BANKRUPTCY AND CONSUMER FINANCE

NEW CRITICAL TAKEAWAYS FOR GENERAL PRACTITIONERS

4:25 p.m. – 5:30 p.m. Thursday, October 3, 2013
Lakeshore Ballroom

2013 ISBA Solo and Small Firm Conference
October 3-5, 2013
Westin Northwest Chicago
Itasca, Illinois

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I. HOME MORTGAGES

- HAMP
- Bankruptcy Ride Through and Reaffirmation
- Bankruptcy Strip Off and Strip Down

II. AUTOMATIC STAY

- Judgment Creditors
- Family Law Cases

III. CFPB

- Ability to Repay
- Servicing Rules
- Student Debt

Home Affordable Modification Program

If you are not unemployed, but you're still struggling to make your mortgage payments, you may be eligible for the **Home Affordable Modification Program (HAMP®)**. HAMP may lower your monthly mortgage payments in order to make them more affordable and sustainable for the long-term.

If you currently occupy your home as your primary residence, we encourage you to contact your mortgage servicer as soon as possible to begin the HAMP evaluation process.

In an effort to continue to provide meaningful solutions to the housing crisis, **effective June 1, 2012**, the Obama Administration expanded the population of homeowners that may be eligible for the Home Affordable Modification Program to include:

- Homeowners who are applying for a modification on a home that is not their primary residence, but the property is currently rented or the homeowner intends to rent it.
- Homeowners who previously did not qualify for HAMP because their debt-to-income ratio was 31% or lower.
- Homeowners who previously received a HAMP trial period plan, but defaulted in their trial payments.
- Homeowners who previously received a HAMP permanent modification, but defaulted in their payments, therefore losing good standing.

If you are a homeowner who falls into any of these criteria, you may be eligible for a modification under the expanded criteria. Please check with your mortgage servicer to see if you are eligible to begin the HAMP evaluation process.

+ Eligibility

+ Program Availability

+ Steps to apply for a HAMP Modification

+ More Information

+ Videos

Key Terms on This Page:

Verified Monthly Gross (pre-tax) Income, Mortgage Modification, Second Mortgage

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Help is a Phone Call Away

888-995-HOPE (4673)

Hearing impaired: 877-304-9709 TTY

As you enter a process that can sometimes be overwhelming, it would be in your best interest to engage a housing expert to help you along the way. Let a HUD-approved housing counselor help you understand your options, prepare your application, and work with your mortgage company.

Homeowner's HOPE™ Hotline

Hear it from Homeowners

Curtis and Darlene of Chicago, IL
Curtis and Darlene had lived in their home for 35 years when Curtis lost his job. That's when MHA helped them cut their mortgage payments in half.

See their story (PSA)

Beware of Scams

Unfortunately, and far too often, homeowners looking for mortgage help end up victimized by scam artists. Know the warning signs to protect yourself, your money, and your home.

Learn where to file a complaint

I. Reaffirmation Standards

A. For enforceable reaffirmation agreement *when debtor is represented by counsel*:

- agreement must be made prior to entry of discharge;
- debtor must receive disclosures in section 524(k)
- agreement must be filed with bankruptcy court, accompanied by declaration or affidavit of debtor's attorney stating that:
  - agreement is informed and voluntary,
  - reaffirmed debt does not impose undue hardship, and
  - attorney has fully advised debtor of legal effect of agreement and any default thereunder; and
- debtor must not have rescinded agreement prior to discharge or within 60 days after agreement has been filed, whichever occurs later.

11 U.S.C. § 524(c).

B. If all requirements are satisfied, agreement becomes effective immediately upon being filed with court *as long as there is no presumption of undue hardship*. 11 U.S.C. § 524(k)(3)(J)(i).

II. Undue Hardship

A. Presumption of undue hardship:

- will arise based on what is shown on debtor's completed and signed statement in support of agreement required under subsection (k)(6)(A) (the "Debtor's Statement in Support"). 11 U.S.C. § 524(m)(1);
- no requirement that information on Debtor's Statement in Support be accurate or, if information is not accurate, that court look to other documents or statements;
- Debtor's Statement in Support must be accompanied by statement of total income and expenses on schedules I and J. If there is a difference between income and expenses on those schedules and Debtor's Statement in Support, the latter must include explanation of the difference. Fed. R. Bank. P. 4008(b).

- Presumption of undue hardship exists if debtor's monthly income less debtor's monthly expenses is less than scheduled payments on reaffirmed debt.

B. Credit Union Exception:

- If creditor is credit union and debtor was represented by attorney during negotiation of reaffirmation agreement, agreement becomes effective upon filing.

- When agreement is with credit union, no presumption of undue hardship exists. 11 U.S.C. § 524(m)(2).

- Code does not provide for independent court review of reaffirmation agreement between represented debtor and credit union.

C. Because of requirements and inaccuracies inherent on Debtor's Statement in Support, two views have developed as to how to determine whether presumption of undue hardship will arise:

- **Broad Scope Determination**—Bankruptcy court has power to evaluate accuracy of financial disclosures made by debtor as part of reaffirmation package. *In re Laynas*, 345 B.R. 505 (Bankr. E.D. Pa. 2006).

- **Narrow Scope Determination**—Determination as to whether presumption of undue hardship will arise is determined solely from figures required by Debtor's Statement in Support. *In re Wilson*, 363 B.R. 220 (Bankr. D.N.M. 2007).

D. If presumption of undue hardship exists, **court must review the application for approval**:

- Debtor can rebut the presumption in writing by identifying "additional sources of funds to make the payments."

- If presumption is not rebutted **to court's satisfaction**, court may disapprove agreement after notice and hearing, which must be concluded before entry of debtor's discharge.

11 U.S.C. § 524(m)(1).

E. Court Review of Undue Hardship

- Very little authority on what constitutes rebutting the presumption "to the court's satisfaction."

- Reaffirmation agreements are strictly construed to protect debtor from "overreaching creditors." *In re Petersen*, 110 B.R. 946, 949-50 (Bankr. D. Colo. 1990) (internal quotation omitted).

- Section 524 is meant to protect a debtor who unwittingly executes, or has been coerced into executing, a reaffirmation agreement; the provisions of section 524(c) are a shield to protect the debtor. *Id.* at 950.

- Code does not provide for independent court review of reaffirmation agreements entered into by represented debtor when there is no presumption of undue hardship or presumption period has passed.

- Court's review of attorney-certified reaffirmation agreements should focus on presumption of undue hardship and whether attorney's certification complies with Rule 9011.

- If debtor seeking approval of reaffirmation agreement is not represented by counsel, bankruptcy court must:

  - inform debtor that reaffirmation is not required,
  - describe legal consequences of reaffirming debt, and
  - decide whether reaffirmation is in debtor's best interest or poses undue hardship.

III. Issues in Connection with Attorney Certification Requirement

A. Two Attorney Certification Requirements Under Section 524 and Official Bankruptcy Form:

- Debtor's attorney must certify that:

  - agreement is "fully informed and voluntary,"
  - it does not impose an "undue hardship on the debtor," and
  - attorney has "fully advised the debtor of the legal effect and consequences" of the agreement.

- If presumption of undue hardship arises, section 524(k)(5)(B) requires debtor's attorney to certify that, in attorney's opinion, debtor will be able to pay debt notwithstanding presumption of undue hardship.

B. Common Ethical Problem Resulting from Requirements

- Debtor wants to reaffirm debt but attorney believes reaffirmation not in debtor's best interests.

- If attorney certifies, runs the risk of violating the rules of professional responsibility and/or Rule 9011 or even committing fraud.

- Code should not be read to *require* attorneys to sign certification.

C. Ways That Attorneys Have Responded to the Potential Ethical Conflicts

- Limiting the scope of representation by excluding reaffirmations
- Partial withdrawal

Some courts have held that limiting the scope of representation and partial withdrawal are not allowed.

IV. The "Made" Requirement Under Section 524(c)(1)

A. Reaffirmation agreement is enforceable only if, *inter alia*, "such agreement was made before the granting of the discharge[.]" 11 U.S.C. § 524(c)(1).

B. Issue: When is a reaffirmation agreement "made" for purposes of section 524(c)(1)?

- ***In re Davis***, 273 B.R. 152, 153 (Bankr. S.D. Ohio 2001): "[W]here it can be shown that a reaffirmation was 'made,' i.e., signed, *before* the granting of the discharge, then the reaffirmation agreement may be 'filed' *after* the granting of the discharge."
- ***In re LeBeau***, 247 B.R. 537, 540-41 (Bankr. M.D. Fla. 2000): Reaffirmation agreement was enforceable as having been "made" prior to entry of debtors' discharge, where parties had reached agreement on terms of agreement and debtors had commenced performance thereunder, even though debtors' signed writing embodying terms of agreement was filed after entry of discharge.

V. The "Ride-Through" (or "Pass-Through") Option

A. "Ride–through" (or "pass-through") allows debtor current on payments to retain property and continue to make payments without reaffirming or redeeming.

- Prior to BAPCPA, five circuits held that ride-through was available to debtors (Second, Third, Fourth, Ninth, Tenth).
- Other circuits rejected ride-through (First, Fifth, Seventh, Eleventh).
- Since BAPCPA, debtor's ability to state ride-through intention when filing chapter 7 has been restricted. Debtor seeking to retain property after filing must now state intention to either reaffirm or redeem. 11 U.S.C. §§ 521(a), 362(h). "Ride-through" still appears to be available, however, under a narrow set of circumstances.

