

## **Debtor's can now strip second mortgages in Chapter 7 bankruptcy**

For many years, it has been well settled law that a Debtor who owns real estate with more than one mortgage can file a Motion with the Bankruptcy Court to eliminate, or “strip,” the second mortgage or equity line from that property. More specifically, “[t]o the extent that a lien secures a claim against a debtor that is not an allowed secured claim, such lien is void.” 11 U.S.C. § 506(d). The caveat to this rule, however, it is that the law was just as well settled that only those consumers in a Chapter 13 case could take advantage of 506(d). Up until recently, a Debtor who filed a Chapter 7 bankruptcy case and wanted to discharge all unsecured debt was not allowed to strip a second lien. The reason for this rule was that, in a Chapter 13 case, the Trustee retains an interest in the property for the bankruptcy estate. Conversely, in a Chapter 7 case, presuming the Trustee abandons any exempt asset, there is no interest in the property by the estate and section 506(a) does not apply. As a result, the court cannot bifurcate the debt into secured and unsecured debt, and without this bifurcation there is no unsecured debt to discharge. Additionally, a Chapter 7 discharge does not extend to an *in rem* claim against property; the discharge is limited to a discharge of personal liability. Dewsnup v. Timm, 502 U.S. 410 (1992).

This week, however, the rule that lien strips cannot take place in Chapter 7 bankruptcy has been turned on its ear. *In Re: McNeal*, Case: 11-11352, Lorraine McNeal v. GMAC Mtg. held that, at least in the 11<sup>th</sup> Circuit, even though a Debtor still cannot *cramdown* the value of an investment property as clearly noted in Dewsnup, a Debtor can *strip* a junior lien from a primary residence. The Court reasoned that because the United States Supreme Court in Dewsnup disallowed only a “strip down” of a partially secured

mortgage lien and did not address a "strip off" of a wholly unsecured lien, it is not "clearly on point" and as such, the issue was not intended to be addressed by that Court.

Upon a reading of this opinion, it seems that this case is ripe for appeal because the court essentially held that, where the Supreme Court only discussed a cramdown in a Chapter 7 case under 506, entirely stripping a junior lien was not addressed. As such, the 11<sup>th</sup> Circuit Court reasoned, there is no restriction on lien stripping. To me, this argument is a little thin. Under this ruling, a Debtor cannot reduce the principal owed to a Creditor, but that Debtor can completely eliminate it. If this holds up, though, it could be very helpful to many Debtors who meet all of the criteria for a Chapter 7, but find themselves in a Chapter 13 for no other reason than to file a Motion to Avoid a Lien.

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