> See, e.g., *Grano v. Wells Fargo Bank (In re Grano)*, 422 B.R. 401, 403 (Bankr. W.D.N.Y. 2010) (noting the absence in chapter 7 of a provision parallel to § 1322(b)(2) that might support avoidance of a totally unsecured junior lien). In *Laskin*, focusing on the *Dewsnup* Court's interpretation of § 506(d) as voiding liens securing disallowed claims, the court also noted that in a rehabilitative proceeding, such as chapter 11 or 13, claims must be allowed or disallowed to determine who gets paid under the plan and how, but that "the allowance of a secured claim, or determination of secured status is meaningless in chapter 7 where the trustee is not disposing of the putative collateral." *In re Laskin*, 222 B.R. at 876. And yet, § 502(a) provides that a claim is simply "allowed" if no party in interest objects. 11 U.S.C. § 502(a). Additionally, determination of the amount of the allowed secured under § 506 also has ramifications in chapter 7 for purposes of, inter alia, distribution, reaffirmation, and redemption. See generally *id.* §§ 546(d), 722, 726.

respectively, a chapter 13 and chapter 11 plan. By definition, there is no need for anything of that ilk in chapter 7, but neither its presence nor its absence ought to have any bearing on whether—and if so, to what extent—a claim is secured. This is a determination that, under the structure of the Code, is identical in *all* types of debtor relief chapters, and hinges on the existence of value in the collateral over and above the sum of all prior liens as of the time of filing (or disposition, although that would be quite unlikely in chapter 7, in the case of over-encumbered property).<sup>222</sup>

Left unanswered by this analysis is, what then should happen to the undersecured portion of a lien in chapter 7 after the collateral has been abandoned or otherwise returned to the debtor and the debtor has been discharged from personal liability? In the case of partially secured debts, *Dewsnup* raises considerable question,<sup>223</sup> but leaves no doubt: the lien stays with the property. In the case of debts “secured” by wholly underwater liens, the overwhelming weight of authority, including most circuit court opinions, is lamentably the same.<sup>224</sup> All of this stems from the postulates set forth in *Dewsnup*: (1) under pre-Code practice, “liens passed through bankruptcy unaffected”; (2) post-petition appreciation belongs to the lender; and (3) first and foremost, the lender’s rights are established under applicable nonbankruptcy law. Professor Howard has already demonstrated that the first of these propositions is a fallacy.<sup>225</sup> The second ignores that the

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<sup>222</sup> It is difficult to overemphasize the importance of drawing the distinction between being secured under state law and in bankruptcy. Conceptually, a creditor that takes or acquires a lien on a used orange peel owned by the debtor is a secured creditor. The fact that the collateral is worthless may matter to that creditor, but is conceptually unimportant under state law where the creditor also maintains its *in personam* claim and the focus is on the individual debtor-creditor relationship, and not, as in bankruptcy, among the debtor’s creditors as a group. In bankruptcy, where we are going to draw a sharp line of demarcation between the debtors pre- and postfiling lives and treat similarly positioned creditors in a like fashion, the fact that a creditor’s collateral has no value takes on considerable significance in terms of classifying that creditor’s claim for distribution purposes, inasmuch as, in substance, that creditor is more like an unsecured creditor than a secured creditor with real collateral. See *supra* note 196; cf. Elizabeth Warren, *Bankruptcy Policy*, 54 U. CHI. L. REV. 775, 783–85 (1987) (explaining the difference in focus between state law and bankruptcy).

<sup>223</sup> See *Woolsey v. Citibank (In re Woolsey)*, 696 F.3d 1266, 1273 (10th Cir. 2012) (describing the result in *Dewsnup* as “topsy-turvy,” both as a matter of statutory construction and in terms of the rationales offered by the majority opinion).

<sup>224</sup> See *supra* note 83.

<sup>225</sup> See Howard, *supra* note 29, at 526–30 (pointing out that, based on the history of bankruptcy law before and after the Bankruptcy Reform Act of 1978, it is more accurate to say that liens pass through bankruptcy unaffected only to the extent that the bankruptcy law does not alter the rights of secured creditors for the purposes of achieving equality and a fresh start); see also Ponoroff & Knippenberg, *supra* note 17, at 2266–69 (discussing the decision in *In re Penrod*, 50 F.3d 459 (7th Cir. 1995), to illustrate that what comes out

accomplishment of bankruptcy policy, whether in the liquidation or reorganization mode, is to draw a sharp line between the debtor's pre- and postpetition life.<sup>226</sup> The third point, which perhaps partially explains the ready willingness of courts to overlook the weakness of the second argument, is the product of a seriously flawed understanding of the relationship between state and federal law in the context of a bankruptcy proceeding. It is that misunderstanding to which attention is next directed.

A. *Time to Kick Butner in the . . .*

The starting place is the Supreme Court's 1979 decision in *Butner v. United States*,<sup>227</sup> the holding which, while quite prosaic and innocuous standing alone, has caused considerable mischief. The specific issue in *Butner*, leading to the Court's statement that determinations of property rights are generally left to state law,<sup>228</sup> was whether a mortgagee's right to a security interest in postpetition rents should be determined under a uniform federal rule or under applicable nonbankruptcy law. Although that issue was mooted by the 1994 amendments to the Code,<sup>229</sup> the holding in *Butner* has continued to cast a long shadow over bankruptcy law and practice. The proposition that courts must look to state law to define property rights in a bankruptcy case is reflexively invoked and applied, including of course by the Supreme Court itself in defining the "rights" of a home mortgage lender immune from modification under § 1322(b)(2),<sup>230</sup> without critical analysis of the very different aims of state debt collection law and the federal bankruptcy system.<sup>231</sup>

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of bankruptcy may bear very little resemblance to that which entered). There is also the point to be made that whatever pre-Code practice may have been insofar as this issue is concerned, it is a limited interpretative value "given that chapter 7 indubitably permits liens to be removed in many situations." *In re Woolsey*, 696 F.2d at 1274 (citing *Harmon v. United States*, 101 F.3d 574, 581 (8th Cir. 1996) (for examples)).

<sup>226</sup> By definition, bankruptcy is a process designed to allow a beleaguered debtor to resolve all of his obligations to his creditors in a single, expedited proceeding, and a collective remedy for those creditors. These interests are recognized in numerous Code provisions from the definition of "claim" to the bankruptcy avoiding powers. *See supra* notes 11, 178 and accompanying text; *infra* notes 263–64 and accompanying text.

<sup>227</sup> *Butner v. United States*, 440 U.S. 48 (1979).

<sup>228</sup> *Id.* at 54.

<sup>229</sup> *See* 11 U.S.C. § 552(b)(2) (2012), which now effectively treats postpetition rents as proceeds rather than as after-acquired property in all cases. By contrast, the law differs from state to state in the determination of when a mortgagee is perfected in rents, ranging from as early as the time of recordation of the mortgage in some instances, to as late as the time the mortgagee takes possession of the real estate in others.

<sup>230</sup> *Nobelman v. Am. Sav. Bank*, 508 U.S. 324, 329 (1993) (citing *Butner*, 440 U.S. at 50–55).

<sup>231</sup> *See infra* text accompanying notes 297–303.

For instance, as noted earlier, the Court's statement in *Butner* that "[p]roperty interests are created and defined by state law"<sup>232</sup> has largely accounted for the view taken by the appellate courts that surrender of a 910 vehicle does not constitute a full satisfaction of the lender's claim,<sup>233</sup> instead of recognizing the existence of a federal interest calling for adoption of the Code's understanding of secured claims. These decisions, in my judgment, give insufficient attention to the limitation that the *Butner* Court placed on its holding that state law governs property rights "[u]nless some federal interest requires a different result. . . ."<sup>234</sup> The federal interest in this situation is either debtor rehabilitation or equity among creditors, inasmuch as adding the undersecured deficiency to the pool of unsecured claims both makes plan confirmation more difficult and, even when accomplished, dilutes the return to be received by the debtor's other unsecured creditors. The bankruptcy (and other) courts that regarded the exclusion of § 506 as to § 1325(a)(\*) claims as eliminating an unsecured deficiency claim when the debtor surrenders the collateral, no less than when the debtor retains the property,<sup>235</sup> seem to have apprehended the importance of this limitation.<sup>236</sup> In essence, Congress has enacted a statute, which the Court in *Butner* conceded it has the constitutional authority to do,<sup>237</sup> that has made the claim in these cases "fully secured" without regard to which option under § 1325(a)(5) the debtor elects to use in her plan.<sup>238</sup> Stated another way, when viewed from the basic objectives of the Code, elimination of § 506(a) from the equation does not necessarily mean that the creditor retains all of the rights established by state law throughout the bankruptcy case and forever thereafter. To the contrary, unless and until

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<sup>232</sup> *Butner*, 440 U.S. at 55.