B. Where the Seventh Circuit Stands

- No Seventh Circuit case on issue since passage of BAPCA

- Pre-BAPCA—***In re Edwards*, 901 F.2d 1383 (7th Cir. 1990)**: Court found ride-through not permitted, holding that debtor must, as condition of retaining, either redeem or reaffirm, even though debtor had performed and was continuing to perform all obligations of loan agreement.

- Post-BAPCA Case in Bankruptcy Court for Northern District of Illinois—***In re Alvarez*, No. 10-B-28565, 2012 WL 441257 (Bankr. N.D. Ill. Feb. 10, 2012).** Court stated its belief that section 521(a)(6) is intended to emphasize that there is no "ride-through option."

C. Ride-Through in Practice:

- Court has discretion to examine situations where there is undue hardship and to suggest to debtor who is current that debtor retain collateral and continue to make payments.

- Court cannot, however, order "ride-through."

- Court needs to know if creditor requires reaffirmation agreement in order for debtor to retain collateral in deciding whether to permit reaffirmation.

D. Circumstances Under Which Ride-Through May Be Available

- **Via a Reaffirmation Agreement That Is Not Approved—*In re Blakeley*, 363 B.R. 225 (Bankr. D. Utah 2007)**: Court found that debtor may still be able to obtain the benefits of "ride-through" if: (1) debtor timely filed statement of intent; (2) debtor timely entered into reaffirmation agreement with creditor; (3) debtor was *pro se* or, despite being represented by counsel, court chose to review the agreement; (4) court denies approval of agreement; and (4) court would have allowed "ride-through" prior to BAPCPA.

- **Via a Default—*In re Rowe*, 347 B.R. 341 (Bankr. D. Kan. 2006)**: Court noted that, although Congress eliminated a debtor's ability to select "ride-through," in Kansas "the practical result in many cases will be no significant change from the pre-BAPCPA Code as construed by the Tenth Circuit, except the stay will be automatically lifted."

- **Based on Section 521(a)(2)(A) Which Was Unchanged by BAPCPA—*Ford Motor Credit Co. v. Baker (In re Baker)*, 400 B.R. 135 (D. Del. 2009):** Relying on Third Circuit's decision in *In re Price*, 370 F.3d 362 (3d Cir. 2004), which in turn relied on section 521(a)(2)(A) which was unchanged by BAPCPA, court held that debtors had option of retaining their vehicles while continuing to make their regular monthly payments.

VI. **Interesting Reaffirmation Statistics**

Source: Government Accountability Report: GAO-08-94—Bankruptcy: Implementation of Reform Act's Debt Reaffirmation Provisions, *available at* http://www.gao.gov/htext/d0894.html, December 2007 (based on a representative sample of bankruptcy filed with reaffirmation agreements between October 17, 2005 and October 17, 2006 in five bankruptcy courts—in Alabama, California, Illinois, Texas, West Virginia)

Attorney Signatures and Certifications

- 95% to 100% of attorneys signed certification agreements for their clients
- In 1% to 11% of certifications, attorneys added language that attorney was not guaranteeing debtor's repayment or ability to repay debt

Collateral & Debt Burden

- Secured debts for cars and homes were most frequent type of reaffirmed debt
- 90% or more of all reaffirmation agreements were for debts secured by assets
- 54% to 87% of reaffirmation agreements were for automobiles
- 15% to 24% of reaffirmation agreements were for homes
- Credit card debt was most frequently reaffirmed unsecured debt
- 2% to 10% of all reaffirmation agreements were for unsecured debts
- Reaffirmed debt burden was less than 25% of total debt (in 2/3 of the cases reviewed)

Interest Rates

- For 56% to 84% of reaffirmed debts, interest rates were equal to original rate
- For 10% to 44% of reaffirmed debts, interest rates were less than original rate
- For 0% to 8% of reaffirmed debts, interest rates were more than original rate

Undue Hardship

- 67% to 88% of agreements included statement that agreement did not impose an undue hardship

Amount of Reaffirmed Debt

- Average amount reaffirmed per reaffirmation agreement was $12,000 to $31,000

I. Definitions

A. **Lien Strip-Offs** – The avoiding of a wholly undersecured junior lien under 11 U.S.C. § 1322(b)(2) in a Chapter 13 proceeding or under 11 U.S.C. § 506(d) in a Chapter 11 proceeding.

B. **Lien Strip-Downs** – The bifurcation of a partially undersecured junior lien into a secured claim and an unsecured claim under 11 U.S.C. § 506(a).

C. **"Chapter 20"** – A Chapter 7 case followed quickly by a Chapter 13 case. In the typical situation, the Debtor's residence is encumbered by multiple mortgages and the Debtor has no equity in the property. The Chapter 7 Trustee under these circumstances will normally make no claim against the residence and will often issue a no-asset report, and the Debtor will receive a discharge of all her debts. If one of the mortgagees has not yet completed foreclosure proceedings, the Debtor will, within a short period of time after the Chapter 7 case is closed, file a Chapter 13 proceeding. Even though she is not entitled to a Chapter 13 discharge under 11 U.S.C. § 1328(f)(1), the Chapter 13 filing will stay foreclosure proceedings while the Debtor attempts to strip off the junior mortgage on the residence. If she is successful in doing so, it will improve her chances of striking a deal with the senior mortgagee and avoiding foreclosure.

II. Summary of Conclusions

A. Lien strip-offs are available in the "reorganization" chapters of the Code (Chapters 11, 12 and 13), but are generally not available in the liquidation chapter of the Code (Chapter 7).

1. The courts are split on the appropriate procedure for obtaining a lien strip-off in Chapter 13. The three choices are (a) by adversary proceeding under Fed. R. Bankr. P. 7001(2); (b) by motion under Fed. R. Bankr. P. 3012; or (c) by plan under 11 U.S.C. § 1322(b)(2).
2. There are practical advantages and disadvantages to each procedure. My view is that attorneys should be free to choose the procedure that best fits their goals for their clients, as long as the notice they provide to the junior lienholder satisfies the requirements of due process.
3. Regardless of the procedure used, the better-reasoned opinions place great weight upon the sufficiency of the notice provided to the junior lienholder.

B. Lien strip-downs are available in Chapter 11 but are not available under Chapter 13 or Chapter 7 with respect to the Debtor's principal residence. Lien strip-downs are available in a Chapter 13 proceeding with respect to collateral other than the Debtor's principal residence.

C. Authorities are split as to whether Chapter 20s are permissible. Similarly, authorities are split as to whether a Chapter 13 debtor who is ineligible for a discharge is entitled to strip off a wholly undersecured lien on her principal residence. Even where Chapter 20s are permissible, the odds are great that the Chapter 13 will be dismissed for having been filed in bad faith.

III. The Governing Statutes and Rules

A. **11 U.S.C. § 506(a)(1)** – "An allowed claim of a creditor secured by a lien on property in which the estate has an interest . . . is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property. . . ."

B. **11 U.S.C. § 506(d)** - "To the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void . . . ."

C. **11 U.S.C. § 1322(b)(2)** – The Chapter 13 plan may "modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence . . . ."

D. **11 U.S.C. § 1325(a)(5)(B)(i)** – "[T]he court shall confirm a [Chapter 13] plan if . . . the plan provides that . . . the holder of [a] claim retain[s] the lien securing such claim until the earlier of . . . the payment of the underlying debt . . . ; or . . . discharge under section 1328; and . . . if the case . . . is dismissed or converted without completion of the plan, such lien shall also be retained by such holder . . . ."

E. **11 U.S.C. § 1328(f)(1)** – "[T]he court shall not grant a discharge . . . if the debtor has received a discharge . . . in a case filed under chapter 7 . . . during the 4-year period preceding the date of the order for relief under this chapter . . . ."

F. **Bankruptcy Rule 3012** – "The 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 and after a hearing on notice to the holder of the secured claim and any other entity as the court may direct."

G. **Bankruptcy Rule 7001(2)** – "An adversary proceeding is governed by the rules of this Part VII. The following are adversary proceedings: . . . (2) a proceeding to determine the validity, priority, or extent of a lien or other interest in property . . . ."

H. **Bankruptcy Rule 7004(h)** – "Service on an insured depository institution (as defined in section 3 of the Federal Deposit Insurance Act) in a contested matter or adversary proceeding shall be made by certified mail addressed to an officer of the institution unless -- (1) the institution has appeared by its attorney, in which case the attorney shall be served by first-class mail; (2) the court orders otherwise after service upon the institution by certified mail of notice of an application to permit service on the institution by first class mail sent to an officer of the institution designated by the institution; or (3) the institution has waived in writing its entitlement to service by certified mail by designating an officer to receive service."

IV. *Dewsnup, Nobelman* and *Lam*

A. *Dewsnup v. Timm*, 502 U.S. 410 (1992) – Section 506(d) does not allow a Chapter 7 debtor to "strip down" a secured creditor's lien to the judicially determined value of the collateral. Because the secured creditor's claim is secured by a lien and has been fully allowed pursuant to § 502, it cannot be classified as "not an allowed secured claim" for purposes of the lien-voiding provision of § 506(d). In reaching its result, the Court rejected the argument that an "allowed secured claim" must be given the same meaning in § 506(d) as it is given in § 506(a), despite the canon of statutory construction that ordinarily requires the same term

within a single statute to be given a single meaning. Instead, the Court emphasized that the pre-Code rule was that liens on real property pass through bankruptcy unaffected. That rule was such a fundamental principle of pre-Code bankruptcy law that the Court refused to conclude that Congress intended to abrogate it, absent clear evidence of such abrogation in either the legislative history or the language of the Code itself.

