UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF COLORADO

In re:	)	
	)	
LOUIS DANIEL MENDOZA and	)	Bankruptcy Case No. 09-22395 HRT
CATALINA DESENA MENDOZA	)	
	)	Chapter 13
Debtors.	)	
	)	

ORDER REGARDING VERIFIED MOTION TO DETERMINE SECURED STATUS PURSUANT TO 11 U.S.C. § 506

I. Background

Debtors previously filed for bankruptcy under Chapter 7 on March 22, 2008, in Case No. 08-13608. An Order of Discharge of Debtor was entered in that case on July 16, 2008. Eleven months later, on June 24, 2009, the Debtors filed the instant case under Chapter 13. An Order of Ineligibility for Discharge was entered in this case on August 27, 2009, pursuant to 11 U.S.C. § 1328(f)(1).

Debtors filed a Verified Motion to Determine Secured Status Pursuant to 11 U.S.C. § 506 on August 31, 2009. In the motion, Debtors state that the payoff on the first deed of trust on their house is $191,869.10, and that the payoff on the second mortgage is $48,884.74. Both mortgages are held by Litton Loan Servicing LP ("Litton"). According to Debtors, the house is valued at $154,029, and there is a $1,156.26 arrearage on the first mortgage. Through their chapter 13 plan and the motion, Debtors seek to pay the Trustee's fee and the arrearage on the first deed of trust. They also propose to pay class four creditors a total of $156, and to strip off the second mortgage lien pursuant to 11 U.S.C. § 506. Under Debtors' proposal, the second mortgage would be treated as unsecured, and therefore as a class four claim.

The Trustee objects to confirmation of Debtors' Chapter 13 plan, arguing that by trying to strip a completely unsecured consensual lien from their primary residence, Debtors are effectively seeking to do that which they cannot do because they are not entitled to discharge. According to the Trustee, state law remedies must determine the rights of a second mortgage holder if no discharge can be entered. Therefore, the second mortgage holder's rights must be determined by the relevant mortgage instruments, which are enforceable under state law. The Trustee contends that Colorado law does not allow the stripping of a second mortgage holder's lien.

II. Discussion

The Bankruptcy Code allows a debtor to file a Chapter 13 case following his receipt of a discharge in a Chapter 7 case. *Johnson v. Home State Bank*, 501 U.S. 78, 111 S.Ct. 2150 (1991). However, in 2005, Congress limited the reach of Chapter 13 by enacting the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"). Under BAPCPA, debtors who already received a discharge in a Chapter 7 case are precluded from receiving a discharge in a Chapter 13 case filed within four years after the Chapter 7 case. 11 U.S.C. § 1328(f)(1).

The Debtors received discharge of their personal liability on their mortgage notes in their Chapter 7 case. The discharge extinguished only the *in personam* claims against them, however, leaving intact Litton's *in rem* claims against the Debtors' property. *Johnson*, 501 U.S. at 84-85, 111 S.Ct. at 2154.

The question now before the Court is whether the *in rem* claim under Litton's second mortgage should continue to survive confirmation of the Debtors' chapter 13 plan, given the fact that these Debtors are ineligible for discharge. That is – can the Debtors, who are ineligible for discharge pursuant to section 1328(f)(1), utilize section 506(a) to strip off an unsecured mortgage through their Chapter 13 plan?

A. 11 U.S.C. § 506

As a starting point, the Court will look to 11 U.S.C. § 506(a) for a determination of the status of a claim as secured or unsecured, *Nobelman v, American Savings Bank*, 508 U.S. 324,328-29, 113 S.Ct. 2106, 2110 (1993), and then to section 506(d) to determine whether the lien is void.

The relevant portions of section 506 provide:

> (a)(1) An allowed claim of a creditor secured by a lien on property in which the estate has an interest, or that is subject to setoff under section 553 of this title, is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, or to the extent of the amount subject to setoff, as the case may be, and is an unsecured claim to the extent that the value of such creditor's interest or the amount so subject to setoff is less than the amount of such allowed claim. Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest.
>
> . . .
>
> (d) To the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void, unless –
>
> (1) such claim was disallowed only under section 502(b)(5) or 502(e) of

> this title; or
> (2) such claim is not an allowed secured claim due only to the failure of any entity to file a proof of such claim under section 501 of this title.