<sup>233</sup> See *supra* notes 186–88 and accompanying text.

<sup>234</sup> *Butner*, 440 U.S. at 55.

<sup>235</sup> See *supra* note 183; see also *Tidewater Fin. Co. v. Kenney*, 531 F.3d 312, 318 (4th Cir. 2008) (noting that the majority of bankruptcy courts have concluded that the elimination of § 506(a) as to 910 claims means that creditors are without recourse to have their undersecured loans bifurcated so as to create an unsecured claim for the excess of the debt over the value of the collateral).

<sup>236</sup> See CHARLES JORDAN TABB, *THE LAW OF BANKRUPTCY*, § 12.19, at 1268 (2d ed. 2009) (pointing out that the appellate courts' deference to state law on this issue is flawed because of the existence of a federal interest in favor of barring bifurcation).

<sup>237</sup> See *Butner*, 440 U.S. at 54 (noting that Congress has authority under the Bankruptcy Clause of the Constitution to fashion a rule that differs from state law).

<sup>238</sup> There is nothing in the wording of § 1325(a)(\*) to indicate that there is a distinction in its application depending on whether the debtor proposes to retain or surrender the collateral. See *supra* note 183 and accompanying text; see also *infra* text accompanying notes 254–58 (concerning the conceptual difference in bankruptcy, as compared with state law, in understanding what it means to be "secured").

Congress chooses to make explicit that the interdiction on bifurcation of 910 vehicle claims applies only when the debtor elects to retain the property, core bankruptcy policy dictates that these claims ought to be regarded as fully secured for all purposes.<sup>239</sup>

While its judgment surely was influenced by the automobile lending lobby groups,<sup>240</sup> § 1325(a)(\*) can rationally only be understood as reflecting a congressional determination that there are sufficient policy justifications for prohibiting bifurcation of 910 vehicle claims despite the fact that doing so makes confirmation and completion of chapter 13 plans more difficult when the debtor wishes to keep the vehicle, and removes one of the incentives intended to encourage debtors to choose chapter 13 over chapter 7.<sup>241</sup> One might with good reason question the wisdom of that judgment,<sup>242</sup> but there is no quarrel that these judgments are for the legislature to make. Unlike *Nobelman*, however, where the Court framed the issue in terms of the lender's "rights," rather than the amount of its "secured claim,"<sup>243</sup> there can be little doubt that if a secured claim is immune from bifurcation under § 506(a), then it is fully secured for bankruptcy purposes and should be treated as such in the collateral surrender scenario no less than in the retention scenario. The larger point to be made is that the Supreme Court's holding in *Butner* does not by any means demand that simply because a creditor's contractual and property rights in a bankruptcy case are initially established under state law, those rights cannot be altered in the subsequent bankruptcy proceeding when necessary to

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<sup>239</sup> See *supra* note 185. Unlike in the case of retention, where the hanging paragraph makes confirmation more difficult for the debtor and decreases the dividend to unsecured creditors, in the surrender scenario it is principally the other unsecured creditors who pay the price of allowing the unsecured deficiency claim through a dilution of their claims, assuming all of the debtor's projected disposable income is already allocated to plan payments under § 1325(b).

<sup>240</sup> See Whitford, *supra* note 174, at 186–87 (discussing the broad creditor coalition that collaborated throughout the nearly ten-year period preceding BAPCPA to achieve passage and enactment of the Act).

<sup>241</sup> Cf. *McDonald v. Master Fin., Inc. (In re McDonald)*, 205 F.3d 606, 614 (3d. Cir. 2000) (commenting on Congress' preference that debtors elect chapter 13 over chapter 7). However, with adoption in BAPCPA of the means test in § 707(b) and the virtual elimination of the super discharge in § 1328, it seems Congress has largely moved from carrots to sticks in influencing debtors' chapter choice. Thus, elimination of an incentive encouraging chapter 13 does not create the same degree of pause it may once have given.

<sup>242</sup> There is no shortage of criticism of BAPCPA. See generally Lawrence Ponoroff, *Reclaim This! Getting Credit Seller Rights in Bankruptcy Right*, 48 U. RICH. L. REV. 733, 734 (2014) (summarizing general criticisms of the Act); David Gray Carlson, *Cars and Homes in Chapter 13 After the 2005 Amendments to the Bankruptcy Code*, 14 AM. BANKR. INST. L. REV. 301 (2006) (covering changes regarding treatment of secured claims in chapter 13).

<sup>243</sup> See *supra* note 59 and accompanying text.

advance an important federal interest.<sup>244</sup> Allowing 910 vehicle lenders to enjoy an advantage regardless of whether the debtor proposes to retain or surrender the collateral,<sup>245</sup> by eliminating the unsecured claim in one instance but not the other, occurs at the expense of other unsecured creditors and thus compromises bankruptcy equality policy. An important federal interest is thus served by a consistent application of the treatment afforded to a claim that is sheltered from § 506(a), namely, that its unsecured component has been eliminated.

### B. *Postvaluation Appreciation (and Other Rhymes)*

Insofar as the *Dewsnup* majority's emphasis on entitlement to postpetition appreciation is concerned,<sup>246</sup> the Court seems to have overlooked another important federal interest. That interest finds expression in the proposition, so critical to the contemporary bankruptcy system, that the filing of the petition brings the curtain down with finality on the debtor's prepetition financial life,<sup>247</sup> other than with respect to those few claims that are specifically

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<sup>244</sup> A more limiting understanding of *Butner* along these lines has been advanced by Professor Juliet Moringiello, who proposes an analysis that limits the holding in *Butner* regarding deference to state law to matters relating to bankruptcy "entry" rights (priority, status, etc.), as distinguished from bankruptcy "exit" rights (remedy). Juliet M. Moringiello, (*Mis*)use of State Law in Bankruptcy: The Hanging Paragraph Story, 2012 WIS. L. REV. 963, 988.

Although a remedy right is a component of a property right, it is just the type of property right that bankruptcy law can and does alter, because allowing a secured creditor to exercise its remedy rights in bankruptcy would upset bankruptcy's collectivist policies. The remedy right, therefore, is a bankruptcy exit right and federal concerns overcome the presumption that state law defines property rights.

*Id.*; see also *Wright v. Union Cent. Life Ins. Co.*, 304 U.S. 502, 517 (1938) (observing that it is the very nature of a bankruptcy proceeding to modify and adjust state property law rights); Ponoroff, *supra* note 242, at 789–90 n.265 (discussing multiple circumstances where a federal interest predominates in bankruptcy to overcome the general presumption in *Butner*). *But see* Thomas E. Plank, *The Erie Doctrine and Bankruptcy*, 79 NOTRE DAME L. REV. 633, 691–92 (2004) (urging that when resolving state law issues, federal courts in bankruptcy must respect the limits on Congress's power to alter state law entitlements).

<sup>245</sup> It is always possible, in addition to these alternatives, to negotiate a third alternative, see *supra* note 182 and accompanying text, which could easily be more beneficial to both parties than the other options, but transaction costs make such negotiated alternatives very rare.

<sup>246</sup> See *supra* note 35 and accompanying text.