B. *Nobelman v. Am. Sav. Bank*, 508 U.S. 324 (1993) – Section 1322(b)(2) prohibits a Chapter 13 debtor from relying on § 506(a) to reduce the amount of a junior lender's partially secured residential mortgage claim by reference to the fair market value of the mortgaged residence at the time of the bankruptcy filing. So long as the § 506(a) valuation determined that the junior lender was at least partially secured, the lender was entitled under § 1322(b)(2) to all of a secured claimant's "rights [as a claim] holde[r]." Those rights include the junior lender's contractual rights to the agreed upon interest rates, monthly payment amounts, and repayment terms. At least where the junior lienholder's claim is partially secured, any modification of those rights proposed in a Chapter 13 plan is impermissible under § 1322(b)(2).

C. *Lam v. Investors Thrift (In re Lam)*, 211 B.R. 36 (B.A.P. 9th Cir. 1997) – The ruling in *Nobelman* that § 1322(b)(2) bars a Chapter 13 plan from modifying the rights of partially secured holders of residential mortgages does not apply to holders of totally unsecured claims, because those creditors hold no "secured claims" within the meaning of § 1322(b)(2).

V. May a lien strip-off (as opposed to a lien strip-down) be accomplished in a Chapter 7 proceeding, notwithstanding *Dewsnup*?

A. Yes

McNeal v. GMAC Mortg., LLC (In re McNeal), No. 11-11352, 2012 WL 1649853 (11th Cir. May 11, 2012). Under the Eleventh Circuit's "prior panel precedent" rule, a later panel may depart from an earlier panel's decision only when the intervening Supreme Court decision is "clearly on point." The Supreme Court's decision in *Dewsnup* only addressed lien strip-downs in Chapter 7s, not lien strip-offs. Because the prior Eleventh Circuit decision in *Folendore v. U.S. Small Bus. Admin.*, 862 F.2d 1537 (11th Cir. 1989) permitted lien strip-offs in Chapter 7s, the "prior panel precedent" rule of the Eleventh Circuit means that the *Folendore* ruling will continue to apply in that Circuit.

B. No

1. *Laskin v. First Nat'l Bank of Keystone (In re Laskin)*, 222 B.R. 872 (B.A.P. 9th Cir. 1998). In concluding that lien strip-offs are not permissible in Chapter 7 proceedings, the Court emphasized that the lien strip-off which was permitted in *Lam* was based on § 1322(b)(2) and not on the distinction drawn between §§ 506(a) and 506(d) in *Dewsnup*. The Court also noted that there is no provision in Chapter 7 equivalent to § 1325(a)(5)(B)(ii), a section which requires the determination of secured claims in the confirmation of Chapter 13 plans. The Court further noted that it does not even make sense to deal with claim allowance in a no-asset Chapter 7 case: "In contrast to Chapter 13, where claims must be allowed or disallowed to determine what gets paid

through the plan, and the would-be secured creditor whose claim is allowed only as unsecured gets paid as an unsecured creditor, the allowance of a secured claim, or determination of secured status is meaningless in a Chapter 7 where the trustee is not disposing of the putative collateral." *Id.* at 876. This was crucial to the Court's reasoning because "*Dewsnup* teaches that, unless and until there is a claims allowance process, there is no predicate for voiding a lien under § 506(d). Absent either a disposition of the putative collateral or valuation of the secured claim for plan confirmation in Chapter 11, 12 or 13, there is simply no basis on which to avoid a lien under § 506(d)." *Id.* Finally, "Section 506 was intended to facilitate valuation and disposition of property in the reorganization chapters of the Code, not to confer an additional avoiding power on a Chapter 7 debtor. In contrast to Chapter 13 debtors, who may use § 506 to determine the amount to be paid to a creditor as a secured claim in return for at least a chance of being paid as an unsecured creditor, Laskin seeks to use § 506(d) to expand the rights afforded Chapter 7 debtors by removing an encumbrance from his real property, which he intends to retain. This result is not authorized by the Bankruptcy Code, and is clearly prohibited by *Dewsnup*." *Id.* (citation omitted).

2. *Ryan v. Homecomings Fin. Network*, 253 F.3d 778 (4th Cir. 2001). The Court held that the reasoning of *Dewsnup* applied equally to Chapter 7 lien strip-offs and to Chapter 7 lien strip-downs. The Court rejected the argument that *Nobelman* changed this result, pointing out that *Nobelman* barely discussed either *Dewsnup* or § 506(d).

3. *Talbert v. City Mortg. Servs. (In re Talbert)*, 344 F.3d 555 (6th Cir. 2003). The Court reached the same result, with the same analysis, as *Ryan*.

VI. Proper method to accomplish lien strip-off in Chapter 13

A. Adversary proceeding required

1. *In re Ginther*, 427 B.R. 450 (Bankr. N.D. Ill. 2010). Because the Debtor seeking a lien strip-off is not seeking to "value" the junior lien under Fed. R. Bankr. P. 3012 (in which case a motion would suffice), but instead is seeking to avoid it entirely under Fed. R. Bankr. P. 7001(2), an adversary proceeding is required. However a creditor may waive his right to an adversary proceeding by failing to object to lien strip-off through an alternative procedure.
2. *In re Forrest*, 424 B.R. 831 (Bankr. N.D. Ill. 2009). The Court applied the same rationale as the *Ginther* case, but also emphasized the necessity to protect the due process rights of the lien holder through the heightened notice requirements imposed in adversary proceedings.

B. Adversary proceeding not required; can strip lien by way of motion or adversary proceeding

1. *In re King*, 290 B.R. 641 (Bankr. C.D. Ill. 2003). The Debtor may not strip a lien under a Chapter 13 plan. She must proceed either by adversary proceeding or motion.
2. *Stewart v. JP Morgan Chase Bank (In re Stewart)*, 408 B.R. 215 (Bankr. N.D. Ind. 2009). Under the Seventh Circuit's decision in *In re Hanson*, 397 F.3d 482 (7th Cir. 2005), a Chapter 13 plan cannot, in and of itself, modify

creditors' interests under circumstances in which those interests are more properly dealt with under a different procedural mechanism under the Bankruptcy Code. Lien-stripping in Chapter 13 proceedings is contemplated either by Fed. R. Bankr. P. 3012 (i.e., by contested motion) or by Fed. R. Bankr. P. 7001(2) (i.e., by adversary proceeding) and not by plan. The Court further opined that Debtors can proceed by motion only where there is a single junior mortgage to be stripped. Where there is more than one, the Debtor must file an adversary proceeding.

C. Can strip lien under plan, by motion or by way of an adversary proceeding, so long as the creditor's due process rights are observed

In re Stassi, No. 09-71563, 2009 WL 3785570 (Bankr. C.D. Ill. Nov. 12, 2009). The Court followed what it described as the majority of cases in permitting lien-stripping to be accomplished through motion or plan, recognizing that some courts require adversary proceedings. The Court's primary emphasis was on the quality of notice provided to the creditor, stressing that Fed. R. Bankr. P. 9014 requires the same type of heightened notice that would be provided in an adversary proceeding.

D. My Rule

I follow a modified version of *Stassi*. I will let attorneys select which procedure they want to use - adversary proceedings, motions or plans. However, the heightened notice requirements applicable to adversary proceeding must be observed. In the case of lien-stripping through a plan, I require not only service by certified mail on an officer of the lender if it is an

insured depository institution, but also explicit and conspicuous language in the notice of service itself emphasizing that the plan seeks to strip the lien of the junior lienholder.

VII. Is discharge eligibility necessary for lien strip? The "Chapter 20" Issue

A. Yes

1. *In re Jarvis*, 390 B.R. 600 (Bankr. C.D. Ill. 2008). In this case, the Debtor received a Chapter 7 discharge and then quickly filed Chapter 13 in an attempt to strip-off the junior lien. The Court held, consistently with *Dewsnup*, that liens generally pass through bankruptcy and that eligibility for Chapter 13 discharge was therefore necessary to obtain junior lien strip-off. Here, the Debtor's recent Chapter 7 discharge made the Debtor ineligible for a Chapter 13 discharge, so the lien strip-off was unavailable.
2. *Lindskog v. M & I Bank FSB (In re Lindskog)*, 451 B.R. 863 (Bankr. E.D. Wis. 2011). Same result and rationale as *Jarvis*.
3. *Erdmann v. Charter One Bank (In re Erdmann)*, 446 B.R. 861 (Bankr. N.D. Ill. 2011). The Court agreed with the majority of courts that discharge eligibility is a prerequisite to lien stripping. The Court also held that giving notice of lien stripping only under a plan denies due process to the junior lienholder.
4. *In re Fenn*, 428 B.R. 494 (Bankr. N.D. Ill. 2010). Same analysis and result as *Jarvis*.

