BURR ALERT

Bankruptcy Courts in Georgia and Florida Show Obedience to Eleventh Circuit Court of Appeals and Reluctantly Begin to Allow Lien Stripping in Chapter 7 Cases

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Three bankruptcy courts within the Eleventh Circuit have recently issued opinions in which they have reluctantly allowed the debtor to entirely strip off the interests held by junior lienholders when the value of the real property collateral is less than the amount of debt securing the senior lien. In In re Malone[1] (Northern District of Georgia -- Judge Diehl), In re Williams[2] (Middle District of Georgia -- Judge Walker), and In re Bertan[3] (Southern District of Florida – Judge Cristol), the courts issued opinions stating that a chapter 7 debtor may strip off a wholly unsecured junior lien, despite what appears to be all three judges' personal disagreement with this outcome.

The facts of Malone, Williams, and Bertan are very similar. In each of these three cases, the debtor owned real property upon which multiple liens had attached.[4] In each case, the value of the property was less than the amount of debt owed to the senior lienholder.[5] The debtors sought a court ruling holding that the liens asserted by junior lienholders can be avoided when the value of the collateral does not extend to the junior lien.[6]

In each of these three cases, the debtor's theory was essentially that a lien held by a junior lienholder should be avoided when the debt owed to the senior lender exceeds the value of the property. For example, in Malone, the debtor argued that because a claim asserted by a creditor is only secured "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" a lien should be avoided when there is no value that attaches to that lien and the claim should thereby be treated as entirely unsecured.[7] In further support of this position, the debtor relied upon § 506(d) of the Bankruptcy Code, which provides that "[t]o the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void."[8]

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[1] 2013 Bankr. LEXIS 1282 (Bankr. N.D. Ga. March 28, 2013).

[2] 2013 Bankr. LEXIS 1107 (Bankr. M.D. Ga. March 15, 2013).

[3] 2013 WL 216231 (Bankr. S.D. Fla. Jan. 18, 2013).

[4] Malone, 2013 Bankr. LEXIS 1282 at *3; Williams, 2013 Bankr. LEXIS 1107 at *2; Bertan, 2013 WL 216231 at *1.

[5] Id.

[6] Id.

[7] Malone, 2013 Bankr. LEXIS 1282 at *5.

[8] Id.

The courts acknowledged that the outcome of these cases would normally be dependent on the courts' interpretation of § 506, but also noted that both the United States Supreme Court and the Eleventh Circuit Court of Appeals had weighed in on this issue, or a similar variation thereof. Therefore, the bankruptcy courts would need to give great weight to the interpretations of these two higher courts.

The bankruptcy courts found themselves in a quandary between what appears to be a conflict between Supreme Court precedent and a line of cases coming out of the Eleventh Circuit. In Dewsnup v. Timm, the Supreme Court ruled in 1992 that a Chapter 7 debtor could not partially "strip down" a partially secured first lien down to the value of the creditor's interest in the collateral.[9] In Dewsnup, the Supreme Court placed emphasis on § 506(d)'s reference to an "allowed secured claim" and what the Supreme Court concluded was a two-step analysis required to determine if one holds an "allowed secured claim" that is therefore not subject to avoidance.[10] First, the Court looked to whether the claim was "allowed" under § 502.[11] Second, the Court looked to whether the claim was "'secured' through 'a lien with recourse to the underlying collateral.'"[12] The Court therefore was not concerned with whether any value had attached to the creditor's lien, but was instead concerned only with the issue of whether the underlying claim was secured based upon a properly-perfected security instrument.[13] As Judge Diehl acknowledged in Malone, the Supreme Court therefore concluded in Dewsnup that "'§ 506(d) does not allow [the debtor] to 'strip down' [respondents'] lien [to the present fair market value of the real property], because respondents' claim is secured by a lien and has been fully allowed pursuant to § 502.'"[14]

Based upon the Supreme Court's holding in Dewsnup that a lien securing a claim may not be avoided if (a) the claim is allowed and (b) the claim is secured by a lien with recourse to the underlying collateral, the bankruptcy courts in Malone, Williams, and Bertan all agreed that a logical conclusion with respect to the outcome of their respective cases would be that if a debtor cannot "strip down" a partially unsecured lien, the debtor certainly cannot "strip off" and completely avoid an entirely unsecured lien. For example, Judge Diehl wrote, "applying Dewsnup's statutory interpretation of § 506(d) to prevent Debtor from voiding [the creditor's] lien seems appropriate and required."[15]

The bankruptcy courts' job in deciding these cases, however, was made more difficult by the seemingly contradictory holding extended in 2012 by the Eleventh Circuit in In re McNeal, in which the Eleventh Circuit held that, regardless of Dewsnup, a chapter 7 debtor may avoid a "wholly unsecured" lien on real property.[16] In McNeal, the Eleventh Circuit stated that Dewsnup was not binding authority

[9] Dewsnup v. Timm, 502 U.S. 410 (1992).

[10] Id at 415.

