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Strip-Off: What is the Correct Procedure to Avoid a Wholly Unsecured Junior Mortgage?

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STRIP-OFF: WHAT IS THE CORRECT PROCEDURE TO AVOID A WHOLLY UNSECURED JUNIOR MORTGAGE?

INTRODUCTION

When the housing market began to collapse in 2007,[1] the application of the rarely used rule for stripping[2] junior mortgages[3] in chapter 13 cases became an important issue in bankruptcy.[4] "Strip-off"[5] entitles the bankruptcy estate to avoid a wholly unsecured[6] junior mortgage on a debtor's principal residence.[7] For twenty years prior to the housing crisis, home values consistently and predictably increased over time,[8] and banks considered mortgage-backed securities a very safe investment.[9] During this time the value of a debtor's home usually exceeded the value of the holder's claim on both the debtor's first and junior mortgage.[10] However, the recent economic situation produced a rapid decline in housing prices that could continue into the foreseeable

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[1] Richard D. Thomas, Comment, *Tipping the Scales in Chapter 11: How Distressed Debt Investors Decrease Debtor Leverage and the Efficacy of Business Reorganization*, 27 EMORY BANKR. DEV. J. 213, 216 (2010).

[2] *See, e.g.*, W. HOMER DRAKE, JR. ET AL., CHAPTER 13 PRACTICE AND PROCEDURE § 9C:5 (2010) ("Because a plan may impose such modification of a secured claim over the creditor's objection, this treatment is commonly referred to as 'cramdown'; the consequent effect on the lien is referred to as 'lien stripping.'").

[3] BLACK'S LAW DICTIONARY 1103 (9th ed. 2009) (defining "junior mortgage" as "[a] mortgage that is subordinate to another mortgage on the same property").

[4] Elizabeth M. Abood-Carroll, *Are Adversary Proceedings Necessary to Strip Mortgagees' Liens in Chapter 13?: Analyzing Supreme Court's Answer in* Espinosa v. United Student Aid Funds, AM. BANKR. INST. J., July–Aug. 2009, at 14, 14.

[5] DRAKE ET AL., *supra* note 2, § 9C:5 ("[E]limination of a lien due to the lack of any value in the encumbered property to support a secured claim is referred to as a 'strip off.'").

[6] "Wholly unsecured" means the value of the encumbered property is less than the entire amount of the junior claim after value is accessed to the senior claim. *See, e.g.*, Pond v. Farm Specialist Realty (*In re* Pond), 252 F.3d 122, 124 (2d Cir. 2001) (citing 11 U.S.C. § 506(a) (2000)).

[7] Tanner v. FirstPlus Fin., Inc. (*In re* Tanner), 217 F.3d 1357, 1359–60 (11th Cir. 2000).

[8] Two graphs using the Composite 10 and Composite 20 indices show housing prices generally trending upwards from 1987 to January 2007. Press Release, Standard & Poors, Home Prices Continued to Decline in November 2011 According to the S&P/Case-Shiller Home Price Indices (Jan. 31, 2012), http://www.standardandpoors.com/indices/articles/en/us/?articleType=PDF&assetID=1245328085691.

[9] *See* Jason Cox et al., *Why Did the Credit Crisis Spread to Global Markets?*, U. IOWA CENTER FOR INT'L FIN. & DEV., 1–3 (Mar. 2010), http://blogs.law.uiowa.edu/ebook/sites/default/files/Part_5_2.pdf.

[10] *See* Alex Ulam, *Why Second-Lien Loans Remain a Worry*, AMERICAN BANKER (May 2, 2011, 3:16 PM), http://www.americanbanker.com/specialreports/176_5/second-lien-loans-remain-worry-1036731-1.html.

future.[11] Subsequently, as the country entered into the economic tailspin now known as the Great Recession,[12] foreclosure rates skyrocketed.[13]

Before the mortgage crisis, homeowners commonly mortgaged their homes multiple times to extract most of the equity in their properties,[14] causing mortgage payments to become a higher percentage of their income.[15] Many homeowners' incomes have fallen during the recession;[16] not being able to keep up with their loan payments, many have ended up defaulting on their mortgages.[17] Homeowners who are unable to pay their debts may file chapter 13 bankruptcies in an attempt to retain their homes.[18] Chapter 13 allows debtors to keep their primary residences and strip off junior mortgages exceeding the current value of the debtors' homes.[19] The debtor is obligated to repay the first mortgage and any junior mortgages, on a priority basis, up to the fair market value of the home.[20] Any wholly unsecured junior mortgage can be thus stripped off. Given the current economic situation, strip-off is an extremely powerful tool for debtors.[21]

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[11] Robert J. Shiller, *Why Home Prices May Keep Falling*, N.Y. TIMES, June 7, 2009, at BU4, *available at* http://www.nytimes.com/2009/06/07/business/economy/07view.html ("Home prices in the United States have been falling for nearly three years, and the decline may well continue for some time.").

[12] David Line Batty, *Dodd-Frank's Requirement of "Skin in the Game" for Asset-Backed Securities May Scalp Corporate Loan Liquidity*, 15 N.C. BANKING INST. 13, 13 (2011) ("The economic devastation [that began in 2007] has come to be known as the Great Recession because it has had far-reaching economic and societal effects not felt since the Great Depression which inspired its name.").

[13] *See* Ronald Mann, Op-Ed, *A New Chapter for Bankruptcy*, N.Y. TIMES, Mar. 12, 2010, at A27, *available at* http://www.nytimes.com/2010/03/12/opinion/12mann.html ("Almost 5 percent of mortgage loans are now in foreclosure, an increase of more than 85 percent since the beginning of 2008, and more than 10 percent of credit card accounts are delinquent.").

[14] Richard L. Ngo, *The Proper Valuation Date of Residential Property for a § 506(a) Lien Strip*, AM. BANKR. INST. J., July–Aug. 2010, at 14, 14 ("Prior to the foreclosure crisis, financing was, to put it lightly, easy to obtain. It was not uncommon for homeowners to mortgage their homes two, three, even four times in order to pull out all of their equity in the property.").

[15] *See* Nick Timiraos, *Linkage in Income, Home Prices Shifts*, WALL ST. J., Aug. 17, 2011, at A2, *available at* http://online.wsj.com/article/SB10001424053111904253204576512532609819142.html ("For the U.S. as a whole, home prices were around 2.9 times incomes from 1985 to 2000. But during the housing boom, values increased at a much faster rate than incomes. The price-to-income ratio peaked at around 5.1 in 2005.").

[16] Memorandum from Heather Boushey et al., Center for American Progress, New Census Data Reveals Decreased Income and Health Coverage 5 (Sept. 17, 2010), *available at* http://www.americanprogress.org/issues/2010/09/pdf/census_poverty_memo.pdf ("Family income has fallen by 5.3 percent since the [Great] [R]ecession began, compared to a 2 percent decline over the early 2000s recession and a 3.4 percent decline over the early 1990s recession.").

[17] *See* Mann, *supra* note 13, at A27.

[18] *Id.*

[19] *See infra* Part I.

[20] *See* Ngo, *supra* note 14, at 14.

[21] *Id.*

However, bankruptcy courts disagree on whether an adversary proceeding[22] is required to strip off a junior mortgage secured by a debtor's principal residence.[23] The majority of bankruptcy courts holds that a strip-off does not require an adversary proceeding.[24] These courts allow strip-off by a contested matter such as a Bankruptcy Rule[25] 3012 motion or the chapter 13 plan confirmation process.[26] Alternatively, the minority of bankruptcy courts holds the opposite view and requires an adversary proceeding pursuant to Rule 7001(2).[27] Some jurisdictions have even taken steps to avoid the issue altogether. The Eastern District of Michigan, for instance, enacted Guideline 12, which requires a debtor to initiate an adversary proceeding in some situations to strip off a junior mortgage.[28]

This Comment argues in favor of the position taken by a majority of bankruptcy courts that strip-off does not require an adversary proceeding. To strip off, a debtor must file a motion separate from the plan confirmation pursuant to Rule 3012.[29] The United States Supreme Court recently ruled on the issue of adversary proceeding requirements in bankruptcy.[30] In *United Student Aid Funds, Inc. v. Espinosa*, the Court decided two important issues applicable to whether strip-off requires an adversary proceeding: (1) the Supreme Court's decision in *Mullane v. Central Hanover Bank & Trust Co.*

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[22] *Collier on Bankruptcy* addresses adversary proceedings, explaining that:

> Adversary proceedings are separate lawsuits within the context of a particular bankruptcy case and have all of the attributes of a lawsuit, including the filing and service of a formal complaint and application, with certain modifications, of the Federal Rules of Civil Procedure, as provided in Part VII of the Bankruptcy Rules.

10 COLLIER ON BANKRUPTCY ¶ 7001.01 (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2011).

[23] David Lloyd & Ariane Holtschlag, *Chapter 13 Strip-Off of Junior Mortgages: Not Whether, but How Under Current Law*, AM. BANKR. INST. J., July–Aug. 2009, at 12, 68.

[24] *See, e.g.*, *In re* Robert, 313 B.R. 545, 549 (Bankr. N.D.N.Y. 2004); *In re* Millspaugh, 302 B.R. 90, 103 (Bankr. D. Idaho 2003).

[25] "Bankruptcy Rule" or "Rule" refers to the Federal Rules of Bankruptcy Procedure whereas "FRCP" refers to specific provisions of the Federal Rules of Civil Procedure.

[26] *In re Millspaugh*, 302 B.R. at 103 ("[A] chapter 13 debtor may, in his plan or in a separate (and usually preconfirmation) motion, seek to strip off a creditor's wholly unsecured lien through a valuation process under § 506(a) and Rules 3012 and 9014."); *see also In re* Sadala, 294 B.R. 180, 185 (Bankr. M.D. Fla. 2003).

[27] *See, e.g.*, Pierce v. Beneficial Mortg. Co. of Utah (*In re* Pierce), 282 B.R. 26, 28 (Bankr. D. Utah 2002) (stating that the plain language of Rule 7001(2) requires an adversary proceeding to achieve strip-off); *see also In re* Chukes, 305 B.R. 744, 744–45 (Bankr. D.D.C. 2004).

[28] E.D. MICH. LBR Guideline 12.

[29] *See In re* Bennett, 312 B.R. 843, 847–48 (Bankr. W.D. Ky. 2004) (holding that strip-off can be achieved through motion).

[30] United Student Aid Funds, Inc. v. Espinosa, 130 S. Ct. 1367 (2010).

sets the constitutional requirement for due process in bankruptcy;[31] and (2) res judicata[32] can bar the appeal of a confirmed plan even though an adversary proceeding was not initiated as required by the Bankruptcy Rules.[33] The Supreme Court's decision in *Espinosa* reinforces this Comment's interpretation that a motion is required for a strip-off.[34]

The significance of this procedural issue in a strip-off cannot be overemphasized given the current economic climate.[35] The inefficiency of the bankruptcy process has made it difficult for debtors to utilize bankruptcy to protect their homes from foreclosure.[36] It is imperative that the bankruptcy procedure is streamlined and that debtors understand the correct procedure to strip off a junior mortgage. If the incorrect procedure is used, the creditor whose lien was stripped off could contest the strip-off after the court has confirmed the plan.[37] An erroneous strip-off thus puts the debtor's chapter 13 payment plan in jeopardy. If the court finds that improper notice was given to the creditor because an adversary procedure *is* required, a court could then find that the lien was never actually stripped off.[38] Instead of the debtor's lien being discharged, the debtor's obligation would have increased.[39] Debtors who do not follow the correct procedure for a strip-off could lose their homes despite making all the plan payments and receiving discharge.

There are several reasons not to require an adversary proceeding to strip off a junior mortgage. Adversary proceedings require additional attorney and

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[31] The Supreme Court prior to *Espinosa* had not addressed the constitutional standard for due process in bankruptcy, causing confusion among the lower courts. *See In re* Forrest, 424 B.R. 831, 834–35 (Bankr. N.D. Ill. 2009) (requiring a higher burden to meet constitutional due process when the Bankruptcy Code and Rules mandate more formal procedures), *overruled by Espinosa*, 130 S. Ct. 1367; *see also* David Gray Carlson, *The Federal Rules of Bankruptcy Procedure in Reorganization Cases: Do They Have a Constitutional Dimension?*, 84 AM. BANKR. L.J. 251, 294 (2010) ("[*Espinosa*] clearly overrules *City of New York v. New York, New Haven & Hartford R.R*[.], which may have held that the procedural rules of bankruptcy set the constitutional minimum for due process . . . [and] indicates that *Mullane v. Central Hanover Bank & Trust Co*. sets the minimum." (footnotes omitted)).

[32] Res judicata means the matter cannot be raised again, either in the same court or in a different court. A court will use res judicata to deny reconsideration of a matter. *See* BLACK'S LAW DICTIONARY, *supra* note 3, at 1425.

[33] *Espinosa*, 130 S. Ct. at 1378, 1380; Carlson, *supra* note 31, at 266.

[34] *See infra* Part III.A.

[35] *See* Mann, *supra* note 13, at A27 ("Almost 5 percent of mortgage loans [were] in foreclosure [in early 2010], an increase of more than 85 percent since the beginning of 2008, and more than 10 percent of credit card accounts [were] delinquent.").

[36] *Id.* ("[O]ur bankruptcy system is too difficult and expensive for the people who use it.").

[37] *See* Abood-Carroll, *supra* note 4, at 14.

[38] *Id.*

[39] *Id.*

filing fees.[40] Furthermore, adversary proceedings delay the confirmation process because the court cannot confirm a plan before it decides whether to strip off the lien.[41] The plan repayment period does not begin until confirmation; however, the Bankruptcy Code requires debtors to begin making plan payments thirty days after the plan is filed.[42] Delays therefore can be harmful to debtors.[43]

This Comment is organized into five parts. Part I provides the relevant background to the strip-off process and its related statutory provisions. It explains how, through the use of a hypothetical situation, a debtor can strip off a lien using §§ 506(a), 506(d), and 1322(b)(2).[44] Part I also includes an analysis of two Supreme Court opinions discussing lien stripping: *Dewsnup v. Timm*[45] and *Nobelman v. American Savings Bank*.[46] Finally, Part I outlines Rules 3012 and 7001, which are at the heart of the disagreement over the correct procedure to strip off.

Part II explains the opposing views of the majority and minority of bankruptcy courts. It lays out the minority approach requiring an adversary proceeding pursuant to Rule 7001 and includes an analysis of the majority's reasoning in the bankruptcy court opinion in *In re King*.[47] It also argues that notice through a motion pursuant to Rule 3012 is a necessary procedure to strip off.[48]

Part III argues in favor of the majority approach, analyzing *United Student Aid Funds v. Espinosa*[49] and focusing on the case's precedential impact on the procedure for strip-off.

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[40] 28 U.S.C. § 1914 (2006) (amended 2011) ("The clerk of each district court shall require the parties instituting any civil action, suit[,] or proceeding . . . to pay a filing fee of $350 . . . ."); *id.* § 1930(a) (amended 2011) ("The Judicial Conference of the United States may prescribe additional fees in cases under title 11 of the same kind as the Judicial Conference prescribes under section 1914(b) of this title."); *accord* Abood-Carroll, *supra* note 4, at 14 ("Some attorneys would say that adversaries require additional expenses such as filing fees and attorney fees.").