<sup>247</sup> See *supra* text accompanying notes 34, 178. One striking illustration of this distinction can be found in Judge Easterbrook's decision which dealt with whether certain transactions to build or improve airport facilities represented secured loans or leases for purposes of § 365. *United Airlines, Inc. v. HSBC Bank USA, N.A.*, 416 F.3d 609 (7th Cir. 2005). The determination was hinged upon whether the airline debtor would have to assume the leases and continue to pay the stipulated rent in order to retain possession of the facilities or whether it could treat the transactions, that had been denominated as leases, as secured loans so that the debtor would, at most, have to pay a fraction of the rent in order to continue using the facilities. Employing an old

excepted from this moment of financial reckoning in order to serve countervailing social policy objectives, or because of the debtor's opprobrious conduct in relation to those debts.<sup>248</sup> This is the critical reason why, in a departure from prior law, Congress adopted the "broadest possible definition" of a "claim"<sup>249</sup> in the Code so as to assure "that all legal obligations of the debtor, no matter how remote or contingent, will be dealt with in the bankruptcy case. It permits the broadest possible relief in the bankruptcy court."<sup>250</sup> This relief cannot be achieved with any degree of effectiveness if, under the rubric of *Butner*, courts reflexively allow all of the specified and unspecified attributes of a prepetition obligation to pass through the supposedly impenetrable barrier imposed by the filing without any critical analysis of whether such an exception is warranted and, even if so, whether benefits served by preserving that interest outweigh the important federal interests implicated in any bankruptcy proceeding.

While *in rem* claims are not discharged per se, nothing in the Code says that liens pass through bankruptcy unaffected.<sup>251</sup> Thus, if the creditor receives

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firm/new firm theory for analyzing the issue of whether the payments were in return for current consumption or in respect of an earlier obligation, Judge Easterbrook articulated his view of reorganization under chapter 11. *Id.* at 613 (citing *Bos. & Me. Corp. v. Chi. Pac. Corp.*, 785 F.2d 562, 565 (7th Cir. 1986)). He had previously used this theory in *Boston & Maine Corp.* and expressed his view as follows:

Bankruptcy draws a line between the existing claims to a firm's assets and newly-arising claims . . . . If there are not enough assets to go around, some [existing] claims may be written down or extinguished. The ongoing operations of the business are treated entirely differently; new claims are paid in full as they arise. It is as if the bankruptcy process creates two separate firms—the pre-bankruptcy firm that pays off old claims against pre-bankruptcy assets, and the post-bankruptcy firm that acts as a brand new venture.

*Bos. & Me. Corp.*, 785 F.2d at 565. While it is bankruptcy rehabilitation policy that supports the analysis in chapter 11 (or 13), the fresh start policy calls for the same sort of sharp demarcation between obligations belonging to the debtor's pre- and postfiling life, respectively. See generally Charles J. Tabb, *The Historical Evolution of the Bankruptcy Discharge*, 65 AM. BANKR. L.J. 325 (1991).

<sup>248</sup> These categories of debts are collected in § 523(a), which applies to individual debtors, and is now largely incorporated into chapter 13 by § 1328. 11 U.S.C. §§ 523(a), 1328 (2012). Certain of these exceptions are extended to entity debtors in chapter 11 and 12. *Id.* §§ 1141(d)(6), 1228(a)(2), 1228(c)(2).

<sup>249</sup> See *supra* note 178 and accompanying text.

<sup>250</sup> See *supra* note 50 and accompanying text; see also Ponoroff & Knippenberg, *supra* note 17, at 2290–91 ("A pivotal, although frequently unarticulated, premise of bankruptcy policy is that . . . pre-filing claims lose their identity once a case is commenced . . . . [E]xcept in circumstances where strong public policy considerations predominate, the origin of any particular claim—whether occurred in good faith or bad, in contract or tort—is no longer relevant.")

<sup>251</sup> See *supra* note 225 and accompanying text; see also Howard, *supra* note 29, at 526 (pointing out the numerous instances where liens, perfectly valid under state law, are completely eliminated in chapter 7, rendering the creditor effectively unsecured).

the judicially determined value of its secured claim, the fresh start and equality policies in chapter 7 auger for relinquishment of the lien,<sup>252</sup> just as the rehabilitative goals in chapters 11 and 13 justify cramdown of undersecured claims in an individual or business reorganization. The creditor's "bargain" was never a perpetual encumbrance against the property until the underlying debt was fully satisfied. The bargain was to be able to realize on the property in support of payment on the debt, without regard to whether the property is worth more or less than the amount of the debt. This fact explains why, under state law, foreclosure washes the collateral free of the lien being foreclosed and all subordinate liens.<sup>253</sup> The bargain was also the right to a deficiency claim against the borrower for the difference between the amount of the debt and the net proceeds from foreclosure, but the unsecured claim fashioned by § 506(a) recognizes and enforces that part of the bargain, except where the Code suspends its operation. Moreover, consistent with the egalitarian impulse that animates the modern bankruptcy regime, it does so by treating that claim in the same manner as all other prepetition unsecured obligations.

## V. WHAT BEING SECURED REALLY DOES MEAN (OR SHOULD)

### A. *There Are No Secured Creditors in Bankruptcy*

In § 101 of the Code, the terms "claim" and "creditor" are defined terms of art; the phrase "secured creditor" is not.<sup>254</sup> Of course, § 506(a) differentiates the extent to which the claim will be regarded as "secured" or "unsecured" for purposes of bankruptcy cases. The point to be made is that concepts of

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<sup>252</sup> In Judge Easterbrook's terms, the balance of the debt belongs to the debtor's old life and needs to be "cashed out" based on whatever the dividend, if any, is for unsecured creditors. *See supra* note 247. In other words, once the creditor receives the value of the collateral, in substance, it is much more like an unsecured than a secured creditor, and the principle of equal treatment of like claims or equality of distribution for similar claims in bankruptcy demands it be treated as such. *Howard Delivery Serv. v. Zurich Am. Ins. Co.*, 547 U.S. 651, 655 (2006) (citations omitted) ("[W]e are mindful that the Bankruptcy Code aims, in the main, to secure equal distribution among creditors."). The strong-arm power in § 544(a) operates on much the same premise. Even though the unperfected security interest is a secured claim under state law, given the vulnerability of the claim to subordination to a subsequent lien creditor, the bankruptcy judgment is that the claim is more like an unsecured claim than a secured one, thus warranting avoidance of the lien so as to accomplish that result. In turn, future appreciation, if any, belongs to the "new debtor," who, as a different person, has no liability on the claim.

<sup>253</sup> *See generally* U.C.C. § 9-617(a) (2001) (addressing personal property). State real property law operates in much the same fashion, save for, typically, a period of redemption following the sale.

<sup>254</sup> *See* 11 U.S.C. § 101(5), (10) (2012). There is no definition of "secured creditor" or "unsecured creditor," since that distinction hinges on the nature of the creditor's claim as determined under § 506(a).

“secured” and “unsecured” for Code purposes relate to the character of the claims and not the status of the creditor. Thus, one can only be considered as having the status of “secured creditor” to the extent one has an allowed secured claim. The status simply does not exist under the Code separate and apart from the character of the creditor’s claim, and that claim cannot be regarded as “secured” beyond the value of the underlying collateral.<sup>255</sup> Thus, generally speaking, a creditor with a lien against property that has no equity over and above prior liens is not a “secured creditor” for bankruptcy purposes, regardless of the fact that the creditor holds a piece of paper granting it what state law calls a “security interest.”<sup>256</sup> This is all quite different from what being “secured” is understood to mean under state law.<sup>257</sup> But it is different precisely because bifurcation is essential to the accomplishment of the goals of a bankruptcy proceeding separate and apart from state law.<sup>258</sup>

It is certainly the case that value, in addition to being innately imprecise,<sup>259</sup> is subject to change. This was an important part of the holding in *Dewsnup*: that the creditors should neither be undercompensated by a conservative valuation nor deprived of postpetition appreciation in the property.<sup>260</sup> But, this simply cannot mean that the status of a claim is forever indeterminate because of the inherent uncertainty associated with valuation<sup>261</sup> or the intrinsic nature

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<sup>255</sup> See, e.g., *Nobelman v. Am. Sav. Bank*, 508 U.S. 324, 329 (1993) (illustrating that there may be other advantages or protected rights associated with being secured in specific situations, but, except where the Code disables or permits disabling the operation of § 506(a), a creditor’s secured claim cannot exceed the value of the collateral, or exist in the absence of value).

<sup>256</sup> See *In re Hornes*, 160 B.R. 709, 715 (Bankr. D. Conn. 1993) (citations omitted) (“The [C]ode does not generally classify creditors based on the existence of a piece of paper purporting to give a creditor rights in specific collateral, but rather on whether a creditor holds a claim supported by valuable estate property.”).