B. No

1. *In re Fair*, 450 B.R. 853 (E.D. Wis. 2011). In concluding that a Chapter 13 discharge is not a prerequisite to lien-stripping, the Court uncoupled § 506(a) from the discharge issue in Chapter 13 proceedings. Section 506(a) provides the statutory authority for a court to declare that a lien that is completely under water is not a secured claim. Once that determination has been made, §§ 1322 and 1325 do not apply, because those provisions apply only to secured claims. However, the Court noted that it still retains power to disapprove the lien strip-off if it determines that the Chapter 13 proceeding was filed in bad faith and proof that it was filed solely for the purpose of stripping off the junior lien is strong evidence of bad faith.
2. *In re Okosisi*, 451 B.R. 90 (Bankr. D. Nev. 2011). Like the Court in *Fair*, the Court in *Okosisi* held that § 1325(a)(5) only applies to "allowed secured claims." Moreover, under *Nobelman*, "when a creditor is wholly unsecured after application of Section 506(a), the creditor has only an unsecured claim for purposes of Section 1322(b)(2)." *Id.* at 98. Unsecured creditors' rights "are subject to modification through the chapter 13 plan . . . and do not qualify to be treated as secured creditors for purposes of Section 1325(a)(5)." *Id.* Where, upon completion of a Chapter 13 plan, the Debtor is not eligible for a discharge, the case will be closed without discharge rather than dismissed. As a result, "the code sections that reverse any lien avoidance actions contained within a chapter 13 plan upon conversion or dismissal are not implicated, and, thus, do not act to prevent the permanence of the lien avoidance." *Id.* at 100.

"Once a debtor successfully completes all plan payments required by a chapter 13 plan, the provisions of the plan become permanent, and the lien avoidance is, similarly, permanent." *Id.* "Section 1328(f) only prohibits discharge. . . . If Congress's goal was to limit the operation of Sections 1322(b)(2) and 1327 as well as discharge, it could have explicitly drafted the statute [BAPCPA] to achieve this goal." *Id.* at 101. Finally, the Court concluded that the Chapter 13 had been filed in good faith, because the Debtor had other valid reasons for filing a Chapter 13 petition, it acted equitably in proposing the plan, it was devoting all of its income to the plan, and it did not use serial filings to avoid payment to creditors.

3. *Anderson v. Harris Bank, N.A. (In re Anderson)*, Ch. 13 Case No. 10 B 45294, Adv. No. 10 A 02467, oral ruling (Bankr. N.D. Ill. June 24, 2011) (Goldgar, J.). Citing *Fair* and *Okosisi* with approval, the Court concluded that § 1328(f)(1) does not itself bar a Debtor otherwise ineligible for a discharge from stripping off an unsecured junior lien. That section is instead concerned solely with the availability of discharge. Nor does the Code condition a Debtor's right to confirm a Chapter 13 plan on the Debtor's eligibility for discharge, because § 1325(a)(5) only applies to allowed secured claims. A wholly undersecured junior lien is an unsecured claim under § 506(a).

United States Court of Appeals,Seventh Circuit.

PALOMAR v. FIRST AMERICAN BANK

Alejandro PALOMAR, Sr., and Rafaela Palomar, Plaintiffs–Appellants, v. FIRST AMERICAN BANK, Defendant–Appellee.

No. 12–3492.

Argued May 21, 2013. -- July 11, 2013

Before POSNER, MANION, and ROVNER, Circuit Judges.

Nathan E. Curtis, Attorney, Law Office of Peter Francis Geraci, Chicago, IL, for Plaintiffs –Appellants.Sean G. Rahilly, First American Bank, Elk Grove Village, IL, for Defendant –Appellee.

Mr. and Mrs. Palomar filed for bankruptcy under Chapter 7 of the Bankruptcy Code in July 2011, and a trustee was appointed. A month after the filing the trustee reported that the estate in bankruptcy contained nothing that could be sold and yield money for the Palomars' unsecured creditors. So a discharge of their dischargeable debts was entered and in December the bankruptcy case was closed.

The day before the trustee issued his no-asset report the Palomars had filed in the bankruptcy court an adversary action against First American Bank, which held (and holds) a second mortgage on their home. The original amount of the loan secured by the mortgage was $50,000, but the current balance is unknown and the bank has not bothered to file an appearance in the adversary action. Another lender, LBPS (IBM Lender Business Process Services, Inc., recently renamed Seterus), had and has a first mortgage on the Palomars' home on which the unpaid balance when the Palomars filed for bankruptcy was $243,000—yet the home was valued then, according to an appraisal attached to the debtors' complaint, at only $165,000. The Palomars argue that the second mortgage was worthless and should therefore be "stripped off"—that is, dissolved by order of the bankruptcy court. As authority they cite 11 U.S.C. § 506(a). The accuracy of the appraisal has not been questioned, though the Palomars had an incentive to obtain a low appraisal in order to bolster their argument for the stripping off of the second mortgage.

By the time the adversary action was ready to be decided by the bankruptcy judge, the bankruptcy had been closed. The judge could have reopened it "to accord relief to the debtor," 11 U.S.C. § 350(b), as by stripping off a lien (if that would be proper relief), provided that the Palomars had not been responsible for a delay in pressing their suit that would have harmed the creditors (that is, provided that the Palomars had not been guilty of laches). In re Bianucci, 4 F.3d 526, 528 (7th Cir.1993); In re Beaty, 306 F.3d 914, 923 (9th Cir.2002). But deciding that the adversary action was meritless, the judge refused to reopen the bankruptcy proceeding and instead dismissed the adversary action. The district court affirmed and the Palomars have appealed to us. First American Bank has not appeared.

So far as relates to the appeal, section 506(a) of the Bankruptcy Code states that "an allowed claim of a creditor secured by a lien on property . is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property . and is an unsecured claim to the extent that the value of such creditor's interest . is less than the amount of such allowed claim." Section 506(d) states that "to the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void." In re Tarnow, 749 F.2d 464, 465–66 (7th Cir.1984), explains that these provisions are best interpreted as confirming the venerable principle of Long v. Bullard, 117 U.S. 617, 620–21 (1886), that bankruptcy law permits a lien to pass through bankruptcy unaffected, provided that it's a valid lien and secures a valid claim ("an allowed secured claim"). The holder of such a claim can if he wants ignore the bankruptcy proceeding and enforce his claim by foreclosing the lien. But alternatively he can file the claim in the bankruptcy proceeding, which will be an unsecured claim to the extent that it exceeds the value of the collateral. The upside of this way of proceeding is that if the claim exceeds that value, yet the debtor has assets sufficient to enable the excess at least or a portion of it to be paid in satisfaction of an unsecured claim, the creditor will be better off than by foreclosing his lien. The downside is that the claim may be disallowed, in which event the lien will be avoided; for all a lien is is security, so if there is nothing to secure, the lien is down the drain. The bankruptcy court's invalidation of a lien, if not reversed, will operate as collateral estoppel should the creditor later try to foreclose, that is, try to enforce the lien.

Note however that partial disallowance of a lien creditor's secured claim doesn't invalidate the lien, but merely shrinks it. "If a party in interest requests the [bankruptcy] court to determine and allow or disallow the claim secured by the lien under section 502 and the claim is not allowed, then the lien is void"—but only "to the extent that the claim is not allowed." H .R. Rep. No. 95–595, 95th Cong., 1st Sess. 357 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6313.

If, however, as Tarnow teaches when read alongside such later decisions as In re Talbert, 344 F.3d 555, 560–61 (6th Cir.2003), and Ryan v. Homecomings Financial Network, 253 F.3d 778, 781–82 (4th Cir.2001), the only lien voided by section 506(d) in whole or part is one securing a claim rejected in whole or part by the bankruptcy court, the statute has no application to this case. First American's claim was not rejected by the bankruptcy court—it filed no claim. No one did; this was a no-asset bankruptcy. And so the bank was free to

foreclose its lien outside of bankruptcy. Nor is there any suggestion that had the bank filed a claim it would have been rejected. It hasn't foreclosed, yet only (we suppose) because at present the Palomars' home is worth less (unless the appraisal is grossly inaccurate) than the sum of the first and second liens on it, the bank's lien being the second. In fact it's worth less than the first lien, that of LBPS alone. But someday the house may be "above water," at which point First American may decide to foreclose.

The holdings in Tarnow, Talbert, and Ryan are supported (as noted in Talbert, 344 F.3d at 560, and Ryan, 253 F.3d at 781–82) by the Supreme Court's post-Tarnow decision in Dewsnup v. Timm, 502 U.S. 410 (1992), which holds that section 506(d) does not allow the bankruptcy court to squeeze down a fully valid lien to the current value of the property to which it's attached. See id. at 417–18. That's the relief the debtor in this case is seeking. The only difference between this case and Dewsnup is that our debtors want to reduce the value of the lien to zero. They point to section 506(a), which makes a "claim of a creditor secured by a lien on property" a "secured claim" only "to the extent of the value of such creditor's interest in [the] property." That value, the Palomars note, currently is zero. But Dewsnup treated the undersecured loan in that case as a "secured claim" within the meaning of section 506(d), and in so doing denied that "the words 'allowed secured claim' must take the same meaning in § 506(d) as in § 506(a)." Id. at 417. The point of section 506 (a) is not to wipe out liens but to recognize that if a creditor is owed more than the current value of his lien, he can by filing a claim in bankruptcy (rather than bypassing bankruptcy and foreclosing his lien) obtain, if he's lucky, some of the debt owed him that he could not obtain by foreclosure because his lien is worth less than the debt.

