Lien-Stripping Under the Official Form Chapter 13 Plan

One of the potential benefits of a debtor choosing to file a chapter 13 proceeding over a chapter 7 proceeding is the possibility of voiding a subordinate mortgage on the debtor’s residence. This is despite the Nobelman exception codified in § 1322(b)(2), if the value of the residence is less than the balance on the first mortgage. The ability of a chapter 13 debtor to accomplish this “strip-off” of a “wholly unsecured” mortgage was recognized in a vast majority of the case law starting in the late 1990s across all circuits, pre-dating and remaining unchanged by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA). The logic behind these opinions is that a subordinate mortgageholder with no equity in its collateral does not hold a “secured” claim under § 506(a), therefore it is not protected by § 1322(b)(2).

However, like many aspects of chapter 13 practice, the procedure for lien-stripping remained unclear. Bankruptcy judges across the nation — and often even in the same division — differed on how this mortgage lien-stripping could be accomplished. Five possible required methods, some cumulative, were identified by the bankruptcy courts: (1) through the plan process alone; (2) through the plan process, but with special provisions included in the plan or heightened service requirements; (3) through a claim objection in conjunction with the plan; (4) through a required motion separate from the plan; and (5) through a required adversary proceeding in conjunction with the plan.

Prior to the adoption of Official Form 113 (which will be referred to as the “Plan Form”) and the accompanying rules discussed in this article, debtors were generally able to draft the chapter 13 plans to their own liking often with unique provisions and varying in length. A mortgageholder recipient could never be certain of where to find this mortgage lien-stripping provision. Further, with differing procedures across 94 judicial districts, a national mortgageholder and its counsel would often not know when a lien strip had been completed or was simply in progress. Initial attempts to impose a nationwide uniform plan and remove local control were historically opposed, as most bankruptcy judges and practitioners believed that their particular plans and provisions were sufficiently working and did not want to lose control over the process.

From the consumer debtor’s point of view, this situation created its own set of problems. Confusion by the mortgage-servicer over whether its lien was in danger of being stripped resulted in a plan objection — adding often unnecessary fees to the debtor’s mortgage loan balance. Since the lien-strip process was not statutory, counsel for consumer debtors were always in danger of a ruling by the circuit court that the way its particular division had been allowing lien-stripping — and therefore years of plans and unpaid mortgages — was incorrect. There were further practical issues from a real estate title point of view. Since most bankruptcy courts confirm chapter 13 plans by text order, in districts where lien-stripping was accomplished through the plan, there was often no single document that could be recorded with the subject county recorder. Many bankruptcy courts discouraged debtor’s counsel from filing a separate motion for a recordable comfort order.

Espinosa and the Plan Form Initiatives

Into this balkanized chapter 13 landscape, with differing rules over what procedure was required to accomplish the chapter 13 debtor’s intentions, the U.S. Supreme Court issued its opinion in United Student Aid Funds Inc. v. Espinosa. Much has been written seeking to interpret the meaning of Espinosa and its effect on chapter 13 procedures, but from many practitioners’ and judges’ point of view, its directives were (1) whatever debtor relief that could be obtained in an adversary proceeding could be accomplished through the chapter 13 plan process alone; and (2) bankruptcy judges were responsible for ensuring that relief contained in a confirmed plan complied with the limits of the Bankruptcy Code.

Counsel for the debtors rejoiced. It seemed clear to many practitioners that under Espinosa, lien-stripping could be accomplished solely through the plan process, ending the need and additional costs not incurred through an adversary proceeding.

2 For a time, there was a minority view — which may still exist in some divisions — that the stripping off of a wholly unsecured subordinate mortgage was barred by § 1322(b)(2), but that minority view is “nearing extinction.” In re Smith, 514 B.R. 331, 334 (Bankr. S.D. Ga. 2014). Based on the author’s research, it appears that the last holdout was the District of Minnesota, but that also appears to have changed based on the district’s local chapter 13 plan form and recent case law. In re Fisette, 455 B.R. 17 (B.A.P. 8th Cir. 2011).
for separate motions/adversary proceedings and potential pitfalls of a later reversal by a circuit court of a particular division’s historical procedural rules. From a bankruptcy court’s point of view, the redundant issue already dealt with through the plan and staff time of the additional adversary proceeding/motion could be avoided. However, various bankruptcy courts viewed Espinosa differently and continued to require their own procedures for lien-stripping, including a separate adversary proceeding. Further, in the wake of Espinosa and its directive to the bankruptcy courts that chapter 13 plan provisions needed to be closely monitored, the push for a nationwide uniform model chapter 13 plan by some members of the Advisory Committee on Bankruptcy Rules was reignited.