[41] *See infra* Part V.A; *see also* Abood-Carroll, *supra* note 4, at 14.

[42] Abood-Carroll, *supra* note 4, at 14.

[43] *Id.*

[44] 11 U.S.C. §§ 506(a), (d), 1322(b)(2). Each "§" designation refers to a provision of the Bankruptcy Code unless otherwise provided.

[45] Dewsnup v. Timm, 502 U.S. 410 (1992).

[46] Nobelman v. Am. Sav. Bank, 508 U.S. 324 (1993).

[47] *In re* King, 290 B.R. 641 (Bankr. C.D. Ill. 2003).

[48] *Infra* Part II.C.2.

[49] United Student Aid Funds, Inc. v. Espinosa, 130 S. Ct. 1367 (2010).

Part IV presents the variety of canons of statutory construction used by courts.[50] It argues that applying these principles demonstrates that Rule 3012 applies to strip-off. Additionally, it explains that the advisory committee's intent indicates that Congress intended to apply Rule 3012 to strip-off.

Finally, Part V provides policy considerations suggesting that strip-off should not require an adversary proceeding. It highlights the additional cost and time associated with adversary proceedings. Part V also proposes that an adversary proceeding requirement would give too much leverage to creditors. Another argument expounded in Part V is that the additional notice afforded by an adversary proceeding may be unnecessary. Part V contends that a Rule 3012 motion is sufficient to give the creditor actual notice of strip-off. Finally, Part V asserts that an adversary proceeding does not furnish any necessary procedural protections not granted by a motion.

I. BACKGROUND

A. Henry Homeowner Hypothetical

Consider the following hypothetical: Henry Homeowner wanted to buy a home in Tucson, Arizona, to use as his principal residence. He procured a mortgage with State Secured Bank for $450,000, which was the market value of the home at that time. After several years had passed, Henry began looking for money to invest in the stock market. His home had increased in value substantially so that the market value of the home reached $750,000. To extract the equity from his home, he took out a second mortgage from Joey's Junior Bank for $300,000. Several years later, the housing market crashed, and Henry was in serious financial trouble. He lost all the money he had invested in the stock market, and to make matters worse, he lost his job. Henry found a new job, but the pay was significantly less. He could no longer afford to pay his debts. He subsequently filed for chapter 13 bankruptcy protection.

During bankruptcy proceedings, Henry petitions the court to value his home at the current fair market value of $300,000. Pursuant to § 506(a), Henry still owes Secured Bank $350,000, and he also owes Junior Bank $250,000.[51] Henry's attorney tells him that, because of the interplay between §§ 506(a),

[50] For an example of how courts apply these canons of statutory construction, see Robinson v. Shell Oil Co., 519 U.S. 337, 340, 346 (1997) (construing Title VII of the Civil Rights Act of 1964).

[51] Henry paid $100,000 of the principal on the Secured Bank mortgage, and he paid $50,000 of the principal on the Junior Bank mortgage.

506(d), and 1322(b)(2), he can strip off the wholly unsecured second mortgage from Junior Bank.[52] A strip-off would completely eliminate Junior Bank's lien.[53] Henry's attorney is pleased that he can help his client remove the Junior Bank lien; however, he is unsure of the correct procedure to achieve this result.

B. Relevant Bankruptcy Statutes

To understand the proper procedure for the strip-off of a wholly unsecured junior mortgage, it is important to understand how the relationship among §§ 506(a), 506(d), and 1322(b)(2) create the opportunity for strip-off. Section 506(a) describes the "valuation requirement" for secured claims and the extent to which a claim is deemed secured.[54] Section 506(a) requires: (1) a lien or right to setoff;[55] (2) an allowed claim;[56] and (3) a creditor.[57] If these three requirements are met, § 506(a) requires a determination of the collateral's value.[58] Section 506(a) valuation is important because it requires the bifurcation of a creditor's secured claim into secured and unsecured portions if the collateral is worth less than the creditor's claim.[59] An allowed secured claim is limited to the collateral's value.[60] Any portion of the claim that exceeds the collateral's value is deemed unsecured.[61] In the Henry Homeowner hypothetical, the creditor, Junior Bank, has an allowed junior claim of $300,000. The collateral has no value to secure this claim; therefore, it becomes an unsecured claim under § 506(a).[62]

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[52] *See* Domestic Bank v. Mann (*In re* Mann), 249 B.R. 831, 836 (B.A.P. 1st Cir. 2000) ("[I]f the property is valued at one penny greater than the claim of the senior mortgagee, the junior mortgagee's claim would receive full protection. However, if the property is valued at one penny less than the claim of the senior mortgagee, the junior mortgagee would be left completely unprotected." (quoting *In re* Perry, 235 B.R. 603, 607 (Bankr. S.D. Tex. 1999), *overruled by* Bartee v. Tara Colony Homeowners Ass'n (*In re* Bartee), 212 F.3d 277 (5th Cir. 2000)) (internal quotation marks omitted)).

[53] DRAKE ET AL., *supra* note 2, § 9C:40.

[54] 4 COLLIER, *supra* note 22, ¶ 506.03; *accord* Assocs. Commercial Corp. v. Rash, 520 U.S. 953, 961 (1997).

[55] The central premise of setoff is that "[i]f A is indebted to B, and B is likewise indebted to A, it makes sense simply to apply one debt in satisfaction of the other rather than require A and B to satisfy their mutual liabilities separately." 5 COLLIER, *supra* note 22, ¶ 553.01.

[56] An allowed claim is a claim that is deemed "valid under applicable nonbankruptcy law and not invalid under some provision of the Code." *Id.* ¶ 506.03.

[57] 11 U.S.C. § 506(a)(1) (2006).

[58] 4 COLLIER, *supra* note 22, ¶ 506.03[6].

[59] *Id.* ¶ 506.03[4].

[60] McDonald v. Master Fin., Inc. (*In re* McDonald), 205 F.3d 606, 609 (3d Cir. 2000).

[61] *Id.*

[62] *See* 11 U.S.C. § 506(a).

Section 506(a) deems Junior Bank's claim wholly unsecured; however, courts disagree about whether a debtor can avoid the claim using § 506(d).[63] Section 506(d) dictates the avoidance of liens secured by claims disallowed by the Code.[64] Section 506(d) provides that if a secured claim against a debtor is not an allowed secured claim, then that claim is avoided.[65] The debtor's ability to use § 506(d) to avoid a wholly unsecured junior mortgage has caused much dispute amongst the courts.[66] Several courts have held that strip-off requires the use of § 506(d) to avoid a wholly unsecured mortgage.[67] Other courts have held that various Code provisions, other than § 506(d), could be used to avoid a junior mortgage.[68] Regardless of the Code provisions used, every circuit court that has considered the issue has held that a debtor can avoid a wholly unsecured junior mortgage.[69]

Section 1322(b)(2) does not prohibit the modification of Junior Bank's lien because it is secured by Henry's principal residence.[70] Section 1322(b)(2) addresses the extent to which a plan may modify the rights of secured claim holders.[71] Section 1332(b)(2) is the "anti-modification provision"[72] and permits a chapter 13 debtor's plan to "modify the rights of holders of secured claims,

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[63] *Compare In re* Robert, 313 B.R. 545, 549–50 (Bankr. N.D.N.Y. 2004) ("If the court values the security interest at zero [under § 506(a)], the lien shall be stripped off upon completion of the Chapter 13 plan and issuance of discharge pursuant to Code § 506(d) without further litigation."), *with In re* Hill, 440 B.R. 176, 181 (Bankr. S.D. Cal. 2010) ("Since § 506(d) does not permit lien strips in Chapter 7 cases, the Bankruptcy Code operates to prevent it from being the statutory basis for lien strips in [Chapter 13] cases as well.").

[64] 4 COLLIER, *supra* note 22, ¶ 506.01; *see also* 11 U.S.C. § 506(d); Dewsnup v. Timm, 502 U.S. 410, 415–16 (1992) (discussing the application of § 506(d)).

[65] 11 U.S.C. § 506(d) (authorizing the avoidance of a lien by a debtor if that lien is not an allowed secured claim and does not fall into one of two exceptions).

[66] 4 COLLIER, *supra* note 22, ¶ 506.06[1].

[67] *See, e.g.*, *In re* Robert, 313 B.R. at 549–50; *In re* Sadala, 294 B.R. 180, 183 (Bankr. M.D. Fla. 2003); *In re* King, 290 B.R. 641, 648 (Bankr. C.D. Ill. 2003) ("Where the result of that claim determination process is that the creditor's claim is determined to be wholly unsecured, the creditor's lien is 'void' [pursuant to § 506(d)].").

[68] *See, e.g.*, Pees v. DAN Joint Venture II (*In re* Claar), 368 B.R. 670, 677–78 (Bankr. S.D. Ohio 2007) (reasoning that the discharge of the wholly unsecured lien could be achieved through the "combined operative effect of §§ 506(a) . . . , 1322(b)(2) . . . , 1325(a)(5) . . . , and 1327(b) and (c)"); *In re* Hill, 304 B.R. 800, 803–04 (Bankr. S.D. Ohio 2003).

[69] Lloyd & Holtschlag, *supra* note 23, at 12; *see also* Zimmer v. PSB Lending Corp. (*In re* Zimmer), 313 F.3d 1220, 1227 (9th Cir. 2002); Lane v. W. Interstate Bancorp (*In re* Lane), 280 F.3d 663, 668–69 (6th Cir. 2002); Pond v. Farm Specialist Realty (*In re* Pond), 252 F.3d 122, 126–27 (2d Cir. 2001); McDonald v. Master Fin., Inc. (*In re* McDonald), 205 F.3d 606, 615 (3d Cir. 2000); Tanner v. FirstPlus Fin., Inc. (*In re* Tanner), 217 F.3d 1357, 1360 (11th Cir. 2000); Bartee v. Tara Colony Homeowners Ass'n (*In re* Bartee), 212 F.3d 277, 288 (5th Cir. 2000).

[70] *See, e.g.*, *In re Lane*, 280 F.3d at 669.

[71] 11 U.S.C. § 1322(b)(2) (2006) (emphasis added).

[72] Padilla v. Wells Fargo Home Mortg., Inc. (*In re* Padilla), 379 B.R. 643, 661 (Bankr. S.D. Tex. 2007).

other than a claim secured only by a security interest in real property that is the debtor's principal residence."[73] Thus, if a court determines that a creditor holds a secured claim under § 506(a), the debtor "may modify terms such as the amount of the payments on the claim, the timing of payments[,] and the finance charges, unless that creditor holds a mortgage protected from modification."[74] Courts have wrestled with the nuances of when to apply the anti-modification provision, which disallows bifurcation under § 506(a).

C. Supreme Court Precedent

The Supreme Court's decision in *Nobelman v. American Savings Bank*[75] answered the question of whether splitting an undersecured[76] home mortgage claim into secured and unsecured portions under § 506(a) constitutes an impermissible § 1322(b)(2) modification.[77] One year before its decision in *Nobelman*, the Supreme Court decided *Dewsnup v. Timm*.[78] The Court in *Dewsnup* held that a chapter 7 debtor could not strip down[79] the unsecured portion of an undersecured mortgage.[80] The interpretation of this decision created a split among the circuit courts. One side held that § 1322(b)(2) prohibits bifurcation of home mortgages in chapter 13 cases, and the other side found such bifurcations permissible.[81]

The Supreme Court resolved the circuit split in *Nobelman*.[82] The Court unanimously held that § 1322(b)(2) prohibited the plan from modifying the state law rights of a lienholder whose lien is secured by the debtor's principal residence.[83] The decision did not rely heavily on *Dewsnup* but instead focused

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[73] 11 U.S.C. § 1322(b)(2) (emphasis added).

[74] 8 COLLIER, *supra* note 22, ¶ 1322.06[1].

[75] Nobelman v. Am. Sav. Bank, 508 U.S. 324 (1993).

[76] An undersecured mortgage is a claim that is "greater than the value of the encumbered property." DRAKE ET AL., *supra* note 2, § 9C:5.

[77] Bartee v. Tara Colony Homeowners Ass'n (*In re* Bartee) 212 F.3d 277, 290 (5th Cir. 2000) (citing *Nobelman*, 508 U.S. at 328–29).

[78] Dewsnup v. Timm, 502 U.S. 410 (1992).

[79] Strip-down is the "[r]eduction of the lien to the value of the encumbered property." DRAKE ET AL., *supra* note 2, § 9C:5.

[80] *Dewsnup*, 502 U.S. at 417; *see also* 7 WILLIAM L. NORTON, JR. & WILLIAM L. NORTON III, NORTON BANKRUPTCY LAW AND PRACTICE 3D § 149:7, at 149-51 (2008).

[81] *Compare* Nobleman v. Am. Sav. Bank (*In re* Nobleman), 968 F.2d 483, 487–89 (5th Cir. 1992), *aff'd*, 508 U.S. 324 (1993) (prohibiting strip-down), *with* Bellamy v. Fed. Home Loan Mortg. Corp. (*In re* Bellamy), 962 F.2d 176, 182–83 (2d Cir. 1992) (allowing strip-down), *overruled by Nobelman*, 508 U.S. 324.

[82] *Nobelman*, 508 U.S. at 325–26.

[83] *See id.* at 325, 332; 8 COLLIER, *supra* note 22, ¶ 1322.06[1][a][i].

on the phrase "rights of holders" in § 1322(b)(2).[84] The rights protected from modification are defined as property rights and contract rights "created and defined by state law."[85] Because the creditors' contractual rights to full payment would be modified, the Court concluded that it was "more reasonable" to bar the modification of an undersecured claim.[86] The Court held that a plan providing for no payments on the unsecured portion of the lien could not be confirmed.[87] Therefore, in the hypothetical described above, it would not be permissible for the bankruptcy court to allow Henry to avoid the undersecured portion of Secured Bank's first mortgage by stripping down Secured Bank's lien from $350,000 to $300,000.

The *Nobelman* Court did not entirely preclude the use of § 506 bifurcation in chapter 13 cases as it did chapter 7 cases after *Dewsnup*.[88] The *Nobelman* opinion strongly implied that a wholly unsecured lien could be stripped off.[89] The Court emphasized the fact that the creditor was "still the 'holder' of a 'secured claim,' because petitioner's home retain[ed] $23,500 of value as collateral."[90] If a creditor holds a lien secured by no value, then the creditor does not hold a secured claim protected by § 1322(b)(2).[91] After the *Nobelman* decision, each circuit court to consider the issue has sustained the strip-off of wholly unsecured junior mortgages.[92] In the Henry hypothetical, Junior Bank is not a "holder of a secured claim" because Junior Bank's lien has no value.[93]

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[84] *Nobelman*, 508 U.S. at 329–30.

[85] *Id.* at 329 (quoting Butner v. U.S., 440 U.S. 48, 55 (1979)). The *Nobelman* Court stated:

> The bank's "rights," therefore, are reflected in the relevant mortgage instruments . . . . They include the right to repayment of the principal in monthly installments over a fixed term at specified adjustable rates of interest, the right to retain the lien until the debt is paid off, the right to accelerate the loan upon default and to proceed against petitioners' residence by foreclosure and public sale, and the right to bring an action to recover any deficiency remaining after foreclosure. These are the rights that were "bargained for by the mortgagor and the mortgagee," and are rights protected from modification by § 1322(b)(2).