The Palomars point out that liens on residential property can be stripped off in bankruptcies under Chapter 13 of the Bankruptcy Code, the counterpart for individual debtors of Chapter 11, which governs corporate reorganizations. A Chapter 13 plan can "modify the rights of holders of secured claims, other than a claim secured only by security interest in real property that is the debtor's principal residence, or of holders of unsecured claims." 11 U.S.C. § 1322(b)(2). And despite the exception, courts allow a Chapter 13 plan to eliminate a secured junior claim (such as a claim secured by a second mortgage) against residential property if the security interest no longer has value because what the debtors owe holders of liens senior to this creditor's lien (the holder of a first mortgage for example) exceeds the value of the property. See In re Bartee, 212 F.3d 277, 292–95 (5th Cir.2000); In re McDonald, 205 F.3d 606, 615 (3d Cir.2000). That is what the Palomars want now, but to get it they would have had to file for bankruptcy under Chapter 13 rather than Chapter 7. The strip-off right in Chapter 13 is a partial offset to the advantages that Chapter 13, relative to Chapter 7, grants creditors, such as access to a larger pool of assets because the debtor must commit all disposable income for three to five years to repaying his unsecured debts. 11 U.S.C. § 1325(b)(1)(B).

The difference between Chapter 13 (also Chapter 11) and Chapter 7 is the difference between reorganization and liquidation. In the latter type of bankruptcy the debtor surrenders his assets (subject to certain exemptions) and in exchange is relieved of his debts

(with certain exceptions), thus giving him a "fresh start." But in a reorganization the assets are not sold—the enterprise continues—though ownership is transferred from the debtor to his creditors. Chapter 13 is only analogous to a reorganization; the debtor does not become a slave. But unlike what happens in a Chapter 7 bankruptcy, his assets are not sold; instead he pays his creditors, over a three- or five-year period, as much as he can afford. 11 U.S.C. § 1325(b). Often this makes the creditors better off than they would be in a liquidation, for the assets, though important to the debtor, may have little market value.

The Palomars point out that liens can sometimes be stripped off even in Chapter 7 bankruptcies. See 11 U.S.C. §§ 522(f), 722. The cited provisions relate, however, to liens on property that is exempt from creditors' claims. Section 522(f) allows the debtor to reduce a lien on exempt property so far as is necessary to preserve the exemption, while section 722 allows a debtor to redeem "tangible personal property intended primarily for personal, family, or household use, from a lien securing a dischargeable consumer debt" by paying the current value of the lien. Both provisions support the "fresh start" policy of Chapter 7, consistent with the aim of bankruptcy law of balancing the bankrupt's interests against his creditors' interests. In any event, sections 522(f) and 722 are not available to the Palomars—and "fresh start" is not an ambulatory policy invokable whenever a debtor makes an appeal to judicial sympathy.

And if there were such a principle it wouldn't be applicable to this case. Given the gross disparity between the current market value of the Palomars' home and the claims secured by it, First American Bank is unlikely, to say the least, to foreclose in the immediate or near future. For that would entail the bank's incurring legal expenses to obtain the ownership of property worth less than the first mortgage on the property; the bank would be compounding its loss. So all that failing to extinguish First American's lien does from a practical standpoint is deprive the debtors of the chance to make some money should the value of their home ever exceed the balance on LBPS's first mortgage. It is hard to see how the deprivation of so speculative a future opportunity could be thought to impair the debtors' ability to make a fresh start. The extinction of the lien would not enable them to obtain a new second mortgage (unless from a predatory lender) or otherwise improve their financial situation.

Affirmed.

POSNER, Circuit Judge.

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UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

IN RE:	)	Bankruptcy No. 13 B 05090
	)	Chapter 7
TIRES N TRACKS, INC.,	)	Judge Donald R. Cassling
	)	
Debtor.	)	

MEMORANDUM OPINION

In this case, two Illinois judgment lien creditors are competing for priority as to the Debtor's personal assets. As of the date of filing the Debtor's bankruptcy petition, both creditors held valid judgment liens arising from Illinois citations to discover assets.[1] After the bankruptcy case was filed, the senior lien-holder, Vermeer-Illinois, Inc. ("Vermeer"), dismissed its citation proceedings to avoid violating the automatic stay. The junior lien-holder, Laser Construction, Inc. ("Laser"), took advantage of that dismissal and objected to Vermeer's secured claim because it had voluntarily dismissed its citation proceedings.

Vermeer insists that its dismissal was not voluntary and that, in any event, its secured status must be measured as of the date the bankruptcy petition was filed. For the reasons that follow, the Court agrees with Laser and holds that Vermeer's dismissal was voluntary and that it lost its secured status when it dismissed its citation proceedings.

I. JURISDICTION AND PROCEDURE

The Court has jurisdiction to entertain this matter pursuant to 28 U.S.C. § 1334 and Internal Operating Procedure 15(a) of the United States District Court for the Northern District of Illinois. It is a core proceeding under 28 U.S.C. § 157(b)(2)(A), (B), and (O).

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[1] Citation liens are a creature of an Illinois statute available to creditors holding judgments from Illinois state or federal courts. Since the statute was amended in 1993, it creates a lien on all non-exempt personal property of either the judgment debtor or a third party as long as the citation to discover assets is properly served on the parties. 735 Ill. Comp. Stat. 5/2-1402. For a discussion of the case law preceding the statutory amendment in 1993, *see Dominick's Finer Foods, Inc. v. Mason (In re Makula)*, 172 F.3d 493 (7th Cir. 1999).

II. BACKGROUND

Vermeer obtained a $17,197.66 state court judgment against Tires N Tracks, Inc. (the "Debtor") on December 6, 2011. (Obj. to Claim, Ex. B.) In an effort to collect on that judgment, Vermeer served a citation to discover assets (the "Citation") on the Debtor on March 9, 2012. (*Id.* Ex. C.) On January 29, 2013, Vermeer conducted a citation examination of the Debtor,[2] and the Citation was continued until February 26, 2013, for hearing and production of additional documents. (*Id.* Ex. D.) Before that hearing could occur, the Debtor filed its Chapter 7 bankruptcy petition on February 11, 2013 (the "Petition Date"). In response to the bankruptcy petition, Vermeer dismissed the Citation on February 26, 2013. (*Id.* Ex. E.) On April 2, 2013, Vermeer filed its proof of claim (Claim No. 3) in the sum of $19,097.79 asserting a secured interest in all personal property of the Debtor "by virtue of a citation to discover assets." (*Id.* Ex. A.)

On September 19, 2012, nine months after Vermeer obtained its judgment, Laser obtained a $68,463 judgment arising out of a breach of contract claim against the Debtor. (Claims Register 6-1.) In an effort to collect on that judgment, Laser served a citation to discover assets on the Debtor on September 26, 2012 (*id.*), thereby creating a lien on the Debtor's personalty as of that date.

On May 24, 2013, Laser filed its objection to Vermeer's proof of claim, arguing that Vermeer's security interest expired when it voluntarily dismissed the Citation.

III. APPLICABLE STANDARDS

A. Standard Governing Claim Objections Generally

[2] The citation examination satisfies one of the principle asset-discovery functions of the citation procedure. It is conducted like a deposition (including the right to demand production of relevant documents), but is limited in its scope to discovering the existence and location of personalty which might be seized and sold to satisfy the judgment against the debtor. 18 Ill. Law and Prac., Executions § 105 (2013).

11 U.S.C. § 502 governs the allowance of claims or interests in a bankruptcy case. Claims are presumed valid under § 502(a) and are prima facie proof of their own validity under Federal Rule of Bankruptcy Procedure 3001(f). *Conn. Gen. Life Ins. Co. v. Schaumburg Hotel Owner Ltd. P'ship (In re Schaumburg Hotel Owner Ltd. P'ship)*, 97 B.R. 943, 950 (Bankr. N.D. Ill. 1989). "A proof of claim executed and filed in accordance with these rules shall constitute prima facie evidence of the validity and amount of the claim." Fed. R. Bankr. P. 3001(f); *see also In re Salem*, 465 F.3d 767, 779 (7th Cir. 2006).

A party objecting to a claim carries the initial burden of proof to rebut the presumption of allowability. *In re Pierport Dev. & Realty, Inc.*, 491 B.R. 544, 547 (Bankr. N.D. Ill. 2013). Once the objector has produced some evidence questioning the allowability of a claim, the burden then shifts back to the claimant to produce evidence to meet the objection and establish that the claim in fact is allowable. *Id.*

B. Standards Governing Citation Liens Specifically

The Illinois legislature has provided judgment creditors with various procedures to enforce their judgments. One of these is the citation to discover assets set forth in 735 Ill. Comp. Stat. 5/2-1402. A citation to discover assets serves three primary functions: (1) it automatically creates a renewable six-month lien on all of the judgment debtor's non-exempt personal assets and income in state and federal courts;[3] (2) it provides the creditor with a specialized discovery procedure to assist it in determining the existence and location of assets that might be seized and sold to satisfy the judgment debt; and (3) it provides a mechanism and forum for compelling

[3] This function was provided by a 1993 amendment to the statute. Prior to that statutory amendment, the case law was unclear as to whether the statute created a lien or not, but the better reasoned decisions held that it did not. *See Makula*, 172 F.3d at 499-500; *see also Chicago City Bank & Trust Co. v. Jaffee (In re Jaffee)*, 111 B.R. 701, 704-05 (Bankr. N.D. Ill. 1990).

turnover of non-exempt assets, so that they might be sold to satisfy the judgment debt.[4]

Illinois Supreme Court Rule 277(a) defines any citation proceeding under 735 Ill. Comp. Stat. 5/2-1402 as a "supplementary proceeding." Ill. Sup. Ct. R. 277(a). That Rule limits supplementary proceedings to six months, although it permits such extensions "as justice may require:"

> A proceeding under this rule continues until terminated by motion of the judgment creditor, order of the court, or satisfaction of the judgment, but terminates automatically 6 months from the date of (1) the respondent's first personal appearance pursuant to the citation or (2) the respondent's first personal appearance pursuant to subsequent process issued to enforce the citation, whichever is sooner. The court may, however, grant extensions beyond the 6 months, as justice may require. Orders for the payment of money continue in effect notwithstanding the termination of the proceedings until the judgment is satisfied or the court orders otherwise.