11 U.S.C. § 506(a), (d).

In this case, it is undisputed that the amount of Litton's first mortgage debt exceeds the value of the property securing that debt. It is also undisputed that Litton's second mortgage debt is wholly unsecured under § 506(a). Litton's second lien, then, appears to be void under § 506(d), because it secures a claim that, at the time of petition, is not an allowed secured claim. However, the Supreme Court held in *Dewsnup v. Timm*, 502 U.S. 410, 112 S. Ct. 773 (1992), that section 506(d) does not allow a Chapter 7 debtor to strip down a creditor's lien on real property to the value of the collateral. *Id.*, 502 U.S. at 417. Thus, section 506 was not intended to change the rule that a creditor's lien passes through bankruptcy unaffected. *Id.*

B. Modification of Rights of Creditors Under 11 U.S.C. § 1322

Chapter 13 provides for modification of creditors' rights not permitted in Chapter 7. Under Chapter 13, if a debtor meets the eligibility requirements for relief, he may submit for the bankruptcy court's confirmation a plan that modifies the rights of both secured and unsecured creditors per section 1322. That section provides that a plan may "modify the rights of holders of *secured claims, other than a claim secured by a security interest in real property that is the debtor's principal residence*, or of holders of *unsecured claims*, or leave unaffected the rights of holders of any class of claims." 11 U.S.C. § 1322(b)(2) (emphasis added). Section 1322(b)(2), therefore, provides special protection for creditors whose claims are secured only by a lien on a debtor's principal residence, *Nobelman v. American Sav. Bank*, 508 U.S 324, 327, 113 S.Ct. 2106, 2109 (1993), but it does not provide any special protection for creditors whose claims are wholly unsecured. *See also Griffey v. U.S. Bank (In re Griffey)*, 335 B.R. 166, 169-70 (10th Cir. 2005) (holding that the antimodification clause of 11 U.S.C. § 1322(b)(2) does not apply to the holder of a wholly unsecured claim). Under the Code, then, the Debtors may submit a plan that modifies the rights of Litton and provides for payment of all or part of its allowed claims.[1]

---

[1] Both parties cite to the unpublished Memorandum Opinion on Remand Confirming Debtors' Chapter 13 Plan in *In re Picht*, Case No. 08-20677, slip op. (Bankr. D. Kan. Jun. 20, 2009), the appeal of which is currently pending in the Tenth Circuit. Debtors ask the Court to adopt the reasoning of the bankruptcy court in *Picht*, while the Trustee urges the Court to disregard it. Both parties characterize *Picht*, however, as a case in which the court allowed the Debtors to strip a completely unsecured consensual lien off of their primary residence through 11 U.S.C. § 506. That is not correct, as *Picht* dealt with a circumstance in which the second mortgage was undersecured – not wholly unsecured, as is the case here. *See Picht*, slip op. at 2 ("Debtors filed for Chapter 13 relief on March 28, 2008. The Bank filed a proof of claim for

C. Avoidance of Lien Where Debtors are Ineligible for Discharge

It does not automatically follow that because debtors generally are allowed to seek modification of such an unsecured creditor's claim through plan confirmation, that debtors, who are ineligible for discharge, are allowed to avoid a lien on the collateral pledged to secure that debt.

In *In re Jarvis*, 390 B.R. 600, 604 (Bankr. C.D. Ill. 2005), the court held that the avoidance of a lien is contingent upon the debtor's completing a plan and receiving a discharge. *Jarvis*, 390 B.R. at 604 (holding that "although the 'lien-avoiding effect of the confirmed plan' is established at confirmation," precedent established prior to BAPCPA demonstrates that avoidance of a lien is contingent upon the debtor's completing a plan and receiving a discharge)(quoting *In re King*, 290 B.R. 641, 651 (Bankr. C.D. Ill. 2003)). Indeed, 11 U.S.C. § 1328 states:

> (f) Notwithstanding subsections (a) and (b), the court shall not grant a discharge of all debts provided for in the plan or disallowed under section 502 if the debtor has received a discharge—
>
> > (1) in a case filed under chapter 7, 11, or 12 of this title during the 4-year period preceding the date of the order for relief under this chapter, or
> >
> > (2) in a case filed under chapter 13 of this title during the 2-year period preceding the date of such order.