Id. at 329–30 (citations omitted) (quoting *Dewsnup*, 502 U.S. at 417).

[86] 8 COLLIER, *supra* note 22, ¶ 1322.06[1][a][i]; *see also Nobelman*, 508 U.S. at 331–32.

[87] *See Nobelman*, 508 U.S. at 326–32.

[88] *See* 7 NORTON, *supra* note 80, § 149:7, at 149-53.

[89] 8 COLLIER, *supra* note 22, ¶ 1322.06[1][a][i] (interpreting *Nobelman*, 508 U.S. 324).

[90] *See Nobelman*, 508 U.S. at 329, *quoted in* 8 COLLIER, *supra* note 22, ¶ 1322.06[1][a][i] (alteration in original).

[91] 8 COLLIER, *supra* note 22, ¶ 1322.06[1][a][i].

[92] Lloyd & Holtschlag, *supra* note 23, at 12 & n.10 (listing the circuit court opinions upholding the majority view).

[93] *See* 11 U.S.C. §§ 506(a), 1322(b)(2) (2006).

Therefore, under the *Nobelman* framework, Henry would be able to strip off the wholly unsecured lien held by Junior Bank.

D. Relevant Federal Rules of Bankruptcy Procedure

Henry can strip off Junior Bank's mortgage; however, his attorney still does not know the proper procedure to achieve strip-off. The Federal Rules of Bankruptcy Procedure, the bankruptcy counterpart to the Federal Rules of Civil Procedure, apply to every case under title 11 in both bankruptcy courts and federal district courts.[94] Whether strip-off requires an adversary proceeding rests on whether Bankruptcy Rule 3012 or 7001 applies.[95] Parties use Rule 3012 in conjunction with § 506 of the Code.[96] Under Rule 3012, the bankruptcy court may determine the value of the secured claim upon motion of any party in interest.[97] Rule 3012 also provides that notice must be given "to the holder of the secured claim and any other entity as the court may direct."[98] The majority of courts holds that strip-off is a valuation issue under § 506, and therefore Rule 3012 applies.[99]

The minority of courts takes the opposing view, holding that Rule 7001 applies.[100] Bankruptcy Rule 7001 classifies adversary proceedings into ten categories, and each category of proceeding is addressed in a different clause.[101] The disagreement among bankruptcy courts over the application of Rule 7001 to strip-off has focused on Clause 2 of Rule 7001.[102] Clause 2 requires an adversary proceeding where the court must "determine the validity, priority, or extent of a lien or other interest in property."[103] The term "validity" is defined as "the existence or legitimacy of the lien itself."[104] "Priority" is "the

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94 FED. R. BANKR. P. 1001; Owens-Ill., Inc. v. Rapid Am. Corp. (*In re* Celotex Corp.), 124 F.3d 619, 629–30 (4th Cir. 1997).

95 *Compare In re* King, 290 B.R. 641, 646–48 (Bankr. C.D. Ill. 2003) (applying Rule 3012 to strip-off), *with In re* Chukes, 305 B.R. 744, 744–45 (Bankr. D.D.C. 2004) (applying Rule 7001 to strip-off).

96 *See* FED. R. BANKR. P. 3012 advisory committee's notes; *see also* 9 COLLIER, *supra* note 22, ¶ 3012.01 (suggesting Bankruptcy Rule 3012 is broader than its antecedents under prior law).

97 FED. R. BANKR. P. 3012.

98 *Id.*

99 *See, e.g.*, *In re King*, 290 B.R. at 646, 648.

100 *See, e.g.*, Pierce v. Beneficial Mortg. Co. of Utah (*In re* Pierce), 282 B.R. 26, 28 (Bankr. D. Utah 2002).

101 Douglas G. Baird & Edward R. Morrison, *Adversary Proceedings in Bankruptcy: A Sideshow*, 79 AM. BANKR. L.J. 951, 954 (2005); *see also* FED. R. BANKR. P. 7001.

102 *See In re* Millspaugh, 302 B.R. 90, 96–97 (Bankr. D. Idaho 2003) (listing cases that have considered whether Rule 7001 applies to strip-off).

103 FED. R. BANKR. P. 7001(2).

104 *In re King*, 290 B.R. at 646.

rank held by the mortgage in relation to other claims attached to the same property."[105] Some courts in the minority view strip-off as changing the priority of the lien and therefore falling under Rule 7001(2).[106]

The third term, "extent of a lien," creates another point of disagreement regarding whether Bankruptcy Rule 7001 applies to strip-off.[107] Courts and commentators have inferred at least two meanings from the term "extent of a lien" in the context of Rule 7001[108]: one is the "scope of the property encompassed by or subject to the lien";[109] another is the "value of the property subject to the lien."[110] The different interpretations of Bankruptcy Rules 7001 and 3012 have created a split among bankruptcy courts.[111]

II. JUDICIAL CONFUSION CONCERNING THE PROCEDURE REQUIRED TO STRIP OFF A LIEN

There is no consensus on whether Rule 3012 or Rule 7001 applies to strip-off.[112] The bankruptcy court split indicates uncertainty surrounding whether Congress intended to require an adversary proceeding to strip off a wholly unsecured junior mortgage. However, in light of the reasoning of the majority of courts and the Supreme Court's decision in *Espinosa*,[113] Rule 3012 should apply to strip-off, and an adversary proceeding under Rule 7001 is unnecessary.

The Bankruptcy Rules provide for the resolution of disputes in two ways: contested matters and adversary proceedings.[114] The Bankruptcy Rules make this distinction because certain matters warrant greater protection, which is provided by an adversary proceeding, than would be provided in contested matters via a motion or hearing.[115] In practice, the differences between

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105 *In re* Sadala, 294 B.R. 180, 183 (Bankr. M.D. Fla. 2003).

106 *In re* Chukes, 305 B.R. 744, 744–45 (Bankr. D.D.C. 2004).

107 *See In re Millspaugh*, 302 B.R. at 96–97; 10 COLLIER, *supra* note 22, ¶ 7001.03[1].

108 10 COLLIER, *supra* note 22, ¶ 7001.03[1]; *see also In re King*, 290 B.R. at 648 (defining "extent" as "the scope of the property encompassed by or subject to the lien").

109 *See In re King*, 290 B.R. at 648 (citing *In re* Beard, 112 B.R. 951, 955 (Bankr. N.D. Ind. 1990)).

110 10 COLLIER, *supra* note 22, ¶ 7001.03[1] (considering and rejecting this interpretation).

111 *Compare In re King*, 290 B.R. at 646–48 (holding that Rule 3012 applies to strip-off), *with In re Chukes*, 305 B.R. at 744–45 (holding that Rule 7001 applies to strip-off).

112 *See* Lloyd & Holtschlag, *supra* note 23, at 68.

113 United Student Aid Funds, Inc. v. Espinosa, 130 S. Ct. 1367, 1378–80 (2010).

114 *In re* Sadala, 294 B.R. 180, 182 (Bankr. M.D. Fla. 2003).

115 *Id.*

adversary proceedings and contested matters are unclear.[116] Understanding the correct procedure to strip off is important because if the procedure is faulty, the lien will remain on the property for the entire amount.[117]

A. Contested Matters and Adversary Proceedings

Contested matters are "part of the main bankruptcy proceeding and have fewer procedural protections than adversary proceedings"; parties are nonetheless constitutionally entitled to notice and an opportunity to be heard.[118] Contested matters require the debtor to provide the creditor with a motion or a copy of the plan.[119] Usually, the debtor is not obligated to pay a filing fee.[120] The responding party must file a response or objection to the motion or plan within a specific time period.[121] If a creditor files a response, the court will set an evidentiary hearing.[122] More commonly, the creditor will not file a response, thereby not disputing the request for relief.[123] The court will typically resolve the matter without any hearing.[124] Thus, while contested matters can produce trials, they provide constitutional due process cost-effectively by not always requiring them.[125]

Adversary proceedings are more formal than a contested matter.[126] An adversary proceeding takes place in the bankruptcy court, before the same judge, and as part of the original bankruptcy case.[127] There are significant filing fees required to file an adversary proceeding.[128] The debtor is required to serve a summons and complaint on the creditor.[129] The court can enter a

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116 *Id.*

117 *See In re* Bennett, 312 B.R. 843, 846 (Bankr. W.D. Ky. 2004).

118 Ill. Dep't of Revenue v. Ayre (*In re* Ayre), 360 B.R. 880, 885 (C.D. Ill. 2007). The creditor's opportunity to be heard is identical in a contested matter and an adversary proceeding. *See infra* Part V.C–E.

119 *See In re Sadala*, 294 B.R. at 182; *In re* King, 290 B.R. 641, 647 (Bankr. C.D. Ill. 2003) (noting that objections to plan confirmation are contested matters).

120 *In re Sadala*, 294 B.R. at 182.

121 Abood-Carroll, *supra* note 4, at 14 ("Debtors filing chapter 13 plans are required to mail notices to all parties-in-interest, giving them at least 25 days to file objections."); *see also* FED. R. BANKR. P. 2002(b)(2).

122 *In re Ayre*, 360 B.R. at 885.

123 *In re Sadala*, 294 B.R. at 182.

124 John Ayer et al., *An Overview of Bankruptcy Litigation*, AM. BANKR. INST. J., Feb. 2004, at 16, 16.

125 *See In re Sadala*, 294 B.R. at 182–83.

126 *Id.*

127 All core proceedings related to the bankruptcy take place in front of the same bankruptcy judge. 28 U.S.C. § 157(b)(1) (2006).

128 *In re Sadala*, 294 B.R. at 183; *see also* 28 U.S.C. § 1914(a) (amended 2011) (requiring $350 filing fee to initiate an adversary proceeding).

129 FED. R. BANKR. P. 7004; *In re Sadala*, 294 B.R. at 183.

judgment for relief against the creditor if the creditor does not respond to the complaint.[130] The adversary proceeding results in a judgment separate from the overall adjudication of the bankruptcy.[131] Generally, an adversary proceeding is more costly and time consuming than a contested matter; however, it does afford additional notice.[132]

B. Minority Approach: Debtors Are Required to File an Adversary Proceeding to Strip Off a Lien

The minority of bankruptcy courts holds that the Bankruptcy Rules require an adversary proceeding to strip off wholly unsecured junior mortgages.[133] They find that creditors should be afforded a high degree of notice, as in an adversary proceeding, because strip-off profoundly affects creditors' rights.[134] Most of the courts that follow the minority view believe that Rule 7001(2), which requires an adversary proceeding, applies to strip-off.[135] Other courts further conclude that constitutional due process requires compliance with the notice provisions in the Bankruptcy Rules.[136] The minority cites several different rationales for the adversary proceeding requirement,[137] and one jurisdiction has even amended their local rules to require a strip-off adversary proceeding.[138]

1. Bankruptcy Court Precedents

The courts that require an adversary proceeding have viewed strip-off as obligating a determination of a lien's priority, extent, or validity.[139] These bankruptcy courts in the minority tend to interpret the advisory committee's

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130 FED. R. BANKR. P. 7004(b).

131 *In re Sadala*, 294 B.R. at 183; *see also* John Silas, *Adversary Proceedings in Bankruptcy*, PRAC. LAW., Jan. 1993, at 55, 55.

132 *See In re Sadala*, 294 B.R. at 182–83 (An adversary proceeding provided additional notice because "the debtor must file and formally serve a complaint upon the creditor.").

133 *See, e.g.*, *In re* Forrest, 424 B.R. 831, 833–34 (Bankr. N.D. Ill. 2009); *In re* Chukes, 305 B.R. 744, 744–45 (Bankr. D.D.C. 2004).

134 *See In re Forrest*, 424 B.R. at 833, 835.

135 *See In re Chukes*, 305 B.R. at 744–45; Pierce v. Beneficial Mortg. Co. of Utah (*In re* Pierce), 282 B.R. 26, 28 (Bankr. D. Utah 2002).

136 *See, e.g.*, *In re Forrest*, 424 B.R. at 836.

137 *See In re Chukes*, 305 B.R. at 744–45; *In re Forrest*, 424 B.R. at 833–35.

138 E.D. MICH. LBR Guideline 12.

139 *In re Forrest*, 424 B.R. at 833 ("Valuations may be appropriate for adequate protection, impairment, or similar purposes, but when the existence of the lien itself is at issue, then the 'validity' and 'extent' of the lien are certainly at issue . . . ."); *In re Chukes*, 305 B.R. at 744 (lien stripping affects priority).

notes to Rule 3012 to apply Rule 7001 to strip-off.[140] The advisory committee's notes state that Rule 7001 applies when the "proceeding is relevant to the basis of the lien itself."[141] The court in *In re Chukes* determined that the phrase "relevant to the basis of the lien itself" refers to the priority of the lien.[142] Lien stripping affects the priority of the lien—the claim changes from secured to unsecured, not based solely on the value of the lien in question, but based rather on the lien's priority.[143] Therefore, the court reasoned that since Rule 7001(2) requires an adversary proceeding to determine the priority of the lien,[144] Rule 7001(2) applies to strip-off.[145] The court in *In re Enriquez* similarly held that an adversary proceeding, not a motion, is required to strip off but did so because it could not find any rule that explicitly permits using a motion to avoid a lien.[146] Regardless of their rationale, these courts ultimately view Rule 7001(2) as governing strip-offs.[147]

Other courts have expanded the Rule 7001(2) analysis by finding a constitutional dimension in the statutory requirements.[148] The court in *In re Forrest* held that strip-off requires an adversary proceeding because both Rule 7001(2) and the Constitution require it.[149] The *Forrest* court concluded that when the Bankruptcy Rules require an adversary proceeding, constitutional due process entitles the creditor to heightened notice through the filing of a summons and complaint.[150] To come to this holding, the *Forrest* court relied heavily on the Seventh Circuit's decision in *In re Hanson*, a student loan

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[140] *See, e.g.*, *In re Chukes*, 305 B.R. at 744 ("The Advisory Committee Note (1983) to Rule 3012 states that '[a]n adversary proceeding is commenced when the validity, priority, or extent of a lien is at issue as prescribed by Rule 7001,' and characterizes such matters as 'relevant to the basis of the lien itself' in contrast to valuation under Rule 3012." (alteration in original) (quoting FED. R. BANKR. P. 3012 advisory committee's notes)).

[141] FED. R. BANKR. P. 3012 advisory committee's notes.

[142] *Id.*, *construed in In re Chukes*, 305 B.R. at 744.

[143] *In re Chukes*, 305 B.R. at 744 ("[I]f the relief sought in the proceeding turns in part on the priority of the lien, the proceeding is an adversary proceeding by reason of Rule 7001(2), and it must be commenced by the filing of a complaint under Rule 7003, not a motion under Rule 3012.").

[144] FED. R. BANKR. P. 7001(2).

[145] *See In re Chukes*, 305 B.R. at 744–45.

[146] *In re* Enriquez, 244 B.R. 156, 158 (Bankr. S.D. Cal. 2000), *overruled on other grounds by* Zimmer v. PSB Lending Corp. (*In re* Zimmer), 313 F.3d 1220 (9th Cir. 2002).

[147] *See, e.g.*, Pierce v. Beneficial Mortg. Co. of Utah (*In re* Pierce), 282 B.R. 26, 28 (Bankr. D. Utah 2002) (stating that the plain language of Rule 7001(2) requires an adversary proceeding to achieve strip-off).

