

UNITED STATES BANKRUPTCY COURT  
FOR THE DISTRICT OF NEBRASKA

IN THE MATTER OF )  
)  
CHAD L. MUZZEY, )  
TERRY S. MUZZEY, ) CASE NO. BK01-82615  
) CH. 7  
)  
DEBTOR(S) )

MEMORANDUM

Hearing was held on January 14, 2002, on a Motion to Avoid Second Lien. Appearances: Wayne Griffin as attorney for debtors and Tim Thompson as attorney for First National Bank. This memorandum contains findings of fact and conclusions of law required by Fed. R. Bankr. P. 7052 and Fed. R. Civ. P. 52. This is a core proceeding as defined by 28 U.S.C. § 157(b)(2)(K).

INTRODUCTION

This matter is before the court on the debtor's Motion to Avoid Second Lien and a Resistance by First National Bank. The debtor argues that First National Bank's lien should be avoided because the lien is essentially unsecured due to the value of the real property and the existence of a prior mortgage. Conversely, First National Bank argues that its loan is secured because the debtors have undervalued their property and the lien is thus unavoidable. No adversary proceeding has been filed in this case concerning the issue at hand. For the reasons stated below, the debtor's Motion to Avoid Second Lien is denied.

According to Fed. R. Bankr. P. 7001(2), an adversary proceeding must be filed in order to determine the validity, priority, or extent of a lien. The matter presently before the court is an attempt by the debtor to avoid a lien. Actions to avoid lien, when an exemption is not at issue, are subject to the requirements of Rule 7001(2). However, the filing of an adversary proceeding can be avoided in certain situations. In this case, neither party raised the procedural issue regarding the necessity of an adversary proceeding. Both parties have submitted evidence and the record has been adequately developed so that, for purposes of this motion, the matter will be treated as an adversary proceeding. Laskin v.

First National Bank of Keystone, 222 B.R. 872 (9<sup>th</sup> Cir. BAP 1998).

#### FACTS

The property was purchased in 1999 at a total cost of \$110,000 with a loan in the same amount from IndyMac Bank, the entity that holds a first deed of trust on the property.<sup>1</sup> The balance of the loan as of October 29, 2001, is \$100,892.67.

Later, in order to secure a loan for a business venture, the debtors granted a security interest in the same real property to First National Bank. The amount of First National Bank's lien as of January 10, 2002 is \$15,951.00.

There is some dispute regarding the value of the real property at issue. First National Bank has presented an appraisal dated May of 2000 which values the property at \$107,000. The debtors have presented a Comparative Market Analysis, completed by a real estate broker, which values the property at \$92,500 as of November of 2001. The debtors listed the real property, on Schedule A, as having a value of \$86,000. It is unnecessary to make a determination of value in this case due to the conclusion reached.

#### ANALYSIS

The question presented in this case is whether an unsecured or under-secured lien may be stripped off the real property which provides security for the loan.

In Chapter 7 cases, the term "lien stripping" is used when a debtor wishes to rid itself of the unsecured portion of an otherwise secured loan. Relevant to this case are "stripping down" a lien and "stripping off" a lien.

The term "stripping down" a lien refers to a "situation where the inferior mortgage is partially secured." Ryan v. Homecoming Financial Network, 253 F.3d 778, 780 n.3 (4<sup>th</sup> Cir.

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<sup>1</sup> The debtor claims that although a loan was given to them in the amount of \$110,000 at the time of the purchase of the real property, it was appraised for only \$86,0000.

2001). The question then is whether the debtor should be allowed to strip down the lien to the amount that is secured, thus avoiding the portion of the lien amount that is unsecured.

The term "strip off" refers to a situation where a junior mortgage is totally unsecured. Ryan, 253 F.3d at 780 n.3. The question then becomes whether the debtor should be allowed to rid itself of the wholly unsecured lien.

The United States Supreme Court, in Dewsnup v. Timm, held that 11 U.S.C. § 506(d) does not allow a Chapter 7 debtor to "strip down" a consensual lien. Dewsnup v. Timm, 502 U.S. 410, 112 S.Ct. 773, 116 L.Ed.2d 903(1992). The Court reasoned that if the debtor was allowed to freeze the value of the collateral to the judicially determined amount, rather than the amount garnered at a foreclosure sale, the mortgage holder would not get the benefit of any increase in the value of the property by the time of the foreclosure sale. Dewsnup, 502 U.S. at 417, 112 S.Ct. at 773. Additionally, the court stated that a contrary reading would fly in the face of the long held rule that liens pass through bankruptcy unaffected. Id.