11 U.S.C. § 1328(f).

As noted by the *Jarvis* court, prior to the enactment of § 1328(f), courts consistently held that "because a portion – the *in rem* portion – of a creditor's claim against a debtor remains after the Chapter 7 discharge, the permanent modification of that claim [could] only be effected by completing the terms of the Chapter 13 and receiving a discharge notwithstanding the discharge of personal liability in the prior case." *Id.* at 606 (citing *In re King* 290 B.R. 641, 651 (Bankr. C.D. Ill. 2003) and *In re Akram*, 259 B.R. 371, 378-79 (Bankr. C.D. Cal. 2001)). Further, the court reasoned, though a no-discharge Chapter 13 case could be utilized to obtain the protections

---

$127,000.00. The Bank's second mortgage secures up to $126,000.00. Debtors value their home at $300,000.00. The value of the first mortgage is $285,147.27. Thus, Debtors' plan proposes to strip down the Bank's lien, pay the Bank $14,852.73 as the value for the second mortgage, and leave the remaining unsecured portion of the Bank's claim discharged by the prior bankruptcy.") (footnotes omitted). Because of those facts, the *Picht* court made a number of findings on the basis of 11 U.S.C. § 1325(a)(5), which the parties here discuss in their briefs. That subsection is inapplicable to this case because it relates solely to allowed secured claims under a Chapter 13 plan. *See* 11 U.S.C. § 1325(a)(5).

of the automatic stay for the purpose of proposing a plan to make payments on debts, it could not "result in a permanent modification of a creditor's rights where such modification has traditionally only been achieved through a discharge and where such modification is not binding if a case is dismissed or converted." *Id.* at 605-06. Looking to "the limited legislative history of BAPCPA," the *Jarvis* court concluded that Congress did not intend to change that result. *Id.* at 606. This Court agrees with the *Jarvis* court's conclusion.

The Court also finds persuasive a recent unpublished decision issued by the U.S. Bankruptcy Court for the Central District of California in *In re Winitzky*, Case No. 08-bk-19337-MT, slip op. (Bankr. C.D. Cal. Aug. 1, 2009). In *Winitzky*, the court recognized that a Chapter 13 plan may "modify the rights of holders of secured claims . . . or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims." 11 U.S.C. § 1322(b)(2). But, under *Nobelman*, the "rights" of the holders of claims are reflected in the mortgage instruments executed by the parties, which are enforceable under state law. Here, given that there is no secured portion of Litton's second mortgage claim, permitting the stripping off of its lien under the second mortgage would do more than modify Litton's *in rem* rights to redeem the property should the first deed of trust holder commence foreclosure proceedings – it would eliminate such rights. *See Winitzky*, slip op.at 2. As aptly stated by the U.S. Bankruptcy Court for the Eastern District of Wisconsin, "[A]llowing a debtor to file Chapter 7, discharge all dischargeable debts, and then immediately file Chapter 13 to strip off a second mortgage lien would not be much different than simply avoiding the mortgage lien in the Chapter 7 itself," *Blosser v. KLC Financial, Inc. (In re Blosser)*, No. 07-28223-svk, 2009 WL 1064455 at *1 (Bankr. E.D. Wisc. Apr. 15, 2009).

Section 1328(f), which was added to the Code by BAPCPA, is the most recent expression of congressional intent regarding discharge of debts in Chapter 13 by individuals who have recently received Chapter 7 discharges. That section clearly states that a court cannot grant a discharge to a debtor who has filed for Chapter 13 within four years after receiving relief under Chapter 7.

It is a basic canon of statutory construction that a statute should not be interpreted so as to render any one part inoperative. *Mountain States Tel. & Tel. Co. v. Pueblo of Santa Ana*, 472 U.S. 237, 249, 105 S.Ct. 2587, 2594 (1985). Allowing Debtors to avoid Litton's second mortgage lien through this subsequent Chapter 13 filing would be tantamount to granting them a discharge as to that debt, and would thereby render the bar set forth in section 1328(f) inoperable. Further,

> a separate lien discharge would also contradict sections 348 and 349 of the Code. Section 348(f)(1)(B) voids 11 U.S.C. § 506(a) valuations when a case under Chapter 13 converts to one under Chapter 7 of the Code. Similarly, section 349(b)(1)(c) reinstates upon dismissal any lien previously avoided under section 506(d). These two provisions demonstrate that conversion or dismissal can happen at any time during a Chapter 13 case until the case is closed. Providing

> for the reinstatement of liens upon conversion or dismissal keeps the bankruptcy court from modifying state law lien rights without a separate legitimate bankruptcy purpose.