<sup>257</sup> See *Lane v. Interstate Bancorp (In re Lane)*, 280 F.3d 663, 668 (6th Cir. 2002) (observing that when Congress separated the universe of claims into secured and unsecured, the dividing line was between those holding a security interest under state law and those not possessed of such an interest, but rather between the lienholder whose interest has some value and the lienholder whose interest is valueless).

<sup>258</sup> This difference is especially clear in reorganization proceedings where, without bifurcation, the cost to the debtor of retaining collateral would be to remain liable for all payments of principal and interest under the secured loan. However, while the Court in *Dewsnup* may have assigned the phrase “secured claim” a different meaning for purposes of § 506(d), the Court did not, nor could it, say that § 506(a) does *not* apply in chapter 7. See, e.g., 11 U.S.C. § 722 (determination of cost to debtor to redeem personal property collateral depends on valuation under § 506(a)).

<sup>259</sup> See *Adler*, *supra* note 209, at 5–6 (defending *Dewsnup* by suggesting creditor opposition to lien-stripping signals persistent judicial undervaluation of collateral). *But see infra* note 261 regarding judicial valuation.

<sup>260</sup> *Dewsnup v. Timm*, 502 U.S. 410, 416–17 (1992).

<sup>261</sup> Bankruptcy judges make valuation judgments all the time. These value determinations have consequences ranging from whether relief from stay will be granted to whether the absolute priority rule has

of property to fluctuate in value.<sup>262</sup> Presumably, the creditors in *Dewsnup* had no problem accepting their \$81,000 unsecured claim, despite the potential for a return on their *in rem* claim from future appreciation in the collateral.<sup>263</sup> Bankruptcy, if it is to provide any meaningful relief at all to debtors, and to creditors as a group, demands that all prepetition obligations be accelerated, adjusted, and accorded the treatment called for under the Code, and that this occurs largely without regard to the past character of the claim or to the fact that circumstances may change in the future.<sup>264</sup> Indeed, everything is in flux, but it is the point of bankruptcy to draw a sharp line of demarcation, so as to close the books on the debtor's prepetition financial life.<sup>265</sup> Decisions need to be made in the here and now. This is why the fact that I might be able to begin paying my current obligations as they come due in the future is not a basis to say today that grounds for involuntary relief do not exist.<sup>266</sup> Likewise, in the case of relief predicated on my insolvency,<sup>267</sup> the possibility of a later change in my financial situation—after all I could win the lottery—neither changes my

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been satisfied in chapter 11. If valuation had to await the disposition of the property, the system would be paralyzed. See *In re Hornes*, 160 B.R. at 716 (opining that the Code often protects, modifies, or abrogates important rights based on property valuations); *In re Paolina*, 72 B.R. 555, 557 (Bankr. E.D. Pa. 1987) (Fox, J.) (“I cannot fathom the basis of [the argument that a lien could not be determined until the property had been liquidated.]”); see also Thomas J. Salerno, Jordan A. Kroop, & Craig D. Hansen, *Urgent Message to the Supreme Court: ‘Just Do It!’*, BCD NEWS AND COMMENT, May 25, 1999 (“[B]ankruptcy courts, as perhaps the most specialized commercial court[s] in the world, are uniquely qualified to make these valuation determinations, and have done so for years.”).

<sup>262</sup> *Yi v. Citibank* (Md.), N.A. (*In re Yi*), 219 B.R. 394, 398 n.12 (Bankr. E.D. Va. 1998) (citations omitted) (“This argument [concerning the possibility of future appreciation] also demonstrates why one cannot place too much reliance on the Supreme Court’s statement in *Dewsnup* that it would not ‘freeze the creditor’s secured interest at the judicially determined valuation,’ a statement that is arguably dictum. . . . If the status of various liens is not based, at least in part, on the judicially determined value, then no lien could ever be bifurcated under § 506(a) or avoided under § 506(d).”), *abrogated by* *Ryan v. Homecomings Fin. Network*, 253 F.2d 778, 783 (4th Cir. 2001).

<sup>263</sup> It is unclear what impact continuation of the lien should have on the creditor’s right to an unsecured claim. See Howard, *supra* note 29, at 517–18 (“Prohibition of strip down should mean that the creditors could not assert an unsecured claim in addition to their secured claim . . . .”). But see Carlson, *supra* note 220, at 23 (noting that if “allowed secured claims” has different meanings in different parts of the Code, it does not necessarily follow that because the secured claim is for 100 percent of the debt for purposes of § 506(d), there can be no unsecured deficiency based on § 506(a)). A similar issue now exists of course with respect to § 1325(a)(\*). See *supra* text accompanying notes 157–62, 221. Finally, it is also unclear who, but for *Dewsnup*, would really enjoy the benefit of future appreciation. See Ponoroff & Knippenberg, *supra* note 17, at 2289–92.

<sup>264</sup> See Ponoroff & Knippenberg, *supra* note 17, at 2290–91.

<sup>265</sup> See *supra* note 226.

<sup>266</sup> See 11 U.S.C. § 303(h)(1) (2012).

<sup>267</sup> *E.g.*, *id.* § 548(a)(1)(B)(i) (concerning the avoidability of certain prepetition transfers made for less than reasonably equivalent value).

bleak financial condition at the moment nor provides a basis for withholding a remedy predicated on that condition.

One of the crowning achievements of Article 9 of the UCC was to broadly recognize the legitimacy and enforceability of the floating lien on after-acquired property in order to enhance the availability of credit based on inventory and receivables financing.<sup>268</sup> But Congress recognized in 1978 that if bankruptcy were to achieve the goal of providing debtors with a new financial life and maximizing returns for prepetition creditors as a group, the floating lien would need to be sunk with respect to most forms of non-proceeds property acquired by the estate after the date of the petition.<sup>269</sup> Thus, the fact that a party is “secured” in a state law sense is not in itself relevant in a bankruptcy proceeding. Instead, although a lien may owe its existence and character to state law, it is the Code (or its silence) that determines how that lien claim will be treated in bankruptcy. This is precisely what Congress did in 2005 in order to prevent strip down of 910 vehicle loans when it eliminated § 506(a) from the equation so the creditor in these situations would be deemed to have a secured claim for the full amount of the debt.<sup>270</sup> In effect, the purpose underlying § 506(a) goes far beyond mere valuation. It is the pivotal determinant of not only the *extent* to which a claim is secured, but also whether a secured claim exists in the first place—not dissimilar from the way in which the existence of a security agreement or deed of trust serves the same function under state law.

This calls into serious question the reasoning in *Dewsnup* that an “allowed secured claim” for purposes of § 506(d) does not connote a claim that is allowed and fully secured, but rather a “claim [that] is secured by a lien and has been fully allowed.”<sup>271</sup> Rectification of that unorthodox reading of the statute insofar as it affects partially secured liens will have to wait another day.<sup>272</sup> It is not, however, necessary for that redress to occur before a lien that

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<sup>268</sup> U.C.C. § 9-204(a) (2001); *see also* 1 GRANT GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY § 11.6–7, at 354–65 (1966) (providing history of the drafting of Article 9 and the “floating lien”).

<sup>269</sup> *See* 11 U.S.C. § 552(a).

<sup>270</sup> *See supra* notes 171–73 and accompanying text.

<sup>271</sup> *Dewsnup v. Timm*, 502 U.S. 410, 417 (1992).

<sup>272</sup> It has been suggested that the disagreement in the case law concerning strip off of unsecured liens in chapter 20 might provide such an opportunity. *See* Benjamin A. Ellison, *Is it Possible that Dewsnup v. Timm Might Finally be Overturned?* AM. BANKR. INST. J. June 2013, at 60 (suggesting that the disagreement in case law concerning the strip off of unsecured liens in chapter 20 might provide an opportunity for clarification). Still, there has yet to be a split in the courts of appeal with regard to the issue. If and when that split occurs, it

is wholly underwater can be stripped off even in chapter 7. This is because in those situations there simply is no secured claim. If there is no secured claim, the whole concept of a “lien” becomes a non sequitur.<sup>273</sup> *Dewsnup* undoubtedly says that the phrase “allowed secured claim” under § 506(d) means something different from the use of the same phrase in § 506(a). But it does not say, as some courts have construed the decision,<sup>274</sup> that § 506(a) is *irrelevant* in chapter 7.<sup>275</sup> In order for the claim to be “secured” by anything, it must be supported by *some* value. Congress can exclude the operation of § 506(a), as it has now done in the hanging paragraph, but the Supreme Court cannot. Thus, as long as § 506(a) continues to be operative for determining the character of claims based on valuation of the collateral, a claim must have some value in order for it to be considered “secured,” whether in whole or in part. And if a claim is not secured at all in a bankruptcy sense, then § 506(d) provides that it may be voided; otherwise § 506(d) means nothing at all.<sup>276</sup>

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would be possible for the Court to resolve the matter without overturning *Dewsnup*, since the issue is strip off, not strip down.