However, since Dewsnup, some courts held that Dewsnup applied only to under-secured liens. These courts found that a wholly unsecured lien could be avoided because a wholly unsecured lien, by definition, is not an allowed secured claim and is, therefore, void. See Warthen v. Smith (In re Smith), 247 B.R. 191 (W.D. Va. 2000); Farha v. First American Title Insurance (In re Farha), 246 B.R. 547, 549 (Bankr. E.D. Mich 2000); Zempel v. Household Finance Corp.(In re Zemple), 244 B.R. 625 (Bankr. W.D. Ky. 1999); Yi v. CitiBank(In re Yi), 219 B.R. 394, 397 (E.D. Va. 1998).

The majority of courts have held that the reasoning of Dewsnup applies regardless of whether the lien is wholly unsecured or merely under-secured. Ryan, 253 F.3d at 783. See also Laskin, 222 B.R. at 872; Bessette v. Bank One, 269 B.R. 644 (Bankr. E.D. Mich. 2001); Keltz v. HomeEq (In re Keltz), 261 B.R. 845, 846 (Bankr. W.D. Pa. 2001); In re Fitzmaurice, 248 B.R. 356, 361-363 (Bankr. W.D. Mo. 2000); Cunningham v. Homecomings Financial Network (In re Cunningham), 246 B.R. 241, 243-46 (Bankr. D. Md. 2000); Swiatek v. Pagliano (In re Swiatek), 231 B.R. 26 (Bankr. D. Del. 1999); In re Virello, 236 B.R. 199 (Bankr. D.S.C. 1999);

Cater v. American General Finance (In re Cater), 240 B.R. 420, 425 (Bankr. M.D. Ala. 1999). These courts reasoned

Whether the lien is wholly unsecured or merely undersecured, the reasons articulated by the Supreme Court for its holding in Dewsnup[- that liens pass through bankruptcy unaffected, that mortgagee and mortgagor bargained for a consensual lien which would stay with real property until foreclosure, and that any increase in value of the real property should accrue to the benefit of the creditor, not the debtor or other unsecured creditors--are equally pertinent.

Ryan, 253 F.3d at 783, quoting Laskin v. First National Bank of Keystone, 222 B.R. at 876.

The reasoning of the Court of Appeals for the Fourth Circuit and the majority of courts is persuasive. A consensual lien, whether unsecured or under-secured. cannot be "stripped" in a Chapter 7 proceeding pursuant to 11 U.S.C. §§ 506(a) and (d). "Under this Chapter 7 proceeding, they [the creditors] are entitled to their lien position until foreclosure or other permissible disposition is had." Ryan, 253 F.3d at 783.

Therefore, because First National Bank's lien cannot be stripped off, the debtor's motion to avoid lien is denied.

Separate order to be entered.

Dated: March 4, 2002.

BY THE COURT:

s/Timothy J. Mahoney  
Chief Judge

Copies faxed by the Court to:

05 GRIFFIN, WAYNE  
62 THOMPSON, TIM W.  
51 KELLY, PHILIP

Movant (\*) is responsible for giving notice of this journal entry to all other parties (that are not listed above) if required by rule or statute.

UNITED STATES BANKRUPTCY COURT  
FOR THE DISTRICT OF NEBRASKA

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|--------------------------|---|-----------------------------------|
| IN THE MATTER OF         | ) |                                   |
|                          | ) |                                   |
| CHAD L. MUZZEY,          | ) |                                   |
| TERRY S. MUZZEY,         | ) | CASE NO. BK01-82615               |
|                          | ) | A                                 |
| _____ DEBTOR(S) _____    | ) |                                   |
|                          | ) | CH. 7                             |
|                          | ) | Filing No. 6, 10                  |
| Plaintiff(s)             | ) |                                   |
| vs.                      | ) | <u>ORDER</u>                      |
|                          | ) |                                   |
|                          | ) | DATE: March 4, 2002               |
| _____ Defendant(s) _____ | ) | HEARING DATE: January<br>14, 2002 |

Before a United States Bankruptcy Judge for the District of Nebraska regarding Motion to Avoid Second Lien by the Debtor and a Resistance by First National Bank

APPEARANCES

Wayne Griffin, Attorney for debtors  
Tim Thompson, Attorney for Bank  
(X) Copy to Law Clerk

IT IS ORDERED:

The debtor's motion to avoid lien is denied. See Memorandum entered this date.

BY THE COURT:

s/Timothy J. Mahoney  
Chief Judge

Copies faxed by the Court to:

- 05 GRIFFIN, WAYNE
- 62 THOMPSON, TIM W.
- 51 KELLY, PHILIP

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