[148] *See In re* Forrest, 424 B.R. 831, 834–35 (Bankr. N.D. Ill. 2009).

[149] *Id.*

[150] *Id.* at 834.

case.[151] The Supreme Court's decision in *Espinosa* effectively overruled *Hanson*, holding that constitutional due process does not require strict compliance with the notice provisions in the Bankruptcy Rules.[152] This weakens the minority's argument that an adversary proceeding is required.[153]

2. Eastern District of Michigan Local Rules: Guideline 12

The United States Bankruptcy Court for the Eastern District of Michigan amended its local rules in 2009 to require adversary proceedings in certain circumstances to strip off liens.[154] The local rule is known as "Guideline 12," and it codifies additional procedures for strip-off.[155] Under the rule, if the debtor and creditor agree to the strip-off, they may file a stipulation and enter a proposed order, which will allow the parties to avoid an adversary proceeding.[156] If no agreement is reached, the debtor must instigate an adversary proceeding but is exempt from the adversary proceeding filing fee.[157] Guideline 12 demonstrates a compromise between two competing policies discussed above—the creditor's notice and the debtor's ability to easily strip off a lien—but does not solve all the problems that requiring an adversary proceeding creates. The additional time requirements and the increased leverage provided to creditors still pose policy problems.[158]

C. Majority Approach: Debtors Are Not Required to File an Adversary Proceeding to Strip Off a Lien

The majority of bankruptcy courts holds that an adversary proceeding is not required to strip off a wholly unsecured junior mortgage.[159] The majority justifies this holding by asserting that the plain meaning of Rule 7001(2) and the advisory committee's intent demonstrate that Rule 7001(2) does not apply

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151 *Id.* at 834–35 (citing *In re* Hanson, 397 F.3d 482, 486–87 (7th Cir. 2005), *overruled by* United Student Aid Funds, Inc. v. Espinosa, 130 S. Ct. 1367 (2010)).

152 *See Espinosa*, 130 S. Ct. at 1378; *see also In re* Ginther, 427 B.R. 450, 456–57 (Bankr. N.D. Ill. 2010) ("*Espinosa* clarified that the Bankruptcy Rules are procedural rules, and therefore overruled *In re Hanson*, which had held that constitutional due process required compliance with notice provisions in the Rules." (citations omitted)).

153 *Infra* Part III.A.

154 E.D. MICH. LBR Guideline 12.

155 *See id.*

156 *Id.*

157 *See id.*

158 *Infra* Part V.A–B.

159 *In re* Robert, 313 B.R. 545, 549 (Bankr. N.D.N.Y. 2004) (listing cases adopting the majority view).

to strip-off.[160] The majority additionally argues that the minority's interpretation of Rule 7001(2) is in conflict with Rule 3012.[161] Courts in this majority seem to agree that property valuation under Rule 3012 is the key to strip-off.[162] However, there is a divide within the majority: courts do not agree about which kind of contested matter is required.[163] One group allows strip-off by motion, while the other allows strip-off through the chapter 13 plan confirmation process.[164] A third group has allowed strip-off by either process.[165] For both statutory and policy reasons, this Comment takes the position that only a Rule 3012 motion is required to strip off a junior mortgage.[166]

1. The Majority Interpretation: An Adversary Proceeding Is Not Required

In re King illustrates the majority's position that a debtor is not required to file an adversary proceeding to strip off a wholly unsecured junior mortgage.[167] The debtors were a married couple who filed for bankruptcy under chapter 13.[168] The debtors' chapter 13 schedules stated that the value of their primary residence was $38,000.[169] They owed Key Bank $40,000 for their first mortgage and owed $48,000 to Bank One for their second mortgage.[170] The court mailed a § 341 meeting notice and a copy of the chapter 13 plan to Bank One.[171] The plan proposed to avoid Bank One's wholly unsecured second mortgage.[172] The § 341 notice stated that "[a]ny party objecting to confirmation must appear at the confirmation hearing to have their objection considered."[173]

Bank One neither appeared at the § 341 meeting nor objected to the debtors' plan, which the court subsequently confirmed.[174] Three months after

160 *See In re* King, 290 B.R. 641, 648 (Bankr. C.D. Ill. 2003).
161 *In re* Hoskins, 262 B.R. 693, 696–97 (Bankr. E.D. Mich. 2001).
162 *See In re* Bennett, 312 B.R. 843, 847–48 (Bankr. W.D. Ky. 2004).
163 *See* Lloyd & Holtschlag, *supra* note 23, at 68.
164 *Id.*
165 *In re* Millspaugh, 302 B.R. 90, 98 (Bankr. D. Idaho 2003).
166 *Infra* Parts IV, V.
167 *See In re* King, 290 B.R. 641, 647–48 (Bankr. C.D. Ill. 2003).
168 *Id.* at 643.
169 *Id.* at 644.
170 *Id.*
171 *Id.*; *see also* 11 U.S.C. § 341(a) (2006) ("Within a reasonable time after the order for relief in a case under this title, the United States trustee shall convene and preside at a meeting of creditors.").
172 *In re King*, 290 B.R. at 644.
173 *Id.*
174 *Id.*

the plan's confirmation, Bank One objected, arguing that, procedurally, the confirmation of the plan was inadequate to strip off a wholly unsecured junior mortgage.[175] Bank One argued that Rule 7001(2) requires an adversary proceeding to strip off, even while acknowledging that "the issue turns primarily on the value of the real estate."[176] The court found that the scope of Rule 7001(2) does not include valuation.[177] Rule 7001(2) only requires an adversary proceeding "to determine the validity, priority, or extent of a lien."[178]

The court reasoned that the debtors' avoidance of Bank One's lien was based on the valuation process of § 506(a), which is "required to be made in conjunction with the hearing 'on a plan affecting such creditor's interest.'"[179] The value of the secured property establishes the claim's secured status.[180] If the § 506(a) valuation process determines that the lien is wholly unsecured, § 506(d) voids the lien.[181] The court held that Rule 3012 only requires a contested matter to strip off a junior mortgage.[182]

The majority raises another point to support its view that Rule 7001 does not apply to strip-offs. Courts in the minority argue that strip-off proceedings are to determine the "validity priority, or extent" of the lien pursuant to Rule 7001(2).[183] The majority asserts, however, that the advisory committee's notes to Rule 3012 disclaimed this interpretation.[184] The notes state:

> An adversary proceeding is commenced when the validity, priority, or extent of a lien is at issue as prescribed by Rule 7001. *That*

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175 *Id.* at 645. Bank One made three additional arguments for why the debtor's liens should not be stripped off: (1) it did not receive adequate notice because the debtors did not use the correct address; (2) the Supreme Court in *Nobelman* disallowed strip-off of even wholly unsecured mortgages; and (3) the debtors acted in bad faith by filing a chapter 13 plan almost two months after receiving a chapter 7 discharge. The court rejected all of these arguments and denied Bank One's motion. *Id.* at 645–46, 648–51.

176 *Id.* at 647–48.

177 *Id.* at 648.

178 FED. R. BANKR. P. 7001(2); *In re King*, 290 B.R. at 648 ("[T]he term 'validity' means the existence or legitimacy of the lien itself, 'priority' means the lien's relationship to other claims to or interests in the collateral, and 'extent' means the scope of the property encompassed by or subject to the lien." (citing *In re* Beard, 112 B.R. 951, 955 (Bankr. N.D. Ind. 1990))).

179 *In re King*, 290 B.R. at 648 (quoting 11 U.S.C. § 506(a)(1) (2006)).

180 *Id.*

181 *Id.* (citing 11 U.S.C. § 506(d)).

182 *Id.*

183 *See, e.g.*, *In re* Chukes, 305 B.R. 744, 744 (Bankr. D.D.C. 2004); Pierce v. Beneficial Mortg. Co. of Utah (*In re* Pierce), 282 B.R. 26, 28 (Bankr. D. Utah 2002).

184 *In re* Robert, 313 B.R. 545, 549–50 (Bankr. N.D.N.Y. 2004); *In re* Sadala, 294 B.R. 180, 182–83 (Bankr. M.D. Fla. 2003).

> *proceeding is relevant to the basis of the lien itself* while valuation under Rule 3012 would be for the purposes indicated above [e.g., to determine the issue of adequate protection, impairment, or treatment of the claim in a plan.][185]

The advisory committee's notes declare that an adversary proceeding is only required when the "basis of the lien itself" is in dispute.[186] In the view of the majority courts, since strip-off does not examine the lien's "existence or legitimacy," the lien's "superiority in rank or position," or "the [specific] property encompassed by or subject to the lien" but rather looks at "the extent to which the claims of the mortgagee are secured," valuing and avoiding a wholly unsecured lien does not require an adversary proceeding.[187] Therefore, Rule 7001(2) most likely does not apply to strip-off.

2. Whether a Debtor Can Strip Off a Lien Using a Chapter 13 Plan or Motion

Courts adopting the majority approach agree that strip-off does not require an adversary proceeding.[188] However, these bankruptcy courts differ in their determination of the best method to achieve strip-off—through a plan confirmation process, through a motion, or through either.[189] Those courts allowing strip-off through plan confirmation rely on § 1327(c) to discharge the wholly unsecured lien, whereas the courts allowing strip-off by a Rule 3012 motion rely primarily on § 506(d).[190]

Courts allowing strip-off through the plan confirmation process do not require a Rule 3012 motion.[191] These courts reason that the discharge of the wholly unsecured lien can be achieved through the "combined operation of §§ 506(a), 1322(b)(2), 1325(a)(5), 1327(b) and (c)."[192] The courts explain that strip-off in chapter 13 cases can be achieved through "valuation under § 506(a), modification under § 1322(b)(2), lien retention under § 1325(a)(5)[,]

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185 *In re Robert*, 313 B.R. at 549 (alteration in original) (quoting FED. R. BANKR. P. 3012 advisory committee's notes).

186 FED. R. BANKR. P. 3012 advisory committee's notes; *see also In re Robert*, 313 B.R. at 549–50.

187 *See, e.g.*, *In re Robert*, 313 B.R. at 549–50.

188 Lloyd & Holtschlag, *supra* note 23, at 68.

189 *Id.*

190 *Id.*

191 *See* Pees v. DAN Joint Venture II (*In re* Claar), 368 B.R. 670, 677–78 (Bankr. S.D. Ohio 2007); *In re* Hill, 304 B.R. 800, 803–04 (Bankr. S.D. Ohio 2003).

192 *In re Claar*, 368 B.R. at 677–78.

and vesting free and clear under § 1327(b) and (c)."[193] However, this argument is unpersuasive because regardless of the provision used to discharge the lien, § 506(a) requires a valuation to determine if the junior lien is wholly unsecured.[194] Because Rule 3012 requires a motion to "determine the value of a claim secured by a lien,"[195] a Rule 3012 motion is at some point required to strip off the lien.

Other courts have treated the plan itself as a de facto motion, thus finding Rule 3012 satisfied by the plan rather than requiring a separate motion.[196] The court in *In re Hoskins* held that there is "no rationale why a separate piece of paper is required if the plan itself contains sufficient information to alert [the creditor] that [the creditor's] claim is in some jeopardy."[197] The court reasoned that a "conventional" motion served the same function as the plan in the adjudication of disputes.[198] Therefore, because the plan is essentially a motion, the Rule 3012 motion requirement is satisfied.[199] The court in *In re Fuller* followed the same reasoning and held that a plan can serve the same purpose as a motion.[200] A plan contains several requests for relief, which are adjudicated through confirmation.[201]

The reasoning of a motion-by-confirmation as illustrated in *Hoskins* is faulty. Courts that allow strip-off through the plan argue that Rule 7001(2)'s adversary proceeding requirement does not apply because Rule 7001(2), broadly construed, would conflict with Rule 3012.[202] It is illogical for courts to claim that Rule 7001(2) does not apply to strip-off because it conflicts with Rule 3012 and then conclude that Rule 3012 does not apply either.[203] The text

193 *Id.* at 678; *see also In re Hill*, 304 B.R. at 803–04 (coming to a similar conclusion, though placing much of the emphasis on § 1327(c) plan confirmation).

194 *See In re Claar*, 368 B.R. at 677–78; *In re Hill*, 304 B.R. at 803–04.

195 FED. R. BANKR. P. 3012.

196 *In re* Bennett, 312 B.R. 843, 846 (Bankr. W.D. Ky. 2004) (listing courts adopting the motion-by-confirmation theory); *see also In re* Hoskins, 262 B.R. 693, 697 (Bankr. E.D. Mich. 2001); *In re* Fuller, 255 B.R. 300, 306 (Bankr. W.D. Mich. 2000).

197 *In re Hoskins*, 262 B.R. at 697.

198 *Id.* at 697–98; *see also* FED. R. BANKR. P. 3015(f) (treating objections to plan confirmation as contested matters "governed by Rule 9014"); *id.* 9014(a) ("In a contested matter not otherwise governed by these rules, relief shall be requested by motion, and reasonable notice and opportunity for hearing shall be afforded the party against whom relief is sought.").

199 *In re Hoskins*, 262 B.R. at 697.

200 *In re Fuller*, 255 B.R. at 306.

201 *Id.*

202 *See, e.g.*, *In re Hoskins*, 262 B.R. at 696–98.

203 *See id.*

of Rule 3012 explicitly requires a "motion of any party in interest."[204] If Congress intended the satisfaction of Rule 3012 by the plan confirmation process, then Congress would not have required a motion. If a court holds that the plan can serve the same purpose as a Rule 3012 motion, then this would be an example of the judiciary overreaching into the domain of the legislature.

The most credible reasoning therefore leads to the conclusion that a debtor must use a Rule 3012 motion to strip off a lien.[205] The court in *In re Bennett* articulated that § 506 valuation is the core principle of strip-off.[206] Rule 3012 states that "[t]he court may determine the value of a claim secured by a lien on property . . . on motion of any party in interest."[207] Further, the advisory committee's notes to Rule 3012 only address the use of motions, suggesting it is the preferred, perhaps even exclusive, method for conducting a § 506(a) valuation.[208] Because strip-off cannot occur without determining whether the junior mortgage is an allowed secured claim under § 506(a), a Rule 3012 motion is necessary to strip off the mortgage.[209]

3. Due Process Requirements[210]

Regardless of whether a majority jurisdiction requires a motion or a chapter 13 plan to strip off, another important issue is whether either meets the standards of due process. Due process ensures that creditors have notice and the ability to object to a debtor's attempted strip-off.[211] As the court in *In re Dickey* warned, "[S]trip[ping] off mortgages without adequate notice contributes to the perception that the bankruptcy system is little more than a procedural jungle in which the parties engage in guerilla tactics, laying camouflaged traps to catch tactical missteps by unwary or distracted

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[204] FED. R. BANKR. P. 3012.

[205] *See In re* Bennett, 312 B.R. 843, 847–48 (Bankr. W.D. Ky. 2004) (holding that a debtor may use a motion to strip off a lien even after recognizing that "there [was] precedent allowing lien stripping through a plan").

[206] *In re Bennett*, 312 B.R. at 847.

[207] FED. R. BANKR. P. 3012; *In re Bennett*, 312 B.R. at 847.

[208] *See* FED. R. BANKR. P. 3012 advisory committee's notes ("This rule permits the issue [of valuing secured claims] to be raised on motion by a party in interest.").