[11] Id.; See 11 U.S.C. § 502(a) (stating that "[a] claim or interest, proof of which is filed under section 501 of this title, is deemed allowed, unless a party in interest, including a creditor of a general partner in a partnership that is a debtor in a case under chapter 7 of this title, objects.").

[12] Id at 417.

[13] Id.

[14] Malone, 2013 Bankr. LEXIS 1282 at *8 (citing Dewsnup, 502 U.S. at 417).

[15] Id. at *18.

[16] In re McNeal, 477 Fed. Appx. 562 (11th Cir. 2002) (unpublished per curium decision).

because the McNeal debtor sought a complete "strip off" of the lien, while in Dewsnup, the debtor sought only a partial "strip down" of the lien.[17] The McNeal court, after making the apparent distinction between a "strip off" and a mere "strip down," looked to a pre-Dewsnup Eleventh Circuit decision – Folendore v. U.S. Small Business Administration[18] -- that contains what appears to be an almost entirely different reading of § 506(d) than given by the Supreme Court.

In Folendore, the Eleventh Circuit allowed a debtor to avoid a "wholly unsecured" junior lien because the senior liens exceeded the value of the collateral.[19] Because there was no value that attached to the perfected junior, "secured" lien, the Eleventh Circuit held that the lien could be avoided.[20] Despite being decided three years prior to Dewsnup, the Eleventh Circuit in the 2012 case of McNeal determined that Folendore was still the controlling precedent. The McNeal court reasoned that because Dewsnup's facts were limited to a partially unsecured claim, as opposed to a "wholly unsecured" claim, Dewsnup did not abrogate Folendore and consequently remained the proverbial the law of the land within the Eleventh Circuit.[21] When confronting the seemingly contradictory ruling from the Supreme Court, the McNeal court stated that even though "the reasoning of an intervening high court decision [may be] at odds with that of our prior decision [there] is no basis for a panel to depart from our prior decision."[22] Moreover, "[o]bedience to a Supreme Court decision is one thing, extrapolating from its implications a holding on an issue that was not before the Court in order to upend settled circuit law is another thing."[23]

Consequently, the courts in Malone, Williams, and Bertan were given the unenviable task of trying to reconcile the seemingly contradictory opinions found in Folendore/McNeal and Dewsnup. Interestingly, the judges all felt compelled to follow the "persuasive"[24] authority provided by Folendore/McNeal despite the judges' personal disagreement with this line of reasoning. For example, Judge Walker stated that the court would "follow McNeal, even though the Court is persuaded that McNeal was wrongly decided."[25] Judge Diehl stated that "[a]though this Court cannot reconcile the Folendore and Dewsnup decisions with respect to the scope and application of § 506(d), deference to the Eleventh Circuit's McNeal decision ultimately tips the balance in favor of the Debtor,"[26] while Judge

[17] Id. at 564.

[18] 862 F. 2d 1537 (11th Cir. 1989).

[19] Folendore, 862 F. 2d at 1538-39.

[20] Id.

[21] McNeal, 477 Fed. Appx. at 564.

[22] Id.

[23] Id.

[24] Because McNeal was not a published decision, it is not binding precedent. See Malone, 2013 Bankr. LEXIS 1282 at *5.

[25] Williams, 2013 Bankr. LEXIS 1107 at *10. Judge Walker went on to say "McNeal and Folendore rely on application of § 506(a) prior to application of § 506(d) to void the wholly unsecured lien. However, § 506(a) serves no function in a no-asset Chapter 7 case. Logically, it should only apply when the case provides a distribution to unsecured creditors. In such circumstances, § 506(a) determines the extent to which an undersecured creditor will participate in the distribution. Nevertheless, the Eleventh Circuit has authorized strip off of a wholly unsecured claim pursuant to § 506(d). Although McNeal is not binding, the court cannot simply ignore a decision of the Eleventh Circuit."

[26] Malone, 2013 Bankr. LEXIS 1282 at *26

Cristol stated "this Court believe[s] the reasoning in Dewsnup [to be] controlling under the circumstances presented in this case."[27]

In each case, the bankruptcy judges disregarded their personal opinion regarding the appropriate outcome of the case and instead complied with what they presumably felt was their duty to respect an on-point decision from a higher court. Even though Judge Cristol may have felt that Dewsnup was controlling, the "Eleventh Circuit Court of Appeals does not believe it is."[28] Similarly, as stated by Judge Walker, "the Court cannot simply ignore a decision of the Eleventh Circuit, especially one that holds that a prior published (and therefore precedential) decision remains good law."[29] In these recent cases, we see bankruptcy judges struggling with how to fulfill their role. Do they disregard the holding of a higher court and rule how they feel best or do they set aside their personal beliefs and instead abide by the holding of the Eleventh Circuit? With respect to at least the McNeal, Williams, and Bertan courts, we see the judges setting aside their personal beliefs and instead abiding by the apparent wisdom of the Eleventh Circuit. It will be interesting to see how other courts within the Circuit handle this issue in the future.

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[27] Bertan, 2013 WL 216231 at *2.

[28] Id.

[29] Williams, 2013 Bankr. LEXIS 1107 at *11.