<sup>273</sup> This is the basic distinction between the state law and bankruptcy meanings of the term “secured.” See *supra* note 222.

<sup>274</sup> E.g., *Wachovia Mortg. v. Smoot*, 478 B.R. 555, 568 (E.D.N.Y. 2012) (stating that the Supreme Court intended the concept of “secured” to have a specific meaning in chapter 7 rendering the valuation of the collateral as irrelevant).

<sup>275</sup> See 11 U.S.C. § 103(a) (2012) (providing that the provisions of chapters 1, 3, and 5 are applicable in chapter 7, 11, 12, or 13). Certainly, § 506(a) applies in chapter 7 cases and remains important for other purposes such as determining entitlement to relief from the automatic stay under § 362(d) and the amount necessary to redeem collateral under § 722. Thus, it might also be regarded as relevant, pursuant to the analysis in *Nobelman*, in determining if a claim is secured for purposes of application of the § 506(d) definition of “allowed secured claim.” See *supra* Part I.C. If not, because the claim is wholly unsecured, strip off should be allowed in order to further the basic policies underlying the bankruptcy system.

<sup>276</sup> If *Dewsnup* is read to mean that under § 506(d) a claim must be “secured” only in the state law sense and without regard to whether the lien is supported by any value in the collateral, then no lien supporting an allowed claim would ever be avoided under its strictures. Yet, the statute refers to both “allowed” and “secured” claims, implying they must both be given meaning. See 11 U.S.C. § 506(a), (d). While *Dewsnup* precludes using § 506(a) to limit the amount of a secured claim to its value, it does require that there be a secured claim, a question that, in order to avoid rendering specific statutory term superfluous, can only be answered under § 506(a). Thus, the better reading of the statute would seem to be that if the lien supporting an allowed claim is unsecured (as opposed to just partially secured), it is voidable. See *Yi v. Citibank (Md.)*, N.A. (*In re Yi*), 219 B.R. 394, 400–01 (Bankr. E.D. Va. 1998) (addressing three possible attacks on the argument that an allowed unsecured lien is voidable); see also Michael Myers, Note, *Dewsnup Strikes Again: Lien-Stripping of Junior Mortgages in Chapter 7 and Chapter 13*, 53 ARIZ. L. REV. 1333, 1355–57 (2011) (urging adoption of the view that § 506(d) can be read to support strip off in chapter 7). But see David N. Saponara, *Lien-Stripping in Consumer Bankruptcy: Debtors Cannot Strip Liens Down Partially, but Can They Strip Them Off Entirely? The Answer Should be No*, 21 AM. BANKR. INST. L. REV. 257 (2013) (arguing that the Supreme Court’s policy favoring protection of secured creditor’s “bargained-for” rights, suggests that no distinction should be drawn between strip down and strip off in chapter 7).

Reading § 506(a) and § 506(d) together satisfies both the policy objectives of chapter 7 bankruptcy proceedings, while, at the same time, fully respecting property rights established under state law.<sup>277</sup>

Unlike in chapter 11,<sup>278</sup> there is no provision giving creditors with a partially secured claim in a chapter 7 case the option to be treated as fully secured. The extent of the secured claim is not only *measured* by § 506(a), it is *defined* by that provision. For all its other warts, there is nothing in the majority opinion in *Dewsnup* that alters this fundamental axiom of bankruptcy law. Furthermore, while of peripheral concern in the present treatment, to the extent that the efficiency of secured credit is justified in terms of reduced monitoring costs,<sup>279</sup> it bears noting that an approach to security that defines secured claims by reference to collateral value can be seen as encouraging more vigilant monitoring of sub-optimal debtor behavior, whether this entails excessive risk taking or underutilizing assets, to ensure the creditor does not get caught unawares with respect to any unsecured deficiency.<sup>280</sup>

If the measure of value under § 506(a) is one dollar or greater, then a secured claim exists to such extent and *Dewsnup*'s interpretation of § 506(d) is that the lien remains with the property even after the *in personam* claim has been discharged—although it is difficult to imagine what purpose this serves other than to frustrate the debtor's fresh start without any corresponding social utility.<sup>281</sup> One the other hand, if the measure of value is zero, a determination

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<sup>277</sup> See Keating, *supra* note 189, at 468, 512–15 (identifying what he regards as the Supreme Court's reluctance, often cloaked in the rationale of strict statutory construction, to impair or diminish the rights of secured creditors in bankruptcy).

<sup>278</sup> See *supra* note 184 and accompanying text.

<sup>279</sup> E.g., Jackson & Kronman, *supra* note 1, at 1050–51 (stating that the existence of collateral is likely to reduce monitoring costs); Saul Levmore, *Monitors and Freeriders in Commercial and Corporate Settings*, 92 YALE L.J. 49, 50–59 (1982) (arguing that secured credit induces efficient levels of monitoring because it addresses freeriding considerations); cf. Daniel Hemel, Note, *The Economic Logic of the Lease/Loan Distinction*, 120 YALE L.J. 1492, 1521–22 (2011) (noting that because of the impact of bifurcation under § 506(a), “the secured creditor will presumably devote more efforts toward monitoring the widget-maker's asset use,” although other costs undercut the extent that the secured creditor, unlike a lessor, can at least recoup some of this “depreciation loss” in the form of the dividend on its unsecured claim). See generally Squire, *supra* note 6, at 850–53 (summarizing and critiquing prior monitoring theories).

<sup>280</sup> Yair Listokin, *Is Secured Debt Used to Redistribute Value from Tort Claimants in Bankruptcy? An Empirical Analysis*, 57 DUKE L.J. 1037, 1049–50 (2008) (commenting on the ability of secured creditors to monitor debtors and threaten foreclosure on assets if a debtor engages in risk-altering behavior, underinvests to maximize its own profits at the expense of a joint venturer, or threatens opportunistic default).

<sup>281</sup> That is, in the sense that it is unrealistic to think that the creditor whose lien has no value as of the time of filing is likely to ever see any return from the property. See *supra* note 214; *infra* note 319.

that hardly goes on in secret,<sup>282</sup> then there is no secured claim.<sup>283</sup> At that juncture, the lien is an unnecessary excrescence that should be amendable to strip off, if not under the language of § 506(d) (which after all does refer to a lien that *secures* a claim) then conceptually as a matter of the inherent powers of the bankruptcy courts to go beyond the literal text of the Code to fashion a rule when necessary to serve a uniquely federal interest.<sup>284</sup> And, the point to be made is that *Dewsnup* does not bar this outcome<sup>285</sup> any more than *Nobelman* precludes strip off in chapter 13 or 20.<sup>286</sup>

### B. *Are the Supremes the Only Court That Can Sing in Motown?*

As observed earlier, the absence of a specific source of statutory authority, as exists in reorganization proceedings, for avoiding an unsecured lien in chapter 7 has been a stumbling block for many courts.<sup>287</sup> Most of the courts of appeal to have addressed the question of strip off in chapter 7<sup>288</sup> have rejected the suggestion that § 506(d) can provide the necessary authority in light of the meaning ascribed to that provision by the majority opinion in *Dewsnup*.<sup>289</sup> The argument, I would maintain, is worthy of reconsideration in those courts, or, more realistically, in the appeals courts yet to address the issue,<sup>290</sup> in light of

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<sup>282</sup> Often overlooked in the rush to criticize judicial valuations is, as the court pointed out in *Yi*, the fact that the creditor has every opportunity to appear and challenge the valuation of the property submitted by the debtor. *Yi v. Citibank (Md.)*, N.A. (*In re Yi*), 219 B.R. 394, 401 (Bankr. E.D. Va. 1998). Thus, the court observed that an injury suffered as a result of the judicially determined valuation, would be a “self-inflicted wound.” *Id.*

<sup>283</sup> *Id.* at 400 (explaining how and why the difference between a lien being secured and unsecured can hinge of one dollar).