Ill. Sup. Ct. R. 277(f).

Although the judgment creditor may obtain an extension of the citation by appropriate motion, courts have the authority to extend it without motion by parties. *West Bend Mut. Ins. Co. v. Belmont State Corp.*. 09 C 354, 2010 WL 5419061, at *5 (N.D. Ill. Dec. 23, 2010), *aff'd,* 712 F.3d 1030 (7th Cir. 2013); *see also Laborers' Pension Fund v. Pavement Maint., Inc.*, 542 F.3d 189, 194-95 (7th Cir. 2008). Moreover, after six months an automatic termination of the citation lien is not guaranteed, notwithstanding the language of § 5/2-1402. *Burditt & Radzius, Chtd. v. Brown (In re Barone)*, 184 B.R. 747, 750 (Bankr. N.D. Ill 1995) (holding that citation proceedings did not terminate automatically because the citation respondent failed to appear for either of the scheduled citations). Therefore, the continuation of a citation to discover assets is a flexible process.

[4] Indeed, the enforcement feature of a citation to discover assets is arguably enhanced over other lien enforcement methods because courts can hold judgment debtors in contempt of court for failing to comply with the citation to discover assets. *See Shales v. T. Manning Concrete, Inc.*, 847 F. Supp.2d 1102, 1116, (N.D. Ill. 2012). Courts can also hold third parties in contempt if they take actions that deliberately put the property beyond the reach of creditors and in violation of the citation. *See In re Weitzman*, 381 B.R. 874, 881 (Bankr. N.D. Ill. 2008).

Illinois citations to discover assets have two unusual features that present special problems for judgment creditors in bankruptcy proceedings: First, in addition to creating liens on the debtor's personalty, they provide an enforcement mechanism for locating and seizing assets to satisfy the creditor's judgment against the debtor. Second, they automatically expire six months after issuance, unless renewed. These two features make them peculiarly susceptible to bankruptcy principles that ordinarily pose no threat to more commonplace liens: The automatic stay under 11 U.S.C. § 362 applies to, and undercuts, the lien enforcement aspect of citations to discover assets. And unless the stay is vacated to permit the lienholder to seek an extension of the citation for another six months, the creditor's lien may well expire during the bankruptcy proceedings.

IV. DISCUSSION

Vermeer raises three arguments in response to Laser's argument that its security interest expired when it voluntarily dismissed the Citation: First, Vermeer argues that the dismissal of the Citation was not voluntary, but was forced upon it by § 362. Second, Vermeer argues that 11 U.S.C. § 108(c) automatically continues all pending civil proceedings (including citation proceedings) and statutes of limitations until thirty days after the conclusion of the bankruptcy case. Finally, Vermeer argues that its secured status was fixed and determined as of the Petition Date and remains unchanged until the bankruptcy case concludes as a matter of law.

In response, Laser argues that: (1) the dismissal was voluntary because Vermeer could have sought to modify the automatic stay rather than dismissing the Citation; (2) because Vermeer relinquished the lien rights it had when the Citation was dismissed, there is no action for § 108(c) to toll; (3) Section 108(c) does not override Vermeer's voluntary dismissal of the Citation; and (4) nothing in the Bankruptcy Code prevents a secured creditor from voluntarily

relinquishing its secured status. For the following reasons, the Court agrees with Laser's analysis and sustains the objection to Vermeer's claim.

A. Vermeer's Dismissal of its Citation Proceedings was Voluntary

The Court finds that Vermeer acted voluntarily when it withdrew the Citation. While its intention in dismissing the Citation may have been to avoid violating the automatic stay, respect for the stay did not require such a drastic step. Instead of dismissing the Citation, Vermeer could have simply moved to modify the automatic stay. So long as the motion to modify the stay made clear that Vermeer would not be seeking to enforce the citation lien, but only to extend the citation proceedings so that its lien rights would be preserved, modifying the stay would have done nothing more than to preserve the status quo among the parties. In the unlikely event that the Court would have denied that motion, Vermeer could simply have refrained from enforcing its lien, let the Citation lapse and then argued that § 108(c) tolled the six-month period set forth in Illinois Supreme Court Rule 277(f). Because Vermeer dismissed the Citation despite the fact that alternatives not requiring dismissal were available, its choice to dismiss must be treated as voluntary.

B. Vermeer Waived Any Tolling Rights It May Have Had Under 11 U.S.C. § 108(c)

Section 108(c) of the Code tolls certain statutes of limitations for actions against a debtor:

> [I]f nonbankruptcy law, an order entered in a nonbankruptcy proceeding, or an agreement fixes a period for commencing or continuing a civil action in a court other than a bankruptcy court on a claim against the debtor ... and such period has not expired before the date of the filing of the petition, then such period does not expire until the later of—
>
> > (1) the end of such period, including any suspension of such period occurring on or after the commencement of the case; or
> >
> > (2) 30 days after notice of the termination or expiration of the stay under section 362, 922, 1201, or 1301 of this title, as the case may be, with respect to such claim.

11 U.S.C. § 108(c).

Significantly, § 108(c) preserves liens that would expire under nonbankrupcy law. *Pierport Dev. & Realty,* 491 B.R. at 548; *see also Shales v. Lanas Constr., Inc.,* 07 C 2970, 2010 Wl 3842362, at *6 (N.D. Ill. Sept. 24, 2010). Under § 108(c), a judgment creditor is not required to take any affirmative steps to preserve its lien. *Pierport,* 491 B.R. at 549; *see also In re Coan,* 96 B.R. 828, 832 (Bankr. N.D. Ill. 1989) (holding that "[v]alid liens do not expire during the pendency of the bankruptcy case, despite the creditor's failure to take action to enforce or perfect the lien within the time period prescribed by state law.").

As a result, an Illinois judgment lien creditor is not ordinarily required to take any affirmative steps to preserve a citation lien existing on the date a bankruptcy petition is filed. Of course, a judgment lien creditor may certainly seek the reassurance of asking the state court for a continuation of the citation to discover assets, provided that the creditor seeks relief from the automatic stay in the bankruptcy court first. However, obtaining relief from the automatic stay may not be required where the judgment creditor seeks merely to inform the state court of the bankruptcy filing and of the automatic continuation of the citation lien, because the creditor is not then acting to enforce the citation lien. But even in that case, nothing in the Code prevents the prudent creditor from first seeking relief from the automatic stay.

In this case, § 108(c) did not preserve Vermeer's lien rights because Vermeer precluded any possible extension of its lien rights when it dismissed the Citation. The moment the state court granted Vermeer's motion to dismiss the Citation there was no longer any action to toll. While it may be true that § 108(c) automatically preserves a judgment creditor's lien, a judgment creditor is not prevented by § 362 from voluntarily withdrawing its citation to discover assets. Similarly, while it is true that valid liens typically pass through a bankruptcy unaffected,[5] nothing prevents lien holders from voluntarily relinquishing their liens. Therefore, because Vermeer

[5] *Dewsnup v. Timm,* 502 U.S. 410, 417 (1992).

voluntarily dismissed the underlying action that created the lien, Vermeer terminated its lien.

C. Vermeer's Lien Status as of the Petition Date

A creditor's status as secured or unsecured is determined as of the bankruptcy petition date. *See In re Schwinn Bicycle Co.*, 200 B.R. 980, 991 (Bankr. N.D. Ill. 1996). However, nothing in the Bankruptcy Code prevents a secured judgment creditor from changing its status as a secured creditor after the bankruptcy petition date by voluntarily releasing its lien. *See In re Metaldyne Corp.*, 409 B.R. 671, 679 n.11 (Bankr. S.D.N.Y. 2009), *aff'd*, 421 B.R. 620 (S.D.N.Y. 2009); *see also In re Norris,* No. 07-00345-KD-B, 2007 WL 3348376, at *4-5 (Bankr. S.D. Ala. Sept. 12, 2007); *In re Green,* 310 B.R. 772, 776-78 (Bankr. M.D. Fla. 2004). In this case, while the parties do not dispute that Vermeer was a secured creditor on the Petition Date, the Court finds that Vermeer relinquished that status when it voluntarily withdrew the Citation, thereby relinquishing its citation lien. Because Vermeer relinquished its lien rights, it is no longer a secured creditor.

V. CONCLUSION

For the foregoing reasons, the Court sustains Laser's objection and finds that Vermeer's Claim No. 3 is unsecured.