[209] *See In re Bennett*, 312 B.R. at 847; FED. R. BANKR. P. 3012 advisory committee's notes.

[210] This section owes a great deal, both intellectually and structurally, to Lloyd & Holtschlag, *supra* note 23, at 68–69.

[211] *See* Mullane v. Cent. Hanover Bank & Trust Co., 339 U.S. 306, 313 (1950).

creditors."[212] Therefore, courts must be careful to ensure that the strip-off notice procedures comply with constitutional standards of due process.

The Supreme Court outlined the constitutional requirements for due process in *Mullane v. Central Hanover Bank & Trust Co*.[213] The Court held that notice must be "reasonably calculated . . . to apprise interested parties of the pendency of the action and afford them an opportunity to present their objections."[214] Bankruptcy courts have applied the *Mullane* standard to the notice procedures for strip-off and found that due process has both qualitative and quantitative aspects.[215] A creditor whose lien is vulnerable to strip-off must have a "reasonable time in which to respond" and be made aware of "the extent of the adverse effect[s] on the [creditor's] rights."[216]

a. The Quantitative Requirement

The quantitative, or timing, requirement obligates the court to give a creditor a reasonable time to consider the plan's terms and respond or object as needed.[217] The quantitative requirement is fulfilled by Rule 2002(b), which requires twenty-eight days notice of a chapter 13 plan confirmation.[218] If the debtor gives the creditor twenty-eight days notice of a plan that contains a strip-off provision, then the creditor will have constitutionally sufficient time to object.[219]

Some courts that allow a strip-off motion also rely on Rule 2002(b) to comply with the quantitative requirement.[220] The court in *In re Bennett* required that debtors file a strip-off motion with the plan.[221] The court cannot confirm a debtor's plan without adjudication of the strip-off,[222] and to confirm

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212 Dickey v. Beneficial Fin. (*In re* Dickey), 293 B.R. 360, 363 (Bankr. M.D. Pa. 2003), *quoted in* Lloyd & Holtschlag, *supra* note 23, at 68.

213 *See Mullane*, 339 U.S. 306.

214 *Id.* at 314.

215 *In re* Yekel, No. 305-47107-tmb13, 2006 Bankr. LEXIS 2208, at *11–12 (Bankr. D. Or. Sept. 14, 2006) (quoting *In re* King, 290 B.R. 641, 649 (Bankr. C.D. Ill. 2003)).

216 *In re King*, 290 B.R. at 649 (citing *Mullane*, 339 U.S. 306).

217 *In re Dickey*, 293 B.R. at 363.

218 FED. R. BANKR. P. 2002(b); Lloyd & Holtschlag, *supra* note 23, at 68.

219 The court in *In re King* found that the then statutorily required twenty-five days to respond was a constitutionally valid "minimum notice period." Therefore, other courts should find twenty-eight days notice to have even greater validity. *See In re King*, 290 B.R. at 649.

220 *See In re* Bennett, 312 B.R. 843, 848 (Bankr. W.D. Ky. 2004).

221 *Id.*

222 *See* Lloyd & Holtschlag, *supra* note 23, at 68.

a plan the court must comply with the Code's provisions.[223] Because § 506(a) valuation is required for strip-off, the court must make a decision regarding valuation before plan confirmation.[224] Therefore, if the strip-off motion is filed with the plan, then Rule 2002(b) gives the creditor twenty-eight days notice to object.[225]

b. The Qualitative Requirement

Satisfaction of the qualitative requirement depends on whether the plan provision or motion makes the creditor aware of the strip-off's impact.[226] The qualitative aspect of strip-off, then, requires that service of the motion or plan be "reasonably calculated" to reach the debtor and that language of the provision sufficiently alerts the creditor of the strip-off.[227] The court in *In re Millspaugh* held that the debtors must serve the motion or plan on the creditor pursuant to Rule 9014(b).[228] Rule 9014(b) requires the debtor to serve the creditor in compliance with Rule 7004.[229] Rule 7004 also governs the service of adversary proceedings, and therefore service of the strip-off motion or plan will provide the same qualitative notice as an adversary proceeding.[230]

The language of the plan or motion must "make clear and conspicuous the proposed treatment of the creditor's claim and the factual and legal basis for such treatment."[231] The burden is on the debtor to ensure the language of the plan or motion provides sufficient notice of the strip-off.[232] The courts have outlined several provisions that would satisfy qualitative due process for a strip-off.[233] The court in *In re Bennett* asserted that the plan or motion must include: (1) the name of the creditor, (2) the "subject real property," (3) a legal description of the property, (4) a statement that the debtor plans to strip off the

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223 11 U.S.C. § 1325(a)(1) (2006).

224 Lloyd & Holtschlag, *supra* note 23, at 68.

225 FED. R. BANKR. P. 2002(b).

226 *See In re* King, 290 B.R. 641, 649 (Bankr. C.D. Ill. 2003).

227 Lloyd & Holtschlag, *supra* note 23, at 68; *see also* Mullane v. Cent. Hanover Bank & Trust Co., 339 U.S. 306, 314 (1950).

228 *In re* Millspaugh, 302 B.R. 90, 101 (Bankr. D. Idaho 2003), *cited in* Lloyd & Holtschlag, *supra* note 23, at 68.

229 FED. R. BANKR. P. 9014(b) (referencing FED. R. BANKR. P. 7004); *see also In re Millspaugh*, 302 B.R. at 101 ("Rule 9014, by direct internal reference, requires service in contested maters to be made consistent with Rule 7004.").

230 *See* Lloyd & Holtschlag, *supra* note 23, at 68–69.

231 *In re Millspaugh*, 302 B.R. at 99.

232 *In re* Bennett, 312 B.R. 843, 848 (Bankr. W.D. Ky. 2004).

233 *See* Lloyd & Holtschlag, *supra* note 23, at 69.

creditor's wholly unsecured junior mortgage and treat the stripped-off mortgage as an unsecured claim, and (5) calculations that demonstrate the creditor's mortgage is wholly unsecured.[234] In *In re Bennett*, the court concluded that if each of these components were included in the plan or motion, the creditor would receive "sufficient information and description" to determine that the debtor planned to strip off their lien.[235]

Courts hold that strip-off by either motion or plan conforms to constitutional due process if the proper procedures are followed.[236] The Supreme Court's decision in *Espinosa* supported this assertion and further applied the *Mullane* "reasonably calculated" standard for constitutionally sufficient due process to bankruptcy reorganizations.[237] The *Mullane* standard is so minimal that by following the Code requirements, a strip-off motion or plan exceeds the notice that is constitutionally required.[238] Therefore, an adversary proceeding is not required to meet constitutional muster.

III. HOW THE *ESPINOSA* DECISION APPLIES TO STRIP-OFF

Neither the Supreme Court nor any of the federal courts of appeal have decided if an adversary proceeding is required to strip off a wholly unsecured residential mortgage.[239] In *Espinosa*, however, the Supreme Court determined whether an adversary proceeding is required as a matter of due process in the context of student loans.[240] Although different Code sections govern student loan and strip-off cases, both cases involve strong due process considerations.[241] Because the Code provides additional protections to student loan and residential mortgage lenders, these creditors believe that their loans are immune from discharge.[242] Both student loan discharges and strip-offs allow debtors to circumvent the extra protections of the Code to discharge these debts.[243] Therefore, it is paramount that courts ensure due process protections are met for these types of creditors. Adversary proceedings clearly

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234 *In re Bennett*, 312 B.R. at 848, *quoted in* Lloyd & Holtschlag, *supra* note 23, at 69.
235 *Id.*
236 *See In re Millspaugh*, 302 B.R. at 98–99.
237 *See* United Student Aid Funds, Inc. v. Espinosa, 130 S. Ct. 1367, 1378–80 (2010).
238 Carlson, *supra* note 31, at 252.
239 *See* Abood-Carroll, *supra* note 4, at 14 n.8 (mentioning that only one circuit opinion has addressed the issue and then only in dicta).
240 *See Espinosa*, 130 S. Ct. at 1373.
241 Abood-Carroll, *supra* note 4, at 81.
242 *Id.*
243 *Id.*

provide the necessary due process to student loan and residential mortgage creditors; however, it is unknown whether other methods can provide sufficient protections.[244]

The Supreme Court in *Espinosa* made two important assertions that apply to the notice requirement for strip-off, each of which will be examined further below.[245] First, the Court suggested that the *Mullane* standard—not the bankruptcy rules of procedure—sets the constitutional minimum for due process in bankruptcy.[246] Second, the majority in *Espinosa* declared that res judicata can bar the appeal of a confirmed plan which did not initiate an adversary proceeding as required by the Rules.[247] These two important assertions, combined with other language in the *Espinosa* decision, support the majority approach that an adversary proceeding is not required to strip off a lien.[248]

A. The Precedential Value of Espinosa

It is important to understand the rationale of the *Espinosa* decision to comprehend how it applies to strip-offs. Francisco Espinosa filed a chapter 13 petition and proposed a plan providing for payment of $13,250 in student loans to United Student Aid Funds, Inc. ("United").[249] Espinosa's plan offered to repay only the principal on his student loan debt, with the remainder being discharged.[250] Both the Code and Bankruptcy Rules require the finding of undue hardship and an adversary proceeding in such a situation.[251] Pursuant to the Bankruptcy Rules, the bankruptcy court mailed notice of Espinosa's bankruptcy and his plan to United.[252] United did not object that Espinosa failed to demonstrate that paying his student loan interest caused him undue

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244 *Id.*

245 *See Espinosa*, 130 S. Ct. at 1378–80; *see also* Carlson, *supra* note 31, at 294–95.

246 *Espinosa*, 130 S. Ct. at 1378; Carlson, *supra* note 31, at 294. *Espinosa* thus effectively overturned a number of lower courts that found that "where the Bankruptcy Code and Bankruptcy Rules require a heightened degree of notice, due process entitles a party to receive such notice before an order binding the party will be afforded preclusive effect." *See, e.g.*, *In re* Forrest, 424 B.R. 831, 834 (Bankr. N.D. Ill. 2009) (quoting *In re* Hanson, 397 F.3d 482, 487 (7th Cir. 2005), *overruled by Espinosa*, 130 S. Ct. 1367) (internal quotation marks omitted).

247 *Espinosa*, 130 S. Ct. at 1380; Carlson, *supra* note 31, at 259.

248 *See Espinosa*, 130 S. Ct. at 1378–80.

249 *Id.* at 1373–74.

250 *Id.* at 1374.

251 *See* Nickolas Karavolas, Note, *Heightened Notice Means Heightened Problems: Due Process Notice Concerns When Discharging Student Loan Debts Under Chapter 13*, 37 HOFSTRA L. REV. 225, 252–53 (2008).

252 *Espinosa*, 130 S. Ct. at 1374.

hardship.[253] Additionally, United did not object to Espinosa's failure to initiate the required adversary proceeding to determine the interest's dischargeablility.[254] After the bankruptcy court confirmed Espinosa's plan without holding an adversary proceeding or making a finding of undue hardship, the bankruptcy trustee advised United that its claim would be treated as set forth in the plan.[255] Espinosa completed the plan payments and received a discharge.[256]

Three years later, the U.S. Department of Education, as assignee to Espinosa's loans,[257] attempted to collect Espinosa's unpaid interest.[258] After recalling the loans, United filed a motion which sought to void the bankruptcy court's order confirming Espinosa's plan.[259] United made two arguments: (1) that Espinosa's failure to file an adversary proceeding violated United's due process rights; and (2) that Espinosa's plan violated both the Code and the Bankruptcy Rules because Espinosa failed to demonstrate undue hardship or initiate an adversary proceeding.[260] The Supreme Court found both of these arguments unpersuasive and upheld the discharge of Espinosa's student loans.[261]

1. Mullane *Sets the Constitutional Standard in Bankruptcy*

The Supreme Court found that Espinosa's failure to file an adversary proceeding did not violate United's due process rights.[262] This holding has important implications for whether an adversary proceeding is required for strip-off.[263] Espinosa's failure to comply with the adversary proceeding requirement "deprived United of a right granted by a procedural rule."[264]

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253 *Id.*

254 *Id.*

255 *Id.*

256 *Id.*

257 *Id.* at 1374 n.3 ("After Espinosa completed payments under the plan, United assigned Espinosa's loans to the Department under a reinsurance agreement. After these proceedings began, United requested and received a recall of the loans from the Department.").

258 *Id.* at 1374.

259 *Id.* at 1374 & n.3.

260 *Id.* at 1374–75.

261 *Id.* at 1378–80.

262 *Id.* at 1378.

263 *See In re* Ginther, 427 B.R. 450, 456–57 (Bankr. N.D. Ill. 2010) ("*Espinosa* clarified that the Bankruptcy Rules are procedural rules, and therefore overruled *In re Hanson*, which had held that constitutional due process required compliance with notice provisions in the Rules." (citations omitted)).

264 *Espinosa*, 130 S. Ct. at 1378; *see also* Karen Cordry, Espinosa*: It's Not So Simple* (pt. 1), 29 AM. BANKR. INST. J., July–Aug. 2010, at 12, 70 ("[I]n *Espinosa*, the Supreme Court made a sweeping statement

United could have objected to Espinosa's failure to file an adversary proceeding on procedural grounds.[265] Failure to file an adversary proceeding, however, was not a violation of United's constitutional due process rights.[266] The Supreme Court cited the *Mullane* standard of notice—"reasonably calculated . . . to apprise interested parties of the pendency of the action and afford them an opportunity to present their objections"—as the minimum required for due process in this situation.[267] The Court noted that United received actual notice because the plan had been mailed to United, thus notifying the lender of the plan's filing and contents.[268]

The *Espinosa* holding favors the majority approach of not requiring an adversary proceeding.[269] Some courts had determined that an adversary proceeding is always the due process minimum if it is required by the Rules.[270] This understanding stems from the 1953 Supreme Court decision, *City of New York v. New York, New Haven & Hartford Railroad Co.*[271] However, in *Espinosa* the Supreme Court indicated that the *Mullane* standard could set the constitutional bar lower than what is required by the statute.[272] The Court's assertion supports the majority because even if an adversary proceeding is required in the relevant jurisdiction, the constitutional minimum is still met by submitting a copy of the plan or a motion to the creditor.[273] If an adversary

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that the failure to serve the summons and complaint merely 'deprived [the lender] of a right granted by a procedural rule' and that the deprivation of proper notice did not violate its constitutional right to due process." (quoting *Espinosa*, 130 S. Ct. at 1378)).

265 *Espinosa*, 130 S. Ct. at 1378.

266 *Id.*

267 *Id.* (quoting Mullane v. Cent. Hanover Bank & Trust Co., 339 U.S. 306, 314 (1950)); *see also* Carlson, *supra* note 31, at 294 ("In *Espinosa*, the Supreme Court indicates that *Mullane v. Central Hanover Bank & Trust Co.* sets the [constitutional] minimum [in bankruptcy]." (footnote omitted)).

268 *Espinosa*, 130 S. Ct. at 1378. It is important to note that, because the creditor in *Espinosa* received *actual* notice, the Court does not explicitly address what would happen if a creditor received less than actual notice.

269 *See supra* Part II.C.