<sup>284</sup> See *Woolsey v. Citibank, N.A. (In re Woolsey)*, 696 F.3d 1266, 1274 (10th Cir. 2012) (noting that chapter 7 “indubitably” permits liens to be removed in many situations); *infra* notes 294–308 and accompanying text (discussing the creation and application of common law bankruptcy, including non-literal judicial interpretation of statutory language for the purpose of furthering a federal interest).

<sup>285</sup> The majority opinion in *Dewsnup* holds that § 506(d) cannot be used to void the unsecured portion of a lien as defined under § 506(a); it does not hold that such a lien is impervious to avoidance by other means in a proper case, such as when it is wholly underwater. *Dewsnup v. Timm*, 502 U.S. 410, 417 (1992).

<sup>286</sup> See *supra* Part III.C.

<sup>287</sup> See *supra* notes 220–21 and accompanying text.

<sup>288</sup> See *supra* Part II.B.

<sup>289</sup> *E.g., In re Woolsey*, 696 F.3d at 1278 (“*Dewsnup* may be a gnarled bramble blocking what should be an open path. But it is one only the Supreme Court and Congress have the power to clear away.”).

<sup>290</sup> This list arguably includes the Eleventh Circuit which, as noted earlier, has, as of this writing, ruled in favor of strip off in Chapter 7 in an opinion that, while now published, is not yet final. See *supra* notes 100–04 and accompanying text.

analysis set forth above.<sup>291</sup> Failing that, however, and recognizing the widespread dissatisfaction with *Dewsnup* even in the courts that dutifully uphold it,<sup>292</sup> the challenge becomes to find another alternative.

Recent scholarship and case law have fairly called into question the extent to which it might be defensible to press the bankruptcy courts' equitable powers under § 105(a) into service for this purpose<sup>293</sup> and the degree to which bankruptcy judges generally may employ nonstatutory equitable principles to support an outcome not expressly countenanced by the Code.<sup>294</sup> Yet, a quite serviceable alternative may be found in an analysis that is not only plausible in formulation, but that also already has a long and proven (albeit *sub silentio*) track record in bankruptcy.<sup>295</sup> Several years ago, Professor Adam Levitin published an intriguing article addressing the difficult question of how to

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<sup>291</sup> An ancillary benefit of adoption of this analysis by a court of appeals would be to create a split in the circuits that might offer then the opportunity for the Supreme Court either to articulate the scope of its holding in *Dewsnup* or reconsider it in its entirety. It has been suggested that the disagreement in the case law regarding strip off in chapter 20 might offer that occasion. See Ellison, *supra* note 272, at 61. But it would be easy for the Court to duck direct confrontation with *Dewsnup* simply by relying on its precedents in *Johnson* and *Nobelman*.

<sup>292</sup> E.g., *In re Woolsey*, 696 F.3d 1266; *Wachovia Mortg. v. Smoot*, 478 B.R. 555 (E.D.N.Y. 2012); *In re Cook*, 432 B.R. 519 (Bankr. D.N.J. 2010).

<sup>293</sup> The scope of the bankruptcy courts' exercise of equitable powers under the expansive language of § 105(a) has been constrained by the requirement that the § 105(a) powers be exercised only within the confines of the Bankruptcy Code. See, e.g., *Wells Fargo Bank of Tex. N.A. v. Sommers (In re Amco Ins.)*, 444 F.3d 690, 695 (5th Cir. 2006) ("Section 105(a) 'does not permit courts to act as roving commissions to do equity.'") (internal quotation marks omitted) (quoting *Mirant Corp. v. Potomac Elec. Power Co. (In re Mirant Corp.)*, 378 F.3d 511, 523 (5th Cir. 2004)); *In re Kmart Corp.*, 359 F.3d 866, 871 (7th Cir. 2004) (noting that the power conferred by § 105(a) is the power "to implement rather than override," and certainly not to ignore Code rules).

<sup>294</sup> See Alan M. Ahart, *The Limited Scope of Implied Powers of a Bankruptcy Judge: A Statutory Court of Bankruptcy, Not a Court of Equity*, 79 AM. BANKR. L.J. 1, 21–28 (2005) (tracing the history of the bankruptcy courts' equity powers through the Supreme Court holding unconstitutional § 241 of the Bankruptcy Reform Act of 1978, which granted the bankruptcy courts "the powers of a court of equity, law and admiralty," and concluding that under the Code, the bankruptcy court lacks these full powers of a court of equity). 28 U.S.C. § 1481 (1982) would have given the bankruptcy courts the same equity powers that the courts enjoyed under § 2 of the Bankruptcy Reform Act of 1898 (30 Stat. 544). Its implementation, however, was delayed by the Supreme Court's decision holding the 1978 Act's jurisdictional scheme unconstitutional in *N. Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50 (1982). It eventually went into effect two years later, but only days thereafter was effectively abrogated by the legislation promulgated in response to *Marathon*, the Bankruptcy Amendments & Federal Judgeship Act, 98 Pub. L. No. 353, 98 Stat. 345 (1984). See Ahart, *supra*, at 21–23.

<sup>295</sup> See, e.g., Adam J. Levitin, *Toward a Federal Common Law of Bankruptcy: Judicial Lawmaking in a Statutory Regime*, 80 AM. BANKR. L.J. 1, 84 (2006) ("[F]ederal common lawmaking is what federal courts have been doing in bankruptcy for over a century.").

reconcile equity with a code-based regime like bankruptcy.<sup>296</sup> Seeking, *inter alia*, to mediate between the narrow, what he terms “proceduralist,” view of bankruptcy<sup>297</sup> and the more expansive “practicalist” account that regards the bankruptcy system as advancing independent and unique substantive goals separate and apart from state commercial law,<sup>298</sup> Professor Levitin has identified a methodological construct for identifying when and how the bankruptcy courts participate in lawmaking under the Code.<sup>299</sup> He associates, quite rightly, the proceduralists with a view that envisages the judicial function in bankruptcy as largely administrative in nature,<sup>300</sup> with bankruptcy judges passively applying clear legal rules in a consistent and predictable fashion, even if at the expense of particularized justice in individual cases.<sup>301</sup> By contrast, he describes the practicalists as placing an emphasis on the flexibility necessary to carry out bankruptcy policy, and, thus, as advocating the need for bankruptcy judges to possess and exercise broad discretion to adopt and apply non-Code practices when necessary to achieve the *desideratum* of the

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<sup>296</sup> *Id.* (arguing that the role of courts in developing non-Code practices in bankruptcy is better defined as federal common lawmaking rather than as acting as a court of “equity”). The issue is, of course, yet another variation on the long-standing debate between rules and standards, certainty and fairness, and formalism and realism. The classic work on this subject probably remains Duncan Kennedy, *Form and Substance in Private Law Adjudication*, 89 HARV. L. REV. 1685 (1976).

<sup>297</sup> Levitin, *supra* note 295, at 4–5 (identifying practicalists as those who desire broad discretion for the bankruptcy judges to implement bankruptcy policy and proceduralists as favoring clear rules over judicial discretion and generally associated with the law and economics branch of legal theory); *see also* Jackson, *supra* note 202, at 857 (discussing the “creditors’ bargain” model, which reflects the proceduralist point of view); Ponoroff & Knippenberg, *supra* note 202, at 948–55 (also discussing the “creditor’s bargain,” but utilizing the rubric of collectivist/traditionalist).

<sup>298</sup> The distinction between these two camps was also described by Professor Knippenberg and me under the rubric of “collectivists” and “traditionalists.” Ponoroff & Knippenberg, *supra* note 202, at 948–66.

<sup>299</sup> Levitin, *supra* note 295, at 84 (“[A] common law approach also presents more predictable application of judicial discretion making it possible for parties to factor in legal regimes into their behavior [ex ante], as the proceduralists would like.”). Professor Levitin’s focus is on reorganization in chapter 11, but there is nothing in his federal common law justification for the creation of extra-Code rights practices that is limited to reorganization; rather it is animated by the need to achieve underlying bankruptcy policy through judicial flexibility, but a flexibility that is executed in a manner that represents a “more predictable application of judicial discretion making it possible for parties to factor in legal regimes into their behavior ex ante, as the proceduralists would like.” *Id.* at 86.

