

## Lien Stripping in Bankruptcy under Chapter 7 and Chapter 13

### Chapter 7

Lien stripping in Chapter 7 is not permitted. The United States Supreme Court in *Dewsnup v. Timm*, 502 U.S. 410 (1992) barred Chapter 7 debtors from stripping a creditor's partially-secured claim down to the value of the underlying property. Likewise, the United States Supreme Court ruled in *Bank of America, N.A. v. Caulkett*, 135 S. Ct. 995 (2015) that a debtor in a Chapter 7 bankruptcy proceeding may not "strip off" or void a junior mortgage lien pursuant to § 506(d) of the Bankruptcy Code when the debt owed on a senior mortgage lien exceeds the present value of the property. For additional analysis please review Bulletin 0601-15-201, dated June 1, 2015.

### Chapter 13

The United States Supreme Court decision in *Nobleman v. American Savings Bank*, 508 U.S. 324 (1993) ruled that the debtor could not "strip down" a partially unsecured lien on the debtor's homestead to the fair market value of the residence. Thus, when insuring property that has passed through a Chapter 13 bankruptcy (or is presently owned by a Chapter 13 debtor), the full amount of a homestead mortgage lien must be set forth as an exception, even where the value of the homestead is less than the outstanding lien balance. Chapter 13 debtors are prohibited from "stripping down" the unsecured portion of a partially unsecured homestead mortgage lien in a Chapter 13 plan.

The determination of whether a Chapter 13 debtor could modify the rights of a junior lien creditor when there was no value to support the collateral – i.e. stripping off a wholly unsecured mortgage – was left untouched by the Court. The majority of circuit courts have held that a Chapter 13 debtor may "strip off" a wholly unsecured junior mortgage lien. Thus, when insuring property that has passed through a Chapter 13 bankruptcy, the full amount of a wholly unsecured junior mortgage lien may be omitted as an exception to title, but *only if* all the following conditions are met:

1. The United States court of appeals in the applicable federal judicial circuit has held that a Chapter 13 debtor may strip off a wholly unsecured junior mortgage lien;
2. The junior lien creditor was properly served with notice of the Chapter 13 bankruptcy proceeding and with notice of the motion to strip off the lien;
3. The debtor has satisfactorily completed the Chapter 13 plan; and
4. A final discharge order has been entered by the bankruptcy court and the appeal period has run.

It is important to bear in mind that in order for the debtor to strip off a wholly unsecured junior mortgage lien in a Chapter 13 bankruptcy, ***the debtor must satisfactorily complete the Chapter 13 plan***, a final discharge order must be entered, and the time to appeal the final discharge order must have run.

The table below summarizes lien stripping in Chapter 7 and Chapter 13 bankruptcy proceedings.

### Chapter 7 Bankruptcy

| Type of Lien             | Strip Permitted | Authority  | Requirements        |
|--------------------------|-----------------|--|---------------------|
| Partially Unsecured Lien | No              | <i>Dewsnup v. Timm</i> , 502 U.S. 410 (1992)               | Strip not permitted |
| Wholly Unsecured Lien    | No              | <i>Bank of America v. Caulkett</i> , 135 S.Ct. 1995 (2015) | Strip not permitted |

### Chapter 13 Bankruptcy

| Type of Lien             | Strip Permitted | Authority   | Requirements  |
|--------------------------|-----------------|---|---|
| Partially Unsecured Lien | No              | <i>Nobelman v. American Savings Bank</i> , 508 U.S. 324 (1993)              | Strip not permitted   |
| Wholly Unsecured Lien    | Maybe           | Check with U.S. court of appeals in the applicable federal judicial circuit | <ol style="list-style-type: none"><li>1. U.S. court of appeals in the applicable federal judicial circuit has held that a Chapter 13 debtor may strip off a wholly unsecured junior mortgage lien;</li><li>2. Junior lien creditor was properly served with notice of the Chapter 13 bankruptcy proceeding;</li><li>3. Junior lien creditor was properly served with notice of the motion to strip off the lien;</li><li>4. <b>The debtor satisfactorily completed the Chapter 13 Plan;</b></li><li>5. A final discharge order has been entered by the bankruptcy court; and</li><li>6. The time to appeal the discharge order has run.</li></ol> |

If you are asked to eliminate the lien of a junior mortgage pursuant to a Chapter 13 bankruptcy order or plan, please seek underwriting guidance from the Corporate Legal Department.

For more information, please review Bulletin 0726-93-201, dated July 26, 1993, Bulletin 0601-15-201, dated June 1, 2015, and Bulletin 1007-16-201, dated October 7, 2016.