270 *See* SLW Capital, LLC v. Mansaray-Ruffin (*In re* Mansaray-Ruffin), 530 F.3d 230, 242 (3d Cir. 2008); *In re* Hanson, 397 F.3d 482, 486–87 (7th Cir. 2005), *overruled by Espinosa*, 130 S. Ct. 1367.

271 Carlson, *supra* note 31, at 258–59 ("'[E]ven creditors who have knowledge of a reorganization have a right to assume that the *statutory* "reasonable notice" will be given them before their claims are forever barred.' [This] sentence . . . has been taken to mean that the procedural rules governing in bankruptcy set the constitutional minimum for creditors." (emphasis added) (quoting City of New York v. N.Y., New Haven & Hartford. R.R. Co., 344 U.S. 293, 297 (1953))).

272 *Espinosa*, 130 S. Ct. at 1378 (quoting *Mullane*, 339 U.S. at 314).

273 *See* Carlson, *supra* note 31, at 294 ("[The *Espinosa* Court] indicates that *Mullane* . . . sets the [constitutional] minimum [for due process]. *Mullane* requires notice by mail whenever the plaintiff knows the name and location of a defendant. The due process standard may in fact be even lower in chapter 13 cases, given the mechanical nature of the deadlines for plan confirmation.").

proceeding was required for strip-off and the debtor did not file for this proceeding but rather sent the creditor a copy of the plan, then the debtor did not violate the creditor's constitutional due process rights.[274] *Espinosa* reminds us that violating the procedural right of notice is not necessarily synonymous with violating a constitutional right.[275] Therefore, any argument by the minority that strip-off through a plan or motion does not comport with constitutional due process[276] is unfounded.

2. Res Judicata Bars the Appeal of a Confirmed Plan That Did Not Follow the Adversary Proceeding Requirement

The Supreme Court held that Espinosa's failure to commence an adversary proceeding and demonstrate undue hardship was legal error.[277] However, because Espinosa's failure was *legal* error and not constitutional or jurisdictional error, there was no basis to void Espinosa's confirmation order.[278] The Supreme Court stated that this legal error could have been successfully contested through the plan confirmation process, but United failed to take such action.[279] The Supreme Court asserted that a confirmation order is not void merely because it is erroneous.[280] A judgment entered without adequate service falls under FRCP 60(b)(4), which mandates that courts grant relief from void judgments regardless of when the issue is raised.[281] FRCP 60(b)(4) "applies only in the rare instance where a judgment is premised either on a certain type of jurisdictional error or on a violation of due process that deprives a party of notice or the opportunity to be heard."[282] The Supreme

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274 *See* Carlson, *supra* note 31, at 294.

275 *Espinosa*, 130 S. Ct. at 1378 ("Espinosa's failure to serve United with a summons and complaint deprived United of a right granted by a procedural rule. . . . But this deprivation did not amount to a violation of United's constitutional right to due process.").

276 *See In re* Forrest, 424 B.R. 831, 832 (Bankr. N.D. Ill. 2009); *infra* Part II.B.1.

277 *Espinosa*, 130 S. Ct. at 1375–80.

278 *Id.* at 1380.

279 *See id.* United could have made a direct attack against Espinosa because of his failure to make an undue hardship showing; however, a direct attack could no longer be made once the plan was confirmed. United therefore attempted a collateral attack on the confirmation order as void due to an alleged violation of United's due process rights. *See* Kenneth N. Klee, *Professor Kenneth N. Klee on the Supreme Court's holding in* United Student Aid Funds, Inc. v. Espinosa, 2010 LEXISNEXIS EMERGING ISSUES ANALYSIS 4966, at 2–3 (2010).

280 *Espinosa*, 130 S. Ct. at 1377.

281 FED. R. CIV. P. 60(b)(4) ("On motion and just terms, the court may relieve a party or its legal representative from a final judgment, order, or proceeding for the following reasons: . . . the judgment is void . . . ."); *Espinosa*, 130 S. Ct. at 1376–77 (noting that FRCP 60(b)(4) applies when there is a problem with jurisdiction or "a violation of due process that deprives a party of notice or the opportunity to be heard").

282 *Espinosa*, 130 S. Ct. at 1377.

Court in *Espinosa* held that FRCP 60(b)(4) did not apply because there was neither a jurisdictional error nor a violation of due process.[283] Since United had notice of the plan and failed to object, United was barred from appeal.[284] The Supreme Court clarified that res judicata barred any collateral attack by United after confirmation.[285]

This holding in *Espinosa* has a major impact on whether an adversary proceeding is required to strip off a wholly unsecured junior lien. Returning to the hypothetical discussed above, suppose the market value of Henry's home is $400,000, and he still owes $350,000 to Secured Bank and an additional $250,000 to Junior Bank. Both Secured and Junior Banks file proof of claims. Henry proposes a plan to strip off Junior Bank's mortgage. This plan is in violation of § 1322(b)(2) and is illegal under the Code.[286] Henry does not file an adversary proceeding but serves a motion on Junior Bank. Junior Bank fails to object to the illegal lien-strip and the court approves the plan. In the minority of jurisdictions, this motion would be considered insufficient,[287] and prior to *Espinosa*, many courts would have held res judicata had no effect on a confirmed plan that violated the Rules by not filing an adversary proceeding.[288] *Espinosa* abrogated these opinions because *Espinosa* upholds some illegal chapter 13 plans based solely on res judicata.[289] Therefore, Junior Bank cannot mount a collateral attack against Henry after confirmation.

The Supreme Court's holding damages the effectiveness of the adversary proceeding requirement. Adversary proceedings are required by the minority to give creditors more notice to contest a strip-off.[290] After *Espinosa*, if a bankruptcy judge confirms a strip-off in a jurisdiction where an adversary proceeding is required and "reasonably calculated" notice is given, but no adversary proceeding is initiated, then res judicata bars the appeal after the debt is discharged.[291]

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283 *Id.*

284 *Id.* at 1380.

285 Carlson, *supra* note 31, at 295.

286 *See* Nobelman v. Am. Sav. Bank, 508 U.S. 324, 332 (1993) (holding that a junior mortgage that is supported by some equity is partially secured and cannot be stripped off).

287 *See In re* Chukes, 305 B.R. 744, 744–45 (Bankr. D.D.C. 2004); Pierce v. Beneficial Mortg. Co. of Utah (*In re* Pierce), 282 B.R. 26, 28 (Bankr. D. Utah 2002).

288 Carlson, *supra* note 31, at 255; *see also* SLW Capital, LLC v. Mansaray-Ruffin (*In re* Mansaray-Ruffin), 530 F.3d 230, 238–39 (3d Cir. 2008).

289 Carlson, *supra* note 31, at 283–84; *see also Espinosa*, 130 S. Ct. at 1380.

290 *See* Abood-Carroll, *supra* note 4, at 14.

291 *See Espinosa*, 130 S. Ct. at 1378.

B. Espinosa *Can Support the Minority's Position if Rule 7001 Applies*

Some aspects of the *Espinosa* decision support the minority position, especially if Bankruptcy Rule 7001 applies to strip-off and an adversary proceeding is required. The *Espinosa* Court overruled the Ninth Circuit's holding "that bankruptcy courts *must* confirm a plan proposing the discharge of a student loan debt without a determination of undue hardship in an adversary proceeding unless the creditor timely raises a specific objection."[292] Instead, the Court held that, in those situations, a bankruptcy court should not confirm a plan when it knows that a procedural rule was violated.[293] The court in *In re Peckens-Schmitt* explained that "the Supreme Court [in *Espinosa*] clearly stated that 11 U.S.C. § 1325(a) '*requires* bankruptcy courts to address and correct a defect in a debtor's proposed plan even if no creditor raises the issue.'"[294] Thus, the Code requires bankruptcy courts to compel the debtor's plan to follow the Bankruptcy Rules.[295] However, as highlighted above, if the bankruptcy court does confirm a plan regardless of its obligation not to, the creditor is barred from appeal because of res judicata.[296]

The obligation of judges not to confirm a plan that violates the Bankruptcy Rules even if the creditor fails to object should act as a strong deterrent.[297] The *Espinosa* decision will compel most judges to deny plans that conflict with the Bankruptcy Rules.[298] The holding is important as to whether an adversary proceeding is required to strip off a mortgage. If the minority approach is right and Bankruptcy Rule 7001 applies to strip-off, bankruptcy courts would be obligated to deny a plan that does not initiate an adversary proceeding even if no creditor objects.[299] Therefore, it is imperative to determine if Bankruptcy Rule 7001 applies to the strip-off of a wholly unsecured junior mortgage.

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292 *Id.* at 1380–81.

293 *In re* Peckens-Schmitt, No. DK 10-04164, 2010 WL 2851520, at *1 (Bankr. W.D. Mich. July 16, 2010) (quoting *Espinosa*, 130 S. Ct. at 1381 n.14 (2010)).

294 *Id.* (quoting *Espinosa*, 130 S. Ct. at 1381 n.14 (2010)).

295 *Espinosa*, 130 S. Ct. at 1381 & n.14 (2010); *In re Peckens-Schmitt*, 2010 WL 2851520, at *1–2.

296 *See Espinosa*, 130 S. Ct. at 1380.

297 *In re Peckens-Schmitt*, 2010 WL 2851520, at *2 ("The court does not believe that *Espinosa* authorizes the court to turn a blind eye to the procedural shortcut that the Debtor proposes in her Plan . . . .").

298 *See Espinosa*, 130 S. Ct. at 1381 & n.14.

299 *See In re Peckens-Schmitt*, 2010 WL 2851520, at *1–2.

IV. WHY THE MAJORITY VIEW REPRESENTS THE CORRECT STATUTORY INTERPRETATION

The split between the bankruptcy courts suggests that the Code and Bankruptcy Rules are ambiguous as to whether strip-off requires an adversary proceeding. Specifically, the jurisdictions disagree about whether Congress meant for Rule 7001(2) or for Rule 3012 to apply to the strip-off of a wholly unsecured junior mortgage. However, the language of the statute, combined with the advisory committee's intent, indicate that Rule 3012, not Rule 7001, applies to strip-off. Therefore, strip-off requires a 3012 motion and not an adversary proceeding.

A. Applying Statutory Canons of Construction to Rules 3012 and 7001

Statutory interpretation begins with an inquiry into the language of the statute.[300] One must determine whether the statutory language is clear or ambiguous.[301] If the meaning of the statute is "clear and unambiguous . . . that would be the end of [the court's] analysis."[302] However, when the statute's meaning is ambiguous, one must look to other indicators to "determine whether 'the statutory scheme is coherent and consistent.'"[303] "[A]mbiguity of statutory language is determined by reference to the language itself, the specific context in which that language is used, and the broader context of the statute as a whole."[304] A statute is facially ambiguous if a reading of its text can lead to at least two plausible interpretations.[305]

1. Application to Rule 7001

Rule 7001(2) is ambiguous in its application to strip-off because there are three plausible interpretations of the Rule. Rule 7001(2) states that an adversary proceeding is necessary to "determine the validity, priority, or extent

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300 United States v. Am. Trucking Ass'ns, 310 U.S. 534, 543 (1940) ("There is, of course, no more persuasive evidence of the purpose of a statute than the words by which the legislature undertook to give expression to its wishes.").

301 Robinson v. Shell Oil Co., 519 U.S. 337, 340 (1997) ("[The] first step in interpreting a statute is to determine whether the language at issue has a plain and unambiguous meaning . . . ."), *cited in* Miyong Mary Kang, Comment, *Is It Time to Hang the Hanging Paragraph, 11 U.S.C. § 1325(a)?*, 26 EMORY BANKR. DEV. J. 49, 66 (2009).

302 Zuni Pub. Sch. Dist. No. 89 v. Dep't of Educ., 550 U.S. 81, 93 (2007).

303 Kang, *supra* note 301, at 66 (quoting *Robinson*, 519 U.S. at 340).

304 *Robinson*, 519 U.S. at 341, *quoted in* Kang, *supra* note 301, at 66.

305 Graham Cnty. Soil & Water Conservation Dist. v. United States *ex rel*. Wilson, 545 U.S. 409, 419 n.2 (2005).

of a lien."[306] Strip-off under § 506 requires an assessment of the residence to determine the value of the attached secured claims.[307] The value of the residence determines the value of the allowed secured claim.[308] The junior mortgage is stripped off if the allowed secured claim renders a mortgage wholly unsecured.[309] The majority has concluded that the value of the collateral is the disputed matter in a strip-off.[310] Under this perspective, change to the "validity, priority, or extent of [the] lien" in strip-off is based solely on the valuation of the residence, and therefore Rule 7001(2) does not apply.[311] Another interpretation, held by the minority, is that Rule 7001(2) applies because, when a lien is stripped off, the lien's priority changes from secured to unsecured.[312] A third possible interpretation is that the phrase "extent of the lien" means "the value of the property subject to the lien."[313] As all three of these interpretations of 7001(2) to strip-off are plausible, the statute is facially ambiguous.[314]

Since Rule 7001(2) is ambiguous as applied to strip-off, it is necessary to determine which reading is the most coherent and consistent with the statutory scheme.[315] Rule 1001 describes the spirit of the Bankruptcy Rules.[316] It states, "These rules shall be construed to secure the just, speedy, and inexpensive determination of every case and proceeding."[317]

The minority's position that Rule 7001(2) applies to strip-off is inconsistent with the goals of the Bankruptcy Rules.[318] A Rule 7001(2) adversary proceeding causes delays to the confirmation of the debtor's plan.[319] The court

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306 FED. R. BANKR. P. 7001(2).

307 *See* 11 U.S.C. § 506(a) (2006); *see also In re* King, 290 B.R. 641, 648 (Bankr. C.D. Ill. 2003).

308 *See* Wolski v. JP Morgan Bank, NA (*In re* Wolski), No. 10-23090, 2010 WL 3614243, at *2 (Bankr. N.D. Ill. Sept. 7, 2010).

309 Tanner v. FirstPlus Fin., Inc. (*In re* Tanner), 217 F.3d 1357, 1360 (11th Cir. 2000).

310 *See In re* Sadala, 294 B.R. 180, 183 (Bankr. M.D. Fla. 2003); *In re* Hoskins, 262 B.R. 693, 696–97 (Bankr. E.D. Mich. 2001); *In re* Fuller, 255 B.R. 300, 306 (Bankr. W.D. Mich. 2000).

311 *See In re Fuller*, 255 B.R. at 305–06.

312 *See, e.g.*, *In re* Chukes, 305 B.R. 744, 744–45 (Bankr. D.D.C. 2004).

313 10 COLLIER, *supra* note 22, ¶ 7001.03[1] (considering and rejecting this interpretation).

314 *Cf.* Graham Cnty. Soil & Water Conservation Dist. v. United States *ex rel.* Wilson, 545 U.S. 409, 419 n.2 (2005).

315 *See* Robinson v. Shell Oil Co., 519 U.S. 337, 340 (1997) (quoting United States v. Ron Pair Enters., Inc., 489 U.S. 235, 240 (1989)).

316 *See* FED. R. BANKR. P. 1001.

317 *Id.*

318 *See, e.g., In re* Sadala, 294 B.R. 180, 182–83 (Bankr. M.D. Fla. 2003) ("Clearly, an adversary proceeding is more formal, takes longer, and is more costly [than a contested matter].").