<sup>300</sup> *See also* Rafael I. Pardo & Kathryn A. Watts, *The Structural Exceptionalism of Bankruptcy Administration*, 60 UCLA L. REV. 384 (2012) (suggesting the benefits of shifting away from a court-centered model of bankruptcy to an administrative model overseen through a regulatory agency).

<sup>301</sup> Levitin, *supra* note 295, at 5 (describing the proceduralist view as emphasizing the rule of law and regarding judicial adoption of non-Code practices as representing “unnecessary, overreaching, and even harmful displays of judicial discretion and activism”).

bankruptcy regime.<sup>302</sup> This would include, when and as necessary, the discretion to develop rules that operate to augment the letter of the Code, as well as to expand and develop practices in the statutory interstices and perhaps even around the edges.<sup>303</sup>

The happy medium offered by Professor Levitin is to explicitly recognize that the use of federal common law offers a valuable alternative framework for understanding and analyzing the undeniable reality of non-Code practices, and as a means to both permit and regulate expansion of the law beyond the four corners of the Code.<sup>304</sup> He describes this approach as dependent on precedent and judicially-devised tests such that it simultaneously constrains the unbridled discretion that is the great fear of the proceduralist, and yet satisfies the practicalist by investing bankruptcy judges with the measured discretion to digress from the rigid letter of the Code when necessary to ensure that the larger goals of the system are served and promoted.<sup>305</sup> Notably, Professor Levitin does not claim to have invented this approach as much as having revealed it, as he describes federal common lawmaking in bankruptcy as being “what federal courts in bankruptcy have been doing for over a century.”<sup>306</sup>

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<sup>302</sup> *Id.* at 4–5 (referring to practicalists as holding the view that bankruptcy has distinctive substantive goals that call at times for the alteration of state law rights and a deviation from the statutory text—and the rule of law—when necessary to advance the purposes of the law).

<sup>303</sup> *Id.* at 1–2 (offering example practices in chapter 11 that are not explicitly authorized in the Code, such as critical vendor orders, substantive consolidation, and discharge or release of non-debtor affiliates of the debtor).

<sup>304</sup> *Id.* at 67 (2006) (citing *United States v. Standard Oil Co.*, 373 U.S. 647, 651 (1947) (noting that the Supreme Court has acknowledged that a federal common law does exist in certain specific areas when necessary to protect a uniquely federal interest and when authorized by Congress, even after the Court’s landmark holding in *Erie R.R. Co. v. Tompkins*, 304 U.S. 64, 78 (1938), that there is no general federal common law). It is important to note for purposes of the present analysis that Professor Levitin’s treatment of the subject focuses on the relationship between Congress and the courts in bankruptcy matters, and does not purport to address the relationship of federal and state law. *Id.* at 3 n.11. It is submitted, however, that this framework for analysis has the potential to say a great deal about that relationship, inasmuch as the bankruptcy power is exclusively federal and constitutional in origin, and the test of when a state law right may be altered is when it is necessary to serve an important federal interest. *See supra* text accompanying note 208. Thus, while it may be that a “uniquely” and an “important” federal interest are not entirely coincident, the same considerations that permit development of a federal common law in specific areas may also apply in determining the federalism-related issues.

<sup>305</sup> Levitin, *supra* note 295, at 3 (“The rule of law wins but a Pyrrhic victory when it defeats the purpose of the law.”); *see also id.* at 81 (2006) (noting that the extremely fact-specific nature along with the structure of the bankruptcy system requires flexibility and discretion).

<sup>306</sup> *Id.* at 84 (2006); *see also* Jay Tidmarsh & Brian J. Murray, *A Theory of Federal Common Law*, 100 NW. UNIV. L. REV. 585 (2006) (suggesting undue state bias as an additional basis for the rule of decision to be guided by federal common law).

Professor Levitin finds the sources of authority to create and apply a federal common law of bankruptcy as (1) deriving from the need to protect a uniquely federal interest as established by the uniformity provision in the Bankruptcy Clause of the Constitution, and (2) implicitly authorized by Congress in the Code, the legislative history to the Code, Congress' acquiescence in the pre-Code practices doctrine, and in the practical necessities of bankruptcy practice.<sup>307</sup>

If the courts, and particularly the courts of appeal, cannot be persuaded for the reasons that have been advanced by this article, and in some of the decisional law,<sup>308</sup> to draw a distinction between strip down and strip off under § 506(d), then the power to void worthless junior liens might be found to exist as a matter of the courts' authority in bankruptcy to craft a federal rule of decision when necessary to advance unique bankruptcy policies, such as the fresh start. Even accepting a federal common law in bankruptcy, however, it needs to be emphasized that reaching the conclusion that the power to strip off unsecured liens exists absent specific statutory stricture requires not only accepting a bankruptcy understanding of the meaning of "secured," rather than the orthodox state law meaning (*Butner* notwithstanding), but also that such a result is not barred by the specific holding in *Dewsnup*. As has hopefully already been demonstrated, both of these conditions are satisfied,<sup>309</sup> such that an avenue is opened for those courts that seek a clear and principled path for further limiting *Dewsnup* even more narrowly to its facts.

It bears mentioning as well, despite the implication to the contrary in *Dewsnup*,<sup>310</sup> there is no constitutional impediment to this conclusion because,

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<sup>307</sup> Professor Levitin cites the Supreme Court's determination in *Cent. Va. Cmty. Coll. v. Katz*, 546 U.S. 356 (2006), that bankruptcy was an important enough federal interest to warrant subordination of state sovereign immunity as illustrative of the importance of the former; he cites Congress's decision to place bankruptcy proceedings in courts, rather than an agency, as evidence of the latter. Levitin, *supra* note 295, at 71–77.

<sup>308</sup> See *supra* note 82.

<sup>309</sup> See *supra* Part VI.A.

<sup>310</sup> The majority opinion in *Dewsnup* cited an earlier Supreme Court case which had invalidated under the Takings Clause the provisions of the Frazier-Lemke Farm Bankruptcy Act of 1934. *Dewsnup v. Timm*, 502 U.S. 410, 419 (1992) (citing *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555 (1935)). That Act had originally permitted reduction of a creditor's lien. Thus, the reference to *Radford* in *Dewsnup* implied that any interpretation of § 506(d) which reduced the amount of a lien for any reason other than payment on the debt might similarly be constitutionally infirm.

in fact, nothing is being taken,<sup>311</sup> and, in any case, it is well established that lien avoidance under the federal bankruptcy power “does not come within the traditional definitions of taking under the Fifth Amendment.”<sup>312</sup> The accommodation of the tenuous balance between a creditor’s interests in property and the debtor’s (and society’s) interest in the fresh start is abundantly clear. You are either secured in a state law sense—with all that entails—or, in a bankruptcy sense—with all of its corresponding consequences. There is no rationale for allowing the creditor with a lien against property of the debtor to assert both an unsecured claim with respect to its deficiency, and retention of its *in rem* claim to support the full amount of the debt, although that is precisely what the majority opinion in *Dewsnup* permits to occur in the case of a partially secured claim. However, neither *Dewsnup* nor the language and structural logic of the Code require that this be so in the case of wholly unsecured liens. Except when the Code instructs or, as in the case of § 1111(b), permits, a claim to be insulated from bifurcation, a secured claim in bankruptcy requires that there be at least some value that attaches to the lien at the time of filing. Otherwise, not only is the lien unsecured, but the *creditor* is unsecured, regardless of the fact that it holds a piece of paper that says otherwise. When the Code makes § 506 inapplicable, or permits a creditor to render bifurcation ineffective, the result is that the entire claim is treated as secured (as under state law), but what then happens to the claim is a bankruptcy, not a state law, question.<sup>313</sup> The decision of Congress in BAPCPA

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<sup>311</sup> Professor Howard has ably debunked this argument by pointing out, among other things, that once the Frazier-Lemke Act was amended, renamed as the Farm Mortgage Moratorium Act of 1935, to apply only prospectively and assure the creditor the value of its collateral, the Court in *Wright v. Vinton Branch of the Mountain Trust Bank*, 300 US 440 (1937), rejected any constitutional challenge. See Howard, *supra* note 29, at 525. Professor Howard also pointed to the Court’s decision in *United States v. Sec. Indus. Bank*, 459 U.S. 70 (1982), upholding the constitutionality of the lien avoidance power in § 522(f) as applied prospectively. *Id.*

<sup>312</sup> See *Pillow v. Avco Fin. Servs. (In re Pillow)*, 8 B.R. 404, 411 (Bankr. D. Utah 1981) (indicating that exercise of the federal bankruptcy power to avoid liens, “does not come within the traditional definitions of taking under the Fifth Amendment”); see also *Yi v. Citibank (Md., N.A. (In re Yi))*, 219 B.R. 394, 401–02 (Bankr. E.D. Va. 1998) (summarizing the same argument).