The results were amendments to various of the Federal Rules of Bankruptcy Procedure and a compromise contained in the new Rule 3015.1 creating the Plan Form — with an “opt-out” option to the districts with specific limitations — which became effective December 2017. Ideally, the Plan Form should resolve all of these open questions and provide a uniform, noncontroversial procedure to accomplish stripping off a wholly unsecured mortgage through the plan process — as Espinosa suggested should be permissible. This article suggests, within the confines of the Plan Form and the amended Rules, a simple and practical road map for debtor practitioners to follow.

Plan Form and Mortgage Lien-Stripping

Unfortunately, the Plan Form contains no explicit provision for stripping off a wholly unsecured mortgage. Further, Rule 3015.1 allows districts to “opt out” of the model plan form, subject to certain restrictions. Currently, approximately 90 percent of the federal districts had made such an election, therefore nearly all practitioners will need to analyze the issues under the language of their particular local plan form. Fortunately for purposes of this article, the relevant portions of the Plan Form being discussed are for the most part mandatory under the opt-out rule provisions, so the following comments are based on reference to the official Plan Form itself.

Under § 1.1 of the Plan Form, the debtor must check the box if the plan seeks “[a] limit on the amount of a secured claim, set out in Section 3.2, which may result in a partial payment or no payment at all to the secured creditor.” It appears clear that a plan seeking to strip off a wholly unsecured mortgage would require this box to be checked. The referenced § 3.2 of the Plan Form allows for a debtor to value an allegedly secured claim of a creditor, and if the value of the collateral securing the claim is listed as having “no value,” the creditor is deemed to hold only an unsecured claim. Although § 506(a) is not specifically referenced, it appears clear that this is the operative Bankruptcy Code section. Amended Rule 3012 now specifically allows a binding determination of the value — or in this case lack of value — of a secured claim through the plan process alone, which should avoid the need for filing a separate motion or claim objection.

Unfortunately, the Plan Form contains no explicit provision for stripping off a wholly unsecured mortgage. Further, Rule 3015.1 allows districts to “opt out” of the model plan form, subject to certain restrictions.

Is § 3.2 alone, asserting that the “secured” creditor holds no secured claim due to no equity in the collateral, sufficient to strip off a wholly unsecured mortgage? Arguably, the answer is “yes,” especially if there is a subsequent order granted by the bankruptcy court under new Rule 5009(d), but there are additional best practice steps that should probably be followed. First, the debtor might make it clear in the “Nonstandard Provisions” section of the Plan Form, and check the box in § 1.3. In a nonstandard provision, the debtor could state essentially all of the facts (such as the recorded document number of the subject mortgage) and the requested relief of what previously would have been a separate motion. Second, the debtor could include a nonstandard provision requesting that a separate order be entered by the bankruptcy court in conjunction with plan confirmation specifically voiding the subject mortgage.

Hopefully, all bankruptcy courts will recognize that the Plan Form and the accompanying amended Rules — with their heightened service requirements — have the effect of allowing mortgage strip-offs through the chapter 13 plan process alone. The Plan Form, even if adapted to a local form, is intended to take the guesswork out of a chapter 13 plan for both the plan drafter and the creditors reviewing it. However, as with many aspects of chapter 13 practice, local culture is often difficult and slow to change.

Service Requirements Under the Plan Form

Unless required by local rules or practice, a filed chapter 13 plan previously did not require mailing by the debtor, as service is made through first-class mail by the Bankruptcy Noticing Center (BNC) to the parties on the matrix. Pursuant to amended Rule 3012, a plan that seeks to set the value of a

---

6 Adversary proceedings filed by a debtor generally do not require court costs, so no revenue for the courts is generated.

7 See Smith, 514 B.R. at 339.


9 The Plan Form provides a notice box and explicit procedure for voiding a lien under § 522(b), but as previously discussed, that is not the operative Code section (§ 506(a)) that can be used to strip off a wholly unsecured mortgage. Proactive districts should add a mortgage-stripping section to their “opt-out” plans. Mortgage strip-offs are not a rare occurrence — especially in the current real estate market — and there does not appear to be any restriction on such provisions under Rule 3015.1.