ENTERED:

DATE: August 27, 2013

Donald R. Cassling

Donald R. Cassling
United States Bankruptcy Judge

THE AUTOMATIC STAY AND PROCEEDINGS FOR INITIAL ACTIONS, MODIFICATION OR ENFORCEMENT

Certain domestic relation matters are not subject to the automatic stay in 11 USC § 362. Under § 362(b)(2), the following actions are not stayed:

1. establishment or modification of a domestic support obligation;

2. establishment of paternity;

3. an action concerning child custody or visitation;

4. an action for the dissolution of marriage, except to the extent that such proceeding seeks to determine the division of property that is property of the estate;

5. an action regarding domestic violence.

The Code excludes from the automatic stay the collection of DSOs from property that is not property of the estate. It also specifically excludes the enforcement of or continuation of an Income Deduction Order pursuant to a judicial order, administrative order or statute. In other words the deductions from salaries through an income deduction order continue even after the filing of a bankruptcy in any chapter.

Also unaffected by the automatic stay is the collection/enforcement procedures used by the child support enforcement division under Illinois law and the Social Security Act including the withholding or suspension of driver's licenses or professional licenses, the reporting of overdue support obligations to credit agencies as well as the inception of tax refunds. 11 USC 362(b)(2)(D-G).

DSO creditors cannot attempt to collect against "property of the estate" which is still exclusively determined by the bankruptcy court. For example, attempting to seize a prepetition

non-exempt bank account of a debtor in Chapter 7 would require stay relief. By contrast, the continued collection of child support through an Income Deduction Order is specifically excepted from the automatic stay and, as discussed earlier, under Chapters 11 and 13, the debtor cannot have a plan confirmed unless all DSOs are paid in full.

The DSO creditor can still proceed to enforce DSOs against exempt property of the debtor. 11 USC § 522(c). Such exempt property might include an IRA or 401(k).

In the case of a pending dissolution of marriage action in which the parties have substantial marital or non-marital property to divide, the family court cannot proceed to divide such property without stay relief from the bankruptcy court. As a practical matter, the bankruptcy court may grant such relief and allow the state court to determine the equitable distribution but may limit the court from actually allowing or authorizing a distribution of that property.

JANUARY 10, 2013

What the new Ability-to-Repay rule means for consumers

Consumer Financial Protection Bureau

Background

When you apply for a mortgage, you may struggle to understand how big a monthly payment you can afford. You may assume that lenders and mortgage brokers will not make you a loan that you cannot afford. But, in the years leading up to the financial crisis, lenders too often made mortgages to consumers who could not pay them back. As a result, many consumers ended up in delinquency and foreclosure.

The Dodd-Frank Wall Street Reform and Consumer Protection Act requires lenders to take more into consideration when making mortgage loans. The Bureau's Ability-to-Repay rule does that. It requires lenders, before making a mortgage loan, to look at a consumer's financial information and be sure that the consumer can afford to repay the loan.

This rule applies to most mortgage loans. However, it excludes certain types of loans, like home equity lines of credit, timeshare plans, reverse mortgages, and temporary loans.

This rule also creates a category of loans that have certain, more stable features. This category of loans is called Qualified Mortgages (QM). Lenders that make QMs are presumed to have met the Ability-to-Repay requirements.

The Ability-to-Repay/QM rule will help make sure that you get a mortgage loan you can afford. The rule will also help make sure that responsible lenders aren't forced to compete with reckless lenders engaged in risky practices.

Ability to repay

Under the Ability-to-Repay rule, before you get a mortgage loan, the lender will have to determine you will have the ability to repay the loan.

The lender must collect and verify your financial information.

When you apply for a mortgage loan, you will have to give the lender certain financial information. The lender will have to check the information using reliable documents, such as a W-2 or pay stub. The lender generally must consider eight types of information:

1. Your current income or assets
2. Your current employment status

3. Your credit history
4. The monthly payment for the mortgage
5. Your monthly payments on other mortgage loans you get at the same time
6. Your monthly payments for other mortgage-related expenses (such as property taxes)
7. Your other debts
8. Your monthly debt payments, including the mortgage, compared to your monthly income ("debt-to-income ratio"). The lender may also look at how much money you have left over each month after paying your debts.

You must have enough assets or income to pay back the mortgage.

The lender must determine that you can repay the loan. The lender may look at your current income and assets (except the value of the mortgage itself). The lender must also look at your debt-to-income ratio or the amount of money you'll have left over each month to pay for things like food and heat.

A lender can't determine your ability to repay using "teaser" rates.

The lender can't use temporary low payment rates to determine whether you are able to repay the mortgage. For example, if the loan is an adjustable-rate mortgage, the lender will generally have to consider the highest interest rate that you may have to pay.

The rule includes exceptions for refinancing a consumer out of a risky loan.

In defined circumstances, the Ability-to-Repay rule may not apply to a creditor refinancing a borrower from a riskier mortgage to a more stable mortgage. An example of a risky loan could be an interest-only loan. An example of a more stable mortgage could be a fixed-rate mortgage.

Qualified mortgages

The rule presumes a lender has met the Ability-to-Repay requirements if the lender makes a Qualified Mortgage, or QM. A QM must meet certain requirements. For example, the loan cannot have certain risky features that harmed consumers during the mortgage crisis.

Here are the features of Qualified Mortgages:

No toxic loan features

QMs cannot have the following loan features:

- An "interest-only" period, when a consumer pays only the interest without paying down the principal.
- "Negative amortization," when the loan principal increases over time, even though the borrower is making payments.
- "Balloon payments," which are larger-than-usual payments at the end of the loan term. However, balloon payments are allowed in certain circumstances.
- Loan terms that are longer than 30 years.

Cap on how much income can go towards debt

QMs will generally require that the borrower's monthly debt, including the mortgage, isn't more than 43 percent of the borrower's monthly pre-tax income. Temporarily, QMs can also be loans that can be bought by Fannie Mae or Freddie Mac or insured by certain government agencies, such as the Federal Housing Administration.

No excess upfront points and fees

QMs have limits on the amount of upfront points and fees that the consumer can be charged. The limits will depend upon the size of the loan. Many third-party charges, such as the cost of a credit report, are not included in the limit. QMs also have limits on discount points, which a consumer pays in return for a reduced interest rate.

Certain legal protections for lenders

Lenders that make QMs get certain legal protections even if the loans default. For QMs that are not higher-priced mortgage loans, lenders get a "safe harbor." This means that the lender complies with the Ability-to-Repay rule if the loan meets the QM definition. Consumers can still legally challenge their lender under this rule if they believe that the loan does not meet the definition of a QM. For QMs that are "higher-priced mortgage loans," with higher than average interest rates, the rule works differently. For those loans, lenders get a "rebuttable presumption" that they met the Ability-to-Repay rule. However, consumers can challenge that presumption by proving that they, in fact, did not have enough income to pay the mortgage and their other living expenses. The Ability-to-Repay rule does not affect the rights of a consumer to challenge a lender for violating any other federal consumer protection laws.

When a Qualified Mortgage can have a balloon payment

While a loan with a balloon payment generally cannot be a Qualified Mortgage, a small lender operating in a rural or underserved area can make a loan with a balloon payment that is a Qualified Mortgage in certain circumstances.

What to do if your lender doesn't follow the rules

If you think your lender is not following following the Ability-to-Replay/Qualified Mortgage rule, the Consumer Financial Protection Bureau wants to know. You can get in touch with us these ways:

Online: www.consumerfinance.gov/complaint
By telephone (in 187 languages)**:**

(855) 411-CFPB (2372)

Español (855) 411-CFPB (2372)

TTY/TDD (855) 729-CFPB

(2372)

8 a.m. to 8 p.m. Eastern, Monday–Friday:

By mail: Consumer Financial Protection Bureau

P.O. Box 4503

Iowa City, Iowa 52244
By fax: (855) 237-2392

The Ability-to-Repay/Qualified Mortgage rule is one of many rules that protect you when you get a mortgage.

You can find more information about these home mortgage rules at http://consumerfinance.gov/regulations.

You can see answers to frequently asked questions about home mortgages at http://consumerfinance.gov/askcfpb/.

Summary of the final mortgage servicing rules

January 17, 2013

The Consumer Financial Protection Bureau (Bureau) is releasing final rules to implement laws to protect consumers from detrimental actions by mortgage servicers and to provide consumers with better tools and information when dealing with mortgage servicers. The rules will take effect on January 10, 2014. The servicing rules are set forth in two notices, one to amend Regulation Z, which implements the Truth in Lending Act, and one to amend Regulation X, which implements the Real Estate Settlement Procedures Act. The rules cover nine major topics and implement certain provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) that relate to mortgage servicing.

BACKGROUND

The mortgage servicing industry was built to handle large volumes of loans for which only limited service was required. In the wake of the financial crisis, the number of distressed borrowers skyrocketed and the servicing industry was unable to keep up. As a result, an increased number of borrowers suffered substantial harm. The Dodd-Frank Act imposed new requirements on servicers and gave the Bureau the authority to both implement the new requirements and also to adopt additional rules to protect consumers. The Bureau is exercising that authority to improve the information consumers receive from their servicers, enhance the protections available to consumers to address servicer errors, and to establish some baseline servicing requirements that will provide additional protections for consumers who have fallen behind on their mortgage payments.

The final rules include a number of exemptions and other adjustments for small servicers, defined as servicers that service 5,000 or fewer mortgage loans and service only mortgage loans that they or an affiliate originated or own. This definition covers substantially all of the community banks and credit unions that are involved in servicing mortgages. These exceptions and adjustments should help reduce burdens for these institutions that have strong consumer service safeguards already built into their business models.