319 *See* Abood-Carroll, *supra* note 4, at 81; *see also In re Sadala*, 294 B.R. at 182–83 ("[T]he debtor must serve a summons accompanied with the complaint to the named defendant . . . .").

cannot confirm the plan until the strip-off has been fully litigated, a process that can take several months.[320] An adversary proceeding also requires additional court and attorney's fees.[321] Moreover, submitting a strip-off motion or plan to a creditor without an adversary proceeding satisfies the constitutional standard of being "reasonably calculated" to provide notice.[322] Requiring an adversary proceeding to strip off a junior mortgage is contrary to the statutory goals of the Bankruptcy Rules to have a "just, speedy, and inexpensive determination of every case";[323] a motion is, after all, faster and cheaper than an adversary proceeding and still provides adequate notice.[324] Therefore, requiring an adversary proceeding is not coherent or consistent with the statutory scheme.

2. Application to Rule 3012

Rule 3012 unambiguously applies to strip-off motions. It states that "[t]he court may determine the value of a claim secured by a lien on property" upon a party in interest's motion.[325] The plain text of the statute provides that only a motion is required to value a claim secured by real property.[326] There is no other plausible interpretation of the statute. As the value of the collateral is the matter in dispute for a strip-off, Rule 3012 clearly applies to strip-off.[327] Because Rule 3012 clearly and unambiguously applies to strip-off, no further inquiry is required.[328] However, if additional statutory examination were required, then applying Rule 3012 to strip-off also is consistent with the statutory scheme. Strip-off via motion provides adequate notice in a cheaper, quicker, and more efficient manner than through an adversary proceeding.[329] Therefore, strip-off can, and should, be achieved through a motion.

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320 *See* Abood-Carroll, *supra* note 4, at 81.

321 *Id.* at 14; *see also In re Sadala*, 294 B.R. at 183 ("Filing fees associated with adversary proceedings are substantial.").

322 *See* Mullane v. Cent. Hanover Bank & Trust Co., 339 U.S. 306, 314 (1950).

323 FED. R. BANKR. P. 1001.

324 *See In re Sadala*, 294 B.R. at 182–83 (noting strip-off by motion "provides due process in a streamlined and efficient manner").

325 FED. R. BANKR. P. 3012.

326 *See id.*

327 *See In re* Robert, 313 B.R. 545, 549 (Bankr. N.D.N.Y. 2004) ("Rule 3012 specifically permits Code § 506(a) collateral valuations to be requested on motion provided notice and opportunity for hearing is given to the affected party." (citing FED. R. BANKR. P. 3012)).

328 *See* Zuni Pub. Sch. Dist. No. 89 v. Dep't of Educ., 550 U.S. 81, 93 (2007).

329 *See In re Sadala*, 294 B.R. at 182–83 (noting the ways that contested matters "provide[] due process in a streamlined and efficient manner"). Conversely, "an adversary proceeding is more formal, takes longer, and is more costly." *Id.* at 183 (citing FED. R. BANKR. P. 7003, 7004, 7008)).

B. The Advisory Committee's Intent

The advisory committee's intent indicates that Rule 3012, not Rule 7001(2), applies to strip-off. Rule 3012 implements § 506(a) and provides that "[t]he court may determine the value of a claim secured by a lien on property in which the estate has an interest on motion of any party in interest."[330] One could argue that such a proceeding is intended to determine the "extent of the lien" pursuant to Rule 7001(2).[331] However, such a reading is contrary to the text of the advisory committee's notes to Rule 3012.[332] The committee's notes assert that a Rule 7001 adversary proceeding "is relevant to the basis of the lien itself" which differs from a Rule 3012 valuation.[333] Furthermore, the committee's notes plainly state that Rule 3012 applies to a § 506(a) valuation of allowed secured claims.[334] If a lien is determined to be wholly unsecured under a § 506(a) valuation, that lien is vulnerable to strip-off.[335] Since Rule 3012 applies to a § 506(a) valuation, a Rule 3012 motion is required to determine the lien subject to strip-off.[336] The intent of the advisory committee makes it clear that a Rule 7001 adversary proceeding is required only when the extent of the lien is in dispute, i.e., what property is subject to the lien.[337] A Rule 3012 motion is required to value (and therefore avoid) a wholly unsecured residential mortgage.[338] The committee's intent was undoubtedly to apply Rule 3012 to strip-off.

V. POLICY ARGUMENTS IN FAVOR OF STRIP-OFF BY MOTION

Policy considerations also support requiring the use of a motion to strip off an unsecured mortgage rather than using an adversary proceeding. An underlying goal of bankruptcy is to achieve fair and balanced results for both creditors and debtors.[339] Further, both methods attempt to balance a policy of

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330 FED. R. BANKR. P. 3012; FED. R. BANKR. P. 3012 advisory committee's notes.

331 10 COLLIER, *supra* note 22, ¶ 7001.03[1].

332 *Id.*

333 *Id.* (quoting FED. R. BANKR. P. 3012 advisory committee's notes).

334 FED. R. BANKR. P. 3012 advisory committee's notes.

335 *In re* King, 290 B.R. 641, 648 (Bankr. C.D. Ill. 2003); *In re* Sadala, 294 B.R. 180, 185 (Bankr. M.D. Fla. 2003).

336 *See* FED. R. BANKR. P. 3012 advisory committee's notes.

337 *See id.* ("[An adversary proceeding under Rule 7001] is *relevant to the basis of the lien itself* while valuation under Rule 3012 would be for the purposes indicated above[, e.g., § 506(a) valuations]." (emphasis added)).

338 *See In re Sadala*, 294 B.R. at 182 (interpreting FED. R. BANKR. P. 3012 advisory committee's notes).

339 Vivian Luo, Comment, *A Preference for States? The Woes of Preempting State Preference Statutes*, 24 EMORY BANKR. DEV. J. 513, 528 (2008) ("In each subsequent Act, Congress sought to better ensure the equal

fairness with a concern for efficiency.[340] The application of Rule 3012 to strip-off, which does not require an adversary proceeding, best achieves the policy goals of both the courts and the Code. This Comment makes six policy arguments for why a Rule 3012 motion is the correct procedure to strip off a wholly unsecured junior mortgage. First, adversary proceedings are more time consuming and costly. Second, they afford too much leverage to creditors, giving them the ability to strong-arm the debtor into full repayment. Third, an adversary proceeding does not actually afford the creditor additional notice of a strip-off. Fourth, a motion is sufficient to afford the creditor actual notice. Fifth, an adversary proceeding does not provide any necessary procedural protections that are not granted by a Rule 3012 motion. Sixth, strip-off via a chapter 13 plan may provide insufficient procedural protections to creditors.

A. Judicial Economy—Increase in Cost and Time

Adversary proceedings require additional expenses such as filing fees and attorney's fees.[341] Initiating an adversary proceeding requires a $350 filing fee.[342] This cost can be significant, especially for a bankrupt individual.[343] Additional attorney's fees may be needed to separately litigate a strip-off in an adversary proceeding.[344] The debtor's attorney must prepare a complaint and file the necessary motions to achieve a strip-off.[345] The debtor's attorney may have to appear in court in a proceeding separate from the plan confirmation process, which is also costly to the debtor.[346] These administrative expenses diminish the money available to pay unsecured creditors.

Additionally, adversary proceedings delay the confirmation process.[347] Rule 7012(a) gives the creditor thirty days to respond to a debtor's strip-off

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treatment of creditors and to balance the rights and obligations of debtors and creditors in a manner that maximizes repayment to creditors while giving debtors a measure of relief.").

340 *See In re* Wash. Mut., Inc., 461 B.R. 200, 243 (Bankr. D. Del. 2011) (considering the "two important bankruptcy goals" of "fairness among creditors and administrative efficiency" in calculating interest for creditor claims (quoting Onink v. Cardelucci (*In re* Cardelucci), 285 F.3d 1231, 1236 (9th Cir. 2002)) (internal quotation marks omitted)).

341 *See* Abood-Carroll, *supra* note 4, at 14.

342 28 U.S.C. § 1914(a) (2006) (amended 2011).

343 *See In re* Sadala, 294 B.R. 180, 183 (Bankr. M.D. Fla. 2003) ("Filing fees associated with adversary proceedings are substantial.").

344 Abood-Carroll, *supra* note 4, at 14.

345 *See* DRAKE ET AL., *supra* note 2, § 11A:4.

346 *See* Abood-Carroll, *supra* note 4, at 81.

347 *Id.* at 14.

adversary proceeding,[348] which is comparable to the twenty-eight days provided by some courts to object to a Rule 3012 motion.[349] However, if the creditor contests the strip-off in an adversary proceeding, the court must provide the creditor with adequate time to engage in discovery, pretrial motions, and potentially a trial.[350] All of this preparation can cause serious delays to the confirmation of the debtor's plan.[351] Adversary proceedings force judges to spend unnecessary time rendering decisions on strip-offs, which causes greater costs to be borne by taxpayers.[352] Further, junior mortgages may be significant secured debts that debtors are obligated to pay to keep their homes.[353] Whether this debt can be stripped off therefore might be vital to the feasibility of the plan,[354] and a court is unable to confirm a plan that is not feasible.[355] Therefore, a court is unlikely to confirm a plan before the strip-off is resolved.

The delay inherent in requiring an adversary proceeding can be harmful to debtors.[356] Resolving issues through an adversary proceeding takes longer than the resolution of motions as adequate time must be afforded to prepare for, and possibly conduct, a trial.[357] Rule 3012 motions avoid these additional procedures. The judge can simply rule on the original motion or, in situations where there is a response, hold a hearing.[358] Although the plan repayment period does not begin until plan confirmation, the Code requires debtors to begin plan "payments not later than [thirty] days after the filing date of the

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348 FED. R. BANKR. P. 7012(a).

349 *See In re* Bennett, 312 B.R. 843, 848 (Bankr. W.D. Ky. 2004) (requiring a Rule 3012 motion to be filed with the plan and thereby incorporating the provisions of Rule 2002(b)).

350 Abood-Carroll, *supra* note 4, at 81.

351 *See id.* at 14.

352 *See* Abood-Carroll, *supra* note 4, at 14, 81.

353 *See In re* Millspaugh, 302 B.R. 90, 93 (Bankr. D. Idaho 2003) (noting that the value of the debtors' junior mortgage was $37,565.98).

354 11 U.S.C. § 1325(a)(6) (2006) (requiring that the plan must be feasible and that it be apparent the debtor will be able to make all payments and to comply with the plan); *see also* 8 COLLIER, *supra* note 22, ¶ 1325.07 (discussing the "feasibility standard" in § 1325(a)(6)).

355 United Student Aid Funds, Inc. v. Espinosa, 130 S. Ct. 1367, 1381 n.14 (2010); *see also* 8 COLLIER, *supra* note 22, ¶ 1325.07 ("[Feasibility is] by far the most important criterion for the confirmation of a chapter 13 plan in terms of promoting the success of chapter 13 proceedings . . . ."). However, bankruptcy courts have considerable discretion in appraising the feasibility of a plan and have confirmed otherwise infeasible plans that were subject to continued monitoring by the court or trustee. *See* 8 COLLIER, *supra* note 22, ¶ 1325.07[1].

356 Abood-Carroll, *supra* note 4, at 14.

357 *See* FED. R. BANKR. P. 7026–7037, 7040–7041, 7055–7056, *cited in* Abood-Carroll, *supra* note 4, at 81 n.20.

358 *See In re* Sadala, 294 B.R. 180, 182–83 (Bankr. M.D. Fla. 2003) ("Often, the creditor will not dispute the relief requested in the motion, files no response, and the motion is granted upon notice but without the need for any hearing after the response period passes.").

plan."[359] Therefore, a debtor may need to make plan payments even though the plan has not been confirmed.

B. Too Much Leverage to the Creditor

Temporal and administrative delays not only hinder the debtor but also increase creditor leverage.[360] Legal fees to initiate and conduct an adversary proceeding are much more burdensome on the individual debtor than the creditor, which is typically a large mortgage-holding institution.[361] Thus, a debtor might be less likely to attempt a strip-off due to the extra cost of the adversary proceeding. Further, an adversary proceeding allows creditors to delay plan confirmation until the proceeding is resolved.[362] As noted, the Code requires the debtor to start paying into the plan thirty days after the plan is filed.[363] If the creditor delays the plan confirmation, the debtor would have to make payments without the benefits of plan confirmation.[364] The adversary proceeding requirement gives a clever creditor more ways to delay the plan confirmation and cost the debtor money.[365] The extra cost and delay may compel the debtor to give up on what is an otherwise legal strip-off. Therefore, the increase in leverage to the creditor would run contrary to the Bankruptcy Rules goal of "just, speedy, and inexpensive determination of every case and proceeding."[366]

C. Adversary Proceeding's Extra Notice Is Unnecessary

A junior creditor does not need an adversary proceeding to receive sufficient notice of a strip-off. A creditor receives notice that its lien will be stripped when a contested matter is initiated through a motion or plan.[367] Usually, a motion includes a statement that the creditor's lien will be stripped

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359 11 U.S.C. § 1326(a)(1); *see also* Abood-Carroll, *supra* note 4, at 14.

360 *See* Abood-Carroll, *supra* note 4, at 14, 81.

361 *See* Arthur E. Wilmarth, Jr., *The Dark Side of Universal Banking: Financial Conglomerates and the Origins of the Subprime Financial Crisis*, 41 CONN. L. REV. 963, 1012 (2009) ("[Large banks] have dominated the markets for residential mortgages and credit cards markets since 2000. In 2001, the top five mortgage lenders were Chase, Wells Fargo, [Bank of America], Washington Mutual (Wamu) and Countrywide.").

362 *See* Abood-Carroll, *supra* note 4, at 81.

363 11 U.S.C. § 1326(a)(1). The court does have statutory discretion to require that the debtor begin making plan payments at a date different than thirty days after the plan is filed. *Id.*

364 Abood-Carroll, *supra* note 4, at 14.

365 *See id.* at 14, 81.

366 *See* FED. R. BANKR. P. 1001.

367 *See In re* Bennett, 312 B.R. 843, 848 (Bankr. W.D. Ky. 2004); *In re* King, 290 B.R. 641, 649 (Bankr. C.D. Ill. 2003).

off and that the creditor has a specified period to contest the strip-off.[368] The plan provisions also warn the creditors that their rights may be impaired.[369] The debtor sends these documents to lenders, many of whom are in the business of administering mortgages.[370] These lenders are typically sophisticated "repeat players" in the bankruptcy process and should be presumed aware that wholly unsecured junior mortgages can be stripped off.[371] A creditor is properly served with a plan or motion when the creditor has a full and fair opportunity to object to the plan.[372] The creditor, once properly served, can object to the legality of the strip-off, the valuation of the property, or the feasibility of the plan;[373] as long as reasonable steps to alert the creditor have been taken, "the constitutional requirements [should be] satisfied."[374]

Supporters of adversary proceedings argue that the use of a motion or plan to strip off a wholly unsecured mortgage is discharge by ambush.[375] Their concern is that the debtor's notice is not intended to notify the creditor of the strip-off. [376] The debtor has every incentive to camouflage the notice and hope that the creditor will overlook the strip-off.[377] A bankruptcy proceeding creates

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368 *In re Bennett*, 312 B.R. at 848.