10 Despite amended Rule 3012(b) making it clear that the plan-confirmation process is a valid and binding procedure for valuing collateral, and therefore should be a proper method by which to strip off a wholly unsecured mortgage, some opt-out district local plan forms are still requiring a separate filing in order for lien voidance to be effective. See, e.g., the Eastern District of California (Form EDC3-080).

11 The exception being courts that had followed the line of cases that allowed mortgage strip-off through the plan process, but required heightened service requirements and a corresponding certificate of service. See In re Miller, 428 B.R. 791 (Bankr. S.D. Ohio 2010); In re Stassi, 2009 WL 3755770 (Bankr. C.D. Ill. 2009).
secured claim through the plan process — and therefore any plan that seeks to strip off a wholly unsecured mortgage — must be served upon the mortgageholder in the manner required by Rule 7004. The rules for service under Rule 7004 are a debated topic itself that will not be discussed in detail in this article, but service through the BNC with a normal mailing address for the mortgage creditor is unlikely to be sufficient.\textsuperscript{12} Most importantly for the practitioner, service under Rule 7004 upon an “insured depository institution” must be made by certified mail addressed to an officer of the institution pursuant to subsection (h). Since most mortgages are held by banks, counsel for the debtor serving plans by certified mail at filing will become a common occurrence.

Therefore, what is the best practice for complying with these heightened service requirements to accomplish a mortgage strip-off? Almost certainly, a certificate of service stating the date and method of the additional service should be filed with the chapter 13 plan. If service is required to be made by certified mail, a good practice is to scan and file the “return of service card” from the recipient with the court upon its receipt back. If the return of service card is never returned by the intended recipient, the practitioner might have a problem for which there is no easy solution.

A problem that existed before the Plan Form service requirements, and will continue to trouble practitioners and the courts, is identifying the proper current “holder” of the mortgage. If a proof of claim is filed with the court, the identity might be easy to later confirm. Otherwise, a search of the title records for assignments might be necessary. Other options include a qualified written request to the mortgage-servicer under the Real Estate Settlement Procedures Act. Ownership inquiries to the servicer and other parties are also available under the Truth in Lending Act.\textsuperscript{13}

**Comfort and Other Recordable Orders**

The debtor, a subsequent title insurance issuer and the local county office will ideally want a recordable clear and unambiguous order signed by a bankruptcy judge confirming voidance of the subject mortgage. A text order confirming the chapter 13 plan, as is done in most districts, might not be sufficient to a nonbankruptcy practitioner to confirm a clear title. One option previously discussed is a “nonstandard provision” request for issuance of a separate order upon confirmation of the plan. However, bankruptcy courts might be reluctant to establish a practice of issuing an order separate from the order confirming a plan, especially one not specifically authorized by a Bankruptcy Code or Rule. Fortunately, newly added Rule 5009(d) provides the mechanism for entry of a comfort order, which can be drafted by counsel to satisfy all of these requirements, confirming voidance of the subject mortgage. The Committee Notes to the new subsection recognize the circumstance of a mortgage strip-off and the likely need for such a separate order certifying in clear language the voidance of the mortgage.

A comfort order under Rule 5009(d) requires a motion and heightened service, once again pursuant to Rule 7004. The Committee Notes to the subsection suggest that the comfort order will likely be sought at the end of the case, as in most districts the case law requires the entry of a chapter 13 discharge prior to the voidance being effective, but recognize that courts may allow the motions sooner. Presumably, a comfort-order motion could be filed upon confirmation of the chapter 13 plan with a provision that voidance is conditioned upon entry of a chapter 13 discharge in the case — an event that is easily shown and automatically entered — allowing the debtor’s attorney to close out the file and not have to calendar an event that is, in some cases, five years in the future.

**Conclusion**

No debtor’s attorney wants the call several years after a bankruptcy representation has ended that a real estate closing is scheduled and the title insurer is not satisfied about the effect of a chapter 13 plan on a voidable mortgage. The Plan Form requirements of Rule 3015.1 and the corresponding Bankruptcy Rule changes, especially the explicit right to the entry of a comfort order, will hopefully create uniformity and end such uncertainty. \textit{abi}

\textsuperscript{12} In a case where the secured claimholder is not an insured depository institution, Rule 7004 service could conceivably be accomplished by listing the creditor in the schedules and matrix with a mailing address that includes attention to an “officer” or qualifying “agent” under Rule 7004(b)(3) and rely on the BNC certificate of service. A cautious practitioner could also use this BNC service method as a backup supplement to the practitioner’s own additional mailing and certificate of service filed with the plan.