Winitzky, slip op.at 2. "[L]ien stripping under these circumstances does not appear to comport with Congressional intent, as evidenced by the 4-year bar between a Chapter 7 discharge and eligibility for a Chapter 13 discharge, and the provisions allowing avoided liens to 'spring back' on conversion or dismissal of the Chapter 13 case." *Blosser*, 2009 WL 1064455 at *1. Thus, avoidance of an unsecured lien prior to discharge does not comport with the Code, and Debtors' interpretation cannot stand.

III. Good Faith Concerns

Though no creditor or the Trustee has objected to confirmation on these grounds, the Court has an independent duty to determine whether the Debtors' plan meets all requirements for confirmation. 11 U.S.C. § 1325; *In re Quiles*, 262 B.R. 191, 195 (Bankr. D.R.I. 2001). Two such requirements are that the plan has been proposed in good faith and not by any means forbidden by law, 11 U.S.C. § 1325(a)(3), and that the petition was filed in good faith,11 U.S.C. § 1325(a)(7).

> In this case, the Debtors state:
>
> Mr. Mendoza retired in the months following the discharge. Property values drastically dropped especially in the Debtors' area of Southern Aurora. Due to reduced income and increased number of family members living in this residence, the Debtors found it increasingly difficult to make all expenses.
>
> To alleviate the debt listed, the Debtors filed the Chapter 123 [sic] Bankruptcy on June 24th, 2009 to attempt to strip the 2nd mortgage. The option to file Chapter 13 was not available in March, 2008 [when the Debtors filed for Chapter 7 bankruptcy] due mostly to higher property valuation.

(Chapter 13 Debtors' Br. at 1.)

In *Winitzky*, the court noted that one of the basic purposes of Chapter 13, to propose a plan to pay back creditors, is defeated in some cases where the only purpose for filing is to strip off an unsecured second mortgage. Where debtors seek only the benefits of Chapter 13, while shunning its burdens, a plan cannot be confirmed. *Winitzky*, slip op. at 3 (citing *Quirles*, 262 B.R. at 194).

It is Debtors' obligation to propose a good-faith payment to holders of unsecured claims. Given the fact that Mr. Mendoza retired shortly after the Chapter 7 discharge, and the fact that Debtors' proposed payment is quite low in comparison to the debt owed on the second mortgage,

one might question whether the plan is, in fact, proposed in good faith. *See Flygare v. Boulden*, 709 F.2d 1344 (10th Cir. 1983). Moreover, in this case, though property values may well have dropped dramatically, it appears that Debtors may be seeking to achieve through Chapter 13 what they could not do in Chapter 7. If, in fact, Debtors' Chapter 13 plan is proposed primarily as an end-run around Chapter 7, or a second bite at the bankruptcy apple, their conduct could constitute an abuse of process that precludes confirmation. *See Marrama*, 498 U.S. at 375-75 (stating that bankruptcy court has inherent authority under § 105(a) to sanction abusive litigation practices).

As of now, the parties have not presented evidence or arguments regarding good faith, so this question is not squarely before the Court, but should the Debtors choose to amend their plan, they should be prepared to address this issue.

IV. Conclusion

Because the Court cannot grant a discharge in this case, the Bankruptcy Code does not allow the Debtors to avoid the second mortgage lien of Litton pursuant to 11 U.S.C. § 506(d). Accordingly, it is

ORDERED that the Debtors may either (a) amend their Chapter 13 plan on or before February 8, 2010, or (b) voluntarily dismiss their case. If no amended plan is filed by February 8, 2010, the case will be dismissed pursuant to 11 U.S.C. 1307(C)(5) and 1322(b)(3).

DATED this 21st day of January, 2010.

BY THE COURT:

Howard R. Tallman, Judge
United States Bankruptcy Court