SUMMARY OF THE FINAL RULES

The final rules cover nine major topics, which are summarized below.

1. **Periodic billing statements.** Creditors, assignees, and servicers must provide a periodic statement for each billing cycle containing, among other things, information on payments currently due and previously made, fees imposed, transaction activity, application of past payments, contact information for the servicer and housing counselors, and, where applicable, information regarding delinquencies. These statements must meet the timing, form, and content requirements provided in the rule. The rule contains sample forms that may be used. The periodic statement requirement generally does not apply to fixed-rate loans if the servicer provides a coupon book, so long as the coupon book contains certain information specified in the rule and certain other information specified in the rule is made available to the consumer. The rule also includes an exemption for small servicers as defined above.

2. **Interest-rate adjustment notices for ARMs.** Creditors, assignees, and servicers must provide a consumer whose mortgage has an adjustable rate with a notice between 210 and 240 days prior to the first payment due after the rate first adjusts. This notice may contain an estimate of the new rate and new payment. Creditors, assignees, and servicers also must provide a notice between 60 and 120 days before payment at a new level is due when a rate adjustment causes the payment to change. The current annual notice that must be provided for ARMs for which the interest rate, but not the payment, has changed over the course of the year is no longer required. The rule contains model and sample forms that servicers may use.

3. **Prompt payment crediting and payoff statements.** Servicers must promptly credit periodic payments from borrowers as of the day of receipt. A periodic payment consists of principal, interest, and escrow (if applicable). If a servicer receives a payment that is less than the amount due for a periodic payment, the payment may be held in a suspense account. When the amount in the suspense account covers a periodic payment, the servicer must apply the funds to the consumer's account. In addition, creditors, assignees, and servicers must provide an accurate payoff balance to a consumer no later than seven business days after receipt of a written request from the borrower for such information.

4. **Force-placed insurance.** Servicers are prohibited from charging a borrower for force-placed insurance coverage unless the servicer has a reasonable basis to believe the

borrower has failed to maintain hazard insurance and has provided required notices. An initial notice must be sent to the borrower at least 45 days before charging the borrower for force-placed insurance coverage, and a second reminder notice must be sent no earlier than 30 days after the first notice and at least 15 days before charging the borrower for force-placed insurance coverage. The rule contains model forms that servicers may use. If a borrower provides proof of hazard insurance coverage, the servicer must cancel any force-placed insurance policy and refund any premiums paid for overlapping periods in which the borrower's coverage was in place. The rule also provides that charges related to force-placed insurance (other than those subject to State regulation as the business of insurance or authorized by Federal law for flood insurance) must be for a service that was actually performed and must bear a reasonable relationship to the servicer's cost of providing the service. Where the borrower has an escrow account for the payment of hazard insurance premiums, the servicer is prohibited from obtaining force-place insurance where the servicer can continue the borrower's homeowner insurance, even if the servicer needs to advance funds to the borrower's escrow account to do so. The rule against obtaining force-placed insurance in cases in which hazard insurance may be maintained through an escrow account exempts small servicers as defined above so long as any force-placed insurance purchased by the small servicer is less expensive to a borrower than the amount of any disbursement the servicer would have made to maintain hazard insurance coverage.

5. **Error resolution and information requests.** Servicers are required to meet certain procedural requirements for responding to written information requests or complaints of errors. The rule requires servicers to comply with the error resolution procedures for certain listed errors as well as any error relating to the servicing of a mortgage loan. Servicers may designate a specific address for borrowers to use. Servicers generally are required to acknowledge the request or notice of error within five days. Servicers also generally are required to correct the error asserted by the borrower and provide the borrower written notification of the correction, or to conduct an investigation and provide the borrower written notification that no error occurred, within 30 to 45 days. Further, within a similar amount of time, servicers generally are required to acknowledge borrower written requests for information and either provide the information or explain why the information is not available.

6. **General servicing policies, procedures, and requirements.** Servicers are required to establish policies and procedures reasonably designed to achieve objectives specified in the rule. The reasonableness of a servicer's policies and procedures takes

into account the size, scope, and nature of the servicer's operations. Examples of the specified objectives include accessing and providing accurate and timely information to borrowers, investors, and courts; properly evaluating loss mitigation applications in accordance with the eligibility rules established by investors; facilitating oversight of, and compliance by, service providers; facilitating transfer of information during servicing transfers; and informing borrowers of the availability of written error resolution and information request procedures. In addition, servicers are required to maintain certain documents and information for each mortgage loan in a manner that enables the services to compile it into a servicing file within five days. This section includes an exemption for small servicers as defined above. The Bureau and the prudential regulators will be able to supervise servicers within their jurisdiction to assure compliance with these requirements but there will not be a private right of action to enforce these provisions.

7. **Early intervention with delinquent borrowers.** Servicers must establish or make good faith efforts to establish live contact with borrowers by the 36th day of their delinquency and promptly inform such borrowers, where appropriate, that loss mitigation options may be available. In addition, a servicer must provide a borrower a written notice with information about loss mitigation options by the 45th day of a borrower's delinquency. The rule contains model language servicers may use for the written notice. This section includes an exemption for small servicers as defined above.

8. **Continuity of contact with delinquent borrowers.** Servicers are required to maintain reasonable policies and procedures with respect to providing delinquent borrowers with access to personnel to assist them with loss mitigation options where applicable. The policies and procedures must be reasonably designed to ensure that a servicer assigns personnel to a delinquent borrower by the time a servicer provides such borrower with the written notice required by the early intervention requirements, but in any event, by the 45th day of a borrower's delinquency. These personnel should be accessible to the borrower by phone to assist the borrower in pursuing loss mitigation options, including advising the borrower on the status of any loss mitigation application and applicable timelines. The personnel should be able to access all of the information provided by the borrower to the servicer and provide that information, when appropriate, to those responsible for evaluating the borrower for loss mitigation options. This section includes an exemption for small servicers as defined above. The Bureau and the prudential regulators will be able to supervise servicers within their jurisdiction to

assure compliance with these requirements but there will not be a private right of action to enforce these provisions.

9. **Loss Mitigation Procedures.** Servicers are required to follow specified loss mitigation procedures for a mortgage loan secured by a borrower's principal residence. If a borrower submits an application for a loss mitigation option, the servicer is generally required to acknowledge the receipt of the application in writing within five days and inform the borrower whether the application is complete and, if not, what information is needed to complete the application. The servicer is required to exercise reasonable diligence in obtaining documents and information to complete the application.

   For a complete loss mitigation application received more than 37 days before a foreclosure sale, the servicer is required to evaluate the borrower, within 30 days, for all loss mitigation options for which the borrower may be eligible in accordance with the investor's eligibility rules, including both options that enable the borrower to retain the home (such as a loan modification) and non-retention options (such as a short sale). Servicers are free to follow "waterfalls" established by an investor to determine eligibility for particular loss mitigation options. The servicer must provide the borrower with a written decision, including an explanation of the reasons for denying the borrower for any loan modification option offered by an owner or assignee of a mortgage loan with any inputs used to make a net present value calculation to the extent such inputs were the basis for the denial. A borrower may appeal a denial of a loan modification program so long as the borrower's complete loss mitigation application is received 90 days or more before a scheduled foreclosure sale.

   The rule restricts "dual tracking," where a servicer is simultaneously evaluating a consumer for loan modifications or other alternatives at the same time that it prepares to foreclose on the property. Specifically, the rule prohibits a servicer from making the first notice or filing required for a foreclosure process until a mortgage loan account is more than 120 days delinquent. Even if a borrower is more than 120 days delinquent, if a borrower submits a complete application for a loss mitigation option before a servicer has made the first notice or filing required for a foreclosure process, a servicer may not start the foreclosure process unless (1) the servicer informs the borrower that the borrower is not eligible for any loss mitigation option (and any appeal has been exhausted), (2) a borrower rejects all loss mitigation offers, or (3) a borrower fails to comply with the terms of a loss mitigation option such as a trial modification.

If a borrower submits a complete application for a loss mitigation option after the foreclosure process has commenced but more than 37 days before a foreclosure sale, a servicer may not move for a foreclosure judgment or order of sale, or conduct a foreclosure sale, until one of the same three conditions has been satisfied. In all of these situations, the servicer is responsible for promptly instructing foreclosure counsel retained by the servicer not to proceed with filing for foreclosure judgment or order of sale, or to conduct a foreclosure sale, as applicable.

This section includes an exemption for small servicers as defined above. However, a small servicer is required to comply with two requirements: (1) a small servicer may not make the first notice or filing required for a foreclosure process unless a borrower is more than 120 days delinquent, and (2) a small servicer may not proceed to foreclosure judgment or order of sale, or conduct a foreclosure sale, if a borrower is performing pursuant to the terms of a loss mitigation agreement.

All of the provisions in the section relating to loss mitigation can be enforced by individuals. Additionally, the Bureau and the prudential regulators can also supervise servicers within their jurisdiction to assure compliance with these requirements.

IMPLEMENTATION

The effective date for both of these rules is January 10, 2014. The Bureau generally believes that the final rules should be made effective as soon as possible, and the Dodd-Frank Act in some cases provides no more than 12 months for implementation. However, the Bureau understands that the final rules will require revisions to software, staff training, and other changes. Some companies may also need to implement other new requirements under other parts of the Dodd-Frank Act. The Bureau will be working to help industry to achieve the implementation of these rules by the effective date.