<sup>313</sup> See *Wright v. Union Cent. Life Ins. Co.*, 304 U.S. 502, 518 (1938). Justice Cardozo stated in summation:

Property rights do not gain any absolute inviolability in the bankruptcy court because created and protected by state law. Most property rights are so created and protected. But if Congress is acting within its bankruptcy power, it may authorize the bankruptcy court to affect these property rights, provided the limitations of the due process clause are observed.

*Id.* The same can be said when the courts exercise their limited, but proper lawmaking role in bankruptcy.

to prevent cramdown of purchase money auto loans by disabling § 506 as to these claims demonstrates the pivotal role of § 506(a) in defining the existence *vel non*, as well as the amount, of a secured claim.<sup>314</sup> Thus, the decisions that prohibit strip off of valueless liens in chapter 7, just as the decisions that permit resurrection of an unsecured deficiency claim when a debtor proposes to surrender § 1325(a)(\*) collateral, misapprehend what it means, and what it does not mean, to be “secured” in bankruptcy.

### CONCLUSION

Over 16 years ago, Professor Knippenberg and I attempted to offer a solution to the long-standing puzzle of how to negotiate a reconciliation between what we termed the immovable object and the irresistible force.<sup>315</sup> Much has happened since that time, but the inherent tension between bankruptcy’s fresh start and rehabilitation policies, on the one hand, and the state law rights and remedies of secured debt on the other, persists. To a degree, this is inevitable because the two systems seek to achieve largely antithetical goals, and there is no perfect balance between the two—just judgments about where to place the normative stanchion.

In the case of lien stripping, it has been my suggestion that one profitable way to approach the issue is by reaching some *modus vivendi* on the question of how to conceptualize the security interest in bankruptcy. In this respect, the Code points the way in § 506(a), which not only limits the amount of a secured claim to the value of the collateral available to the lien, but determines if a secured claim exists at all. The counterargument is that this approach deprives the secured party of other essential aspects of its bargain with the debtor, most importantly, the right to foreclose.<sup>316</sup> It has also been submitted that because of the innate subjectivity of judicial valuations, this understanding of security carries a high risk of depriving the secured creditor of current or future value.<sup>317</sup>

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<sup>314</sup> See *supra* text accompanying notes 175–77.

<sup>315</sup> Ponoroff & Knippenberg, *supra* note 17.

<sup>316</sup> This is the pivotal distinction between strip down and strip off. If there is no secured claim at all, then *Dewsnup*’s prohibition based on its interpretation of § 506(d) as applying to “secured” in a state law sense, does not apply.

<sup>317</sup> See *supra* note 209 and accompanying text.

I have attempted to demonstrate that the first concern is unfounded because the economic advantages of security beyond the value of the collateral are largely ephemeral. As to the latter argument, not only does the distrust of judicial valuations lack empirical substantiation, but, given the depressed prices associated with forced sales, there is reason to suppose that creditors may actually realize more from their collateral inside rather than outside bankruptcy. This is particularly true in the circumstances where the Code now insists on replacement cost valuation.<sup>318</sup> Insofar as future appreciation is concerned, not only is that prospect not assured, even in the case of real property collateral—as we have learned in recent years—but it is unlikely to be realized unless the junior secured creditor is prepared to pay cash to buy out the prior lien, become the long-term owner of a nonproductive asset, and then await a better market. It is improbable, to say the least, that the professional lending community would have much interest in such a course of action.<sup>319</sup> Moreover, the argument ignores altogether the crucial fact that bankruptcy at its essence requires the final totaling up and close out of prepetition claims in order to achieve parity among similarly positioned creditors and to provide relief to debtors in both the liquidation and reorganization contexts.<sup>320</sup>

It should be stressed that these issues about the characterization of secured debt are not simply creditor versus debtor issues, which are of course the fashion in which state law apprehends the rights associated with security. Bankruptcy is also a collectivized debt collection procedure designed to maximize returns for creditors as a group, but this sometimes comes at the expense of a single creditor. A conceptualization of security that insists on minimizing to the point of triviality the infringement on state law rights also undermines this goal of the system, usually to very little avail. While the Supreme Court's limited lien-stripping jurisprudence has undoubtedly been chary when it comes to upsetting the state law remedies of secured creditors,<sup>321</sup>

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<sup>318</sup> See 11 U.S.C. § 506(a)(2) (2012) (superseding in part the Supreme Court's decision in *Assoc. Commercial Corp. v. Rash*, 520 U.S. 953 (1997)).

<sup>319</sup> See *supra* note 76; see also Myers, *supra* note 276, at 1356 (pointing out that the concern over future increase in value is specious in that most lienholders are not in the business of property management nor in a position to hold underwater real properties to see if the market will recover).

<sup>320</sup> See *supra* text accompanying notes 178, 247–52.

<sup>321</sup> See generally Keating, *supra* note 189.

the Court has not been oblivious to the rights of debtors nor to creditors as a group in the bankruptcy process.<sup>322</sup>

The jurisprudence that has developed in the lower courts since *Dewsnup* in relation to lien stripping, including most recently the Fourth Circuit's decision in *Branigan v. Davis*, is generally consistent with the account of security advanced here and is most readily apparent in the case of strip off. The glaring exception is strip off in chapter 7, a product, it would seem, of an overly broad reading of *Dewsnup*, and perhaps a wariness born from the absence of a specific cramdown mechanism in chapter 7. Whatever the rationale, as has been shown, this reading of *Dewsnup* ignores the primacy of § 506(a) and the criticality of claim bifurcation to the accomplishment of the key objectives of bankruptcy: equality among similarly-placed creditors and a fresh start for debtors. Strip off, however, does not hinge on the availability of a statutory mechanism for cramming down claims. Rather, it is a function of the determination of whether or not the claim, as opposed to the claimant, is secured.<sup>323</sup> In the case of a wholly underwater lien, the creditor decidedly does not hold a secured claim, and avoidance of the lien is, therefore, either authorized by the statute<sup>324</sup> or is left to the discretion of judges to make appropriate public policy decisions to achieve the basic objectives of bankruptcy.<sup>325</sup> Strip off is also consistent with a proper view of the meaning of security in bankruptcy.

Recent amendments to the Code, despite their overall creditor-friendly orientation, actually support this analysis.<sup>326</sup> *Dewsnup*, on the other hand, does not. While I believe the majority holding in *Dewsnup* is more than worthy of reconsideration, it is maintained that, properly understood, there is nothing in that holding that precludes strip off, as opposed to strip down. The courts should thus take their proper role in the development of such a rule in the traditional common law style, leaving *Dewsnup* a curious aberration whose

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<sup>322</sup> See, e.g., *Johnson v. Home State Bank*, 501 U.S. 78 (1991) (upholding the ability to modify a secured creditor's claim in chapter 20); *United Sav. Ass'n v. Timbers of Inwood Forest Assocs., Inc. (In re Timbers of Inwood Forest Assocs., Inc.)*, 484 U.S. 365 (1988) (denying a secured lender adequate protection for its lost opportunity costs); see also *supra* note 37; Howard, *supra* note 29, at 530 (reasoning that the suggestion in *Dewsnup* that *in rem* rights are unaffected by bankruptcy is inconsistent with the Court's holding in *Timbers* denying a secured creditor's claim for protection of its lost opportunity cost).

<sup>323</sup> See *supra* text accompanying notes 254–58.

<sup>324</sup> See *supra* note 276 and accompanying text.

<sup>325</sup> See *supra* note 305.

<sup>326</sup> See *supra* text accompanying notes 174–77.

precedential value is narrowly confined to the specific facts and circumstances of that case. The bankruptcy system and its participants would all benefit from both this limited reading of *Dewsnup* and from a fixed and enduring understanding of the nature of secured claims in bankruptcy.