369 *See* United Student Aid Funds, Inc. v. Espinosa, 130 S. Ct. 1367, 1374 (2010). ("In boldface type immediately below the caption, the plan stated: 'WARNING IF YOU ARE A CREDITOR YOUR RIGHTS MAY BE IMPAIRED BY THIS PLAN.'").

370 The Court of Appeals for the Ninth Circuit in *Espinosa* stated:

> It makes a mockery of the English language and common sense to say that [the creditor] wasn't given notice, or was somehow abused or taken advantage of. The only thing the creditor was not told is that it could insist on an adversary proceeding and a judicial determination of undue hardship. . . . But it's not clear why letting the creditor know, in plain terms, that its rights will be impaired by the proposed plan—and then leaving it up to the creditor and his lawyers to figure out what objections or remedies are available—doesn't satisfy the Tenth Circuit's "heart of the . . . notice" standard. After all, we aren't talking here about destitute widows and orphans, or people who don't speak English or can't afford a lawyer. The creditors in such cases are huge enterprises whose business it is to administer the very kinds of debts here in question.

See Espinosa v. United Student Aid Funds, Inc., 553 F.3d 1193, 1201 (9th Cir. 2008) (second alteration in original), *aff'd*, 130 S. Ct. 1367 (2010).

371 *See* Bennett v. Springleaf Fin. Servs. (*In re* Bennett), No. 11-32916, 2012 Bankr. LEXIS 31, at *36 (Bankr. S.D. Ohio Jan. 12, 2012) ("The [strip-off] provisions address the claims of sophisticated institutional creditors . . . who make loans to consumers often secured by a junior lien on a debtor's residence."); *see also Espinosa*, 553 F.3d at 1201.

372 *See* Mullane v. Cent. Hanover Bank & Trust Co., 339 U.S. 306, 314 (1950).

373 *See In re* Sadala, 294 B.R. 180, 182–83 (Bankr. M.D. Fla. 2003).

374 *Mullane*, 339 U.S. at 314–15.

375 *See In re* Forrest, 424 B.R. 831, 832–33 (Bankr. N.D. Ill. 2009).

376 *See Discharge-by-Declaration: The Ninth Circuit Flies Solo*, BANKR. L. LETTER, Nov. 2008, at 6, 7 (addressing similar concerns in student loan cases).

377 *See id.*

a "flood of paperwork" and thus "requires clear rules to . . . 'know what notices to notice as opposed to the notices that are deafening legal background noise.'"[378] It costs the debtor nothing to insert an otherwise improper strip-off provision into its plan.[379] Creditors in the residential mortgage business are unlikely to be misled by the plan confirmation process or somehow tricked by the debtor into not recognizing its rights will be impaired.[380] These types of creditors have resources which are sufficient to protect their rights.[381] Moreover, mortgage creditors that have teams of attorneys are unlikely to fail to understand that their liens would be stripped off once the creditors are served with a motion.[382]

D. A Motion Is Sufficient to Afford the Creditor Notice

Courts prescribe, or should prescribe, specific requirements for Rule 3012 strip-off motions that make it very likely actual notice will occur.[383] The motion must "make clear and conspicuous the proposed treatment of the creditor's claim and the factual and legal basis for such treatment."[384] The motion must be filed with a chapter 13 plan, which grants parties at least twenty-eight days to file objections.[385] These safeguards, in addition to the fact that strip-off motions are served on creditors in the business of making residential loans, make it very likely that actual notice will be achieved.[386]

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[378] *See id.* (quoting *In re* Ruehle, 296 B.R. 146, 164 (Bankr. N.D. Ohio 2003), *aff'd sub nom.* Ruehle v. Educ. Credit Mgmt. Corp. (*In re* Ruehle), 307 B.R. 28 (B.A.P. 6th Cir. 2004), *aff'd*, 412 F.3d 679 (6th Cir. 2005), *overruled by* United Student Aid Funds, Inc. v. Espinosa, 130 S. Ct. 1367 (2010)).

[379] *See id.*

[380] *See* Bennett v. Springleaf Fin. Servs. (*In re* Bennett), No. 11-32916, 2012 Bankr. LEXIS 31, at * 36 (Bankr. S.D. Ohio Jan. 12, 2012) ("[A] financial institution in the business of making loans to debtors . . . secured by residential real estate, indisputably stands as a sophisticated creditor that should be versed in the intricacies of bankruptcy generally and [c]hapter 13 specifically."); *see also* Espinosa v. United Student Aid Funds, Inc., 553 F.3d 1193, 1205 (9th Cir. 2008), *aff'd*, 130 S. Ct. 1367 (2010). *But see In re Forrest*, 424 B.R. at 832–33.

[381] *See Espinosa*, 553 F.3d at 1201.

[382] *See In re Bennett*, 2012 Bankr. LEXIS 31, at *35–36 ("If [the creditor] did not understand the provisions of the Plan addressing valuation of the real estate, it was incumbent upon that representative to inquire of its legal counsel.").

[383] *In re* Bennett, 312 B.R. 843, 848 (Bankr. W.D. Ky. 2004).

[384] *In re* Millspaugh, 302 B.R. 90, 99 (Bankr. D. Idaho 2003) (citing *In re* Rheaume, 296 B.R. 313, 321 (Bankr. D. Vt. 2003)).

[385] *In re Bennett*, 312 B.R. at 848 ("The [Rule 3012] motion must be filed with the Chapter 13 plan . . . ."); FED. R. BANKR. P. 2002(b).

[386] *See Espinosa*, 553 F.3d at 1201 (addressing a similar issue regarding student loan creditors).

Even if the creditor does not get actual notice of the strip-off, the notice granted by a Rule 3012 motion would likely still be constitutional.[387] The constitutional standard for notice in bankruptcy need only be "reasonably calculated" to offer the creditor the opportunity to object.[388] Actual notice is not required; notice by mail is necessary only when the name and location of the creditor is known.[389] The mailing of a clearly identifiable strip-off motion to a sophisticated creditor easily meets the *Mullane* standard for notice. Therefore, the extra cost imposed on the debtor to carry out an adversary proceeding for a strip-off is unnecessary and a waste of resources.

E. Adversary Proceedings Provide No Essential Additional Procedural Protections

An adversary proceeding pursuant to Rule 7001 does not add to the procedural protections that a creditor has under a Rule 3012 motion. A Rule 3012 motion initiates a contested matter pursuant to Rule 9014.[390] Litigation of a dispute via a contested matter is very similar to an adversary proceeding.[391] "Contested matters . . . can still result in discovery and in trials before the bankruptcy judge."[392] Rule 9014 contested matters apply forty-seven of the seventy-seven FRCPs that apply in adversary proceedings; the applicable FRCPs relate to findings of fact, discovery, subpoenas, evidence, judgments, and conclusions of law.[393] When applied to contested matters, these rules should provide sufficient due process for a creditor contesting a strip-off through a Rule 3012 motion.[394]

In extraordinary cases, Rule 9014 gives the judge discretion to order additional procedural protections.[395] The onus to initiate extra protections lies on the judge, which eliminates the excessive leverage granted to the creditor by

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387 *See* Jones v. Flowers, 547 U.S. 220, 225 (2006) ("[D]ue process does not require actual notice . . . ."); Mullane v. Cent. Hanover Bank & Trust Co., 339 U.S. 306, 314–15 (1950).

388 *See Espinosa*, 130 S. Ct. at 1378 (interpreting *Mullane*, 339 U.S. at 314).

389 *See Jones*, 547 U.S. at 225; *see also Mullane*, 339 U.S. at 314–18.

390 FED. R. BANKR. P. 9014 advisory committee's notes ("Whenever there is an actual dispute, other than an adversary proceeding, before the bankruptcy court, the litigation to resolve that dispute is a contested matter."); *see also* 9 COLLIER, *supra* note 22, ¶ 3012.01.

391 John G. Stevenson, Jr., Comment, *Discovery Under the Federal Rules of Bankruptcy Procedure*, 9 BANKR. DEV. J. 643, 660–61 (1993).

392 Ayer, *supra* note 124, at 16.

393 Christopher M. Klein, *Bankruptcy Rules Made Easy (2001): A Guide to the Federal Rules of Civil Procedure That Apply in Bankruptcy*, 75 AM. BANKR. L.J. 35, 39 (2001).

394 *See* 10 COLLIER, *supra* note 22, ¶ 9014.06.

395 Klein, *supra* note 393, at 39; *see also* FED. R. BANKR. P. 9014.

an adversary proceeding.[396] Judicial discretion allows the judge to determine which cases deserve additional protection and thus provides a balance between a streamlined procedure and protecting creditor's rights through additional processes.[397] In the overwhelming majority of cases, the procedural safeguards in strip-off motions are constitutionally sufficient.[398] Coupled with judicial discretion to enact additional procedures, the strip-off of a wholly unsecured junior mortgage by motion provides a creditor with adequate due process protections without the additional cost and time associated with adversary proceedings.

F. Strip-off by Plan May Provide Insufficient Procedural Protections

Both a chapter 13 plan and a motion to strip off a lien provide constitutionally sufficient procedural protection to the creditor. However, there are several reasons why filing a motion to achieve strip-off is a better procedure than allowing strip-off by the plan. As previously determined, Rule 3012 requires a motion to strip off a lien.[399] Furthermore, these mortgage lenders are typically sophisticated business entities and should understand that a chapter 13 plan could alter their rights, making adversary motions a needless burden.[400]

Nevertheless, suppose the rare circumstance happens where the creditor is a private individual, and the only loan the creditor has ever made is now subject to a strip-off. A motion to strip off a lien is a one or two-page document that is usually very easy to understand.[401] At a minimum, it may prompt the creditor to seek legal advice. A chapter 13 plan is usually much longer and contains information about every creditor, as well as detailed financial statements.[402]

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396 *See* Stevenson, *supra* note 391, at 661 (noting that the judge's discretion "prevent[s] a simple contested matter from becoming mired down in unnecessary procedural formalities").

397 *See id.*; *see also In re* Sadala, 294 B.R. 180, 182–83 (Bankr. M.D. Fla. 2003).

398 *See, e.g.*, *In re* Millspaugh, 302 B.R. 90, 102 (Bankr. D. Idaho 2003) (holding the use of a Rule 3012 motion to strip off "compl[ies] with considerations of due process"); *In re* King, 290 B.R. 641, 651 (Bankr. C.D. Ill. 2003) (holding chapter 13 plan providing for a strip-off "comport[s] with due process concerns").

399 *Supra* Part II.C.2.

400 *Supra* Part V.C.

401 For an example, see Motion to Value Collateral at 4, *In re* Kountanis, No. BK-S 10-10253-BAM (Bankr. D. Nev. May 11, 2010), 2010 WL 2213356.

402 *See In re* Forrest, 424 B.R. 831, 832 (Bankr. N.D. Ill. 2009).

The plan is harder for unsophisticated creditors to understand and so these creditors may inadvertently give up their rights to oppose the strip-off.[403]

Allowing strip-off through the plan also runs contrary to the purpose of the chapter 13 plan document and may be judicially deficient. In many jurisdictions, the court provides debtor's counsel with a form chapter 13 plan.[404] The form includes common terms and conditions that may be inserted in the plan such as details of the debtor's finances.[405] These forms, however, do not usually include "provisions that act as declaratory judgments that purport to adjudicate legal issues between parties if the plan is confirmed."[406] Strip-off via the plan would do just that by undermining the rights of the junior creditor through confirmation of the plan.[407] A motion puts the resolution of the strip-off dispute in its proper medium, protecting junior creditors' rights by guaranteeing clearer notice and a modicum of procedure. Therefore, the correct procedure is strip-off via motion, not through a plan.

CONCLUSION

Although the majority of bankruptcy courts have held an adversary proceeding is not required for strip-off, the controversy is far from over. No circuit courts have addressed the issue, and practitioners are left in the dark as to the correct procedure for strip-off. In the absence of authoritative direction from the Supreme Court or the circuit courts of appeals, this Comment has attempted to clarify this complex and confusing issue.

The main point of contention between the minority and majority approaches is the applicability of Rule 7001.[408] The minority contends that the plain language of Rule 7001 indicates that it applies to strip-off.[409] On the other hand, the majority holds that Rule 7001 does not apply because the Rule 3012 and advisory committee's intent indicate that Rule 3012 applies to strip-

403 *See* Bennett v. Springleaf Fin. Servs. (*In re* Bennett), No. 11-32916, 2012 Bankr. LEXIS 31, at *35 (Bankr. S.D. Ohio Jan. 12, 2012) ("The language advising creditors that the [plan] confirmation hearing would serve as a [strip-off] hearing may be difficult for a lay person to comprehend.").

404 *In re Forrest*, 424 B.R. at 832.

405 *Id.*

406 *Id.*

407 *See id.* at 832–33.

408 *See, e.g.*, *In re* Chukes, 305 B.R. 744, 744–45 (Bankr. D.D.C. 2004); *In re* King, 290 B.R. 641, 646–48 (Bankr. C.D. Ill. 2003).

409 Pierce v. Beneficial Mortg. Co. of Utah (*In re* Pierce), 282 B.R. 26, 28 (Bankr. D. Utah 2002) (explaining that the plain language of Rule 7001(2) requires an adversary proceeding to achieve a strip-off).

off.[410] Further, there is more disagreement within the majority as to whether a strip-off must be accomplished by a separate motion or if a plan indicating an intent to strip off suffices.[411] Rule 7001 does not apply to strip-off and a separate motion is required to comply with Rule 3012.

The Supreme Court's decision in *Espinosa* further indicates that an adversary proceeding is not required by undercutting two key arguments that the minority uses to support requiring an adversary proceeding to strip off a junior mortgage.[412] The Supreme Court held that the "reasonably calculated" standard is the constitutional requirement for notice in bankruptcy and that res judicata can bar an appeal of a confirmed plan that did not initiate an adversary proceeding as required by the Bankruptcy Rules.[413] These holdings have important implications to the procedural requirements for strip-off and they support the majority's approach.

Further, from a policy perspective, an adversary proceeding is unnecessary for strip-offs of wholly unsecured junior mortgages. Important policy considerations such as maintaining judicial economy, avoiding needless additional costs, and granting creditors too much leverage all speak against requiring an adversary proceeding for strip-off. Although an adversary proceeding does afford a higher degree of notice through the filing of a formal complaint, this extra notice is unnecessary.[414] A motion provides creditors with the necessary procedural protections to contest a strip-off.

It is important to ensure that chapter 13 debtors who are trying to keep their homes know and follow the correct strip-off procedure. The Great Recession and the increased number of foreclosures[415] has made strip-off a powerful tool for debtors. If a debtor follows the incorrect procedure, however, a court might find the plan invalid due to insufficient notice and find that the junior lien on his or her home was never actually stripped off. Because a debtor's largest and

410 *In re* Robert, 313 B.R. 545, 549–50 (Bankr. N.D.N.Y. 2004); *In re* Sadala, 294 B.R. 180, 182 (Bankr. M.D. Fla. 2003).
411 Lloyd & Holtschlag, *supra* note 23, at 68.
412 *See supra* Part III.A.
413 *See* United Student Aid Funds, Inc. v. Espinosa, 130 S. Ct. 1367, 1380–81 (2010).
414 *See In re Sadala*, 294 B.R. at 185.
415 *See* Mann, *supra* note 13, at A27.

most important asset—his or her home—is at risk, an insufficient strip-off will create serious problems in achieving an equitable outcome in bankruptcy.

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