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signed 7-19-00

**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF KANSAS**

In re:

**JERRY LYNN McGINLEY,
CYNTHIA SUE McGINLEY,**

DEBTORS.

**CASE NO. 00-40223-13
CHAPTER 13**

**ORDER SUSTAINING OBJECTION TO PLAN PROVISION REQUIRING SECURED
CREDITOR TO RELEASE LIEN BEFORE COMPLETION OF CHAPTER 13 PLAN**

This matter is before the Court for resolution of an issue affecting many chapter 13 cases filed here. Debtors Jerry Lynn McGinley and Cynthia Sue McGinley appear by counsel Fred W. Schwinn. Ford Motor Credit Company ("FMCC") is the opposing creditor, and appears by counsel Charles R. Hay and Carol R. Bonebrake. The Court has reviewed the relevant pleadings and is now ready to rule.

FACTS

The McGinleys filed a chapter 13 plan in February 2000 that calls for FMCC to retain its lien on their pickup truck and be paid the truck's value through the plan. However, the plan also contains the following provision:

F. Upon the satisfaction or other discharge of a security interest in a motor vehicle . . . , or in any other property of this estate in bankruptcy for which ownership is evidenced by a certificate of title, the secured party shall within 10 days after demand and, in any event, within 30 days, execute a release of its security interest on the said title or certificate, in the space provided therefore on the certificate or as the division of motor vehicles prescribes, and mail or deliver the certificate and release to the debtor(s) or the attorney for the debtor(s). Confirmation of this plan shall impose an affirmative and direct duty on each such secured party to comply with this provision and upon failure to so comply such a party will be liable for liquidated and fixed damages of no less than \$2,000.00 plus reasonable legal fees and, in appropriate cases, for special damages and punitive damages. This provision shall be enforced in a proceeding filed before the bankruptcy court and each such creditor consents to such jurisdiction by failure to file any timely objection [to] this plan. Such an enforcement proceeding may be filed by the debtor(s) in this case either before or after the entry of the discharge order and either before or after the closing of this case.

FMCC objected to this provision, among others. The parties agree that the provision would require FMCC to release its lien on the debtors' vehicle as soon as the debtors have paid the value of the vehicle as established by agreement or court order, even though the debtors might not yet have completed all the payments called for by their plan.

At a hearing on May 22, 2000, the Court announced that FMCC could not be required to release its lien on the McGinleys' vehicle until they had completed all the payments under their plan and received a discharge. Since the McGinleys' counsel indicated they may want to appeal the decision, the Court is issuing this order to fully explain its reasoning.

DISCUSSION AND CONCLUSIONS

The debtors rely on 11 U.S.C.A. §§506(a), 1322(b), and 1325(a) and case law to support paragraph F of their plan. Section 506(a) provides in pertinent part:

An allowed claim of a creditor secured by a lien on property in which the estate has an interest . . . is a secured claim 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.

Section 1322(b) provides in pertinent part that a chapter 13 plan "may— . . . (2) modify the rights of holders of secured claims." Section 1325(a)(5) provides that a plan can be confirmed over a secured creditor's objection if:

with respect to [the creditor's] allowed secured claim provided for by the plan—

. . .

- (B) (i) the plan provides that the holder of such claim retain the lien securing such claim; and
- (ii) the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim.

Once all the payments required under §1325(B)(ii) to satisfy an allowed secured claim have been made, the debtors contend, the creditor must release the lien retained under §1325(B)(i). A number of cases have agreed with this assertion. *See, e.g., In re Johnson*, 213 B.R. 552 (Bankr. N.D. Ill. 1997); *In re Nicewonger*, 192 B.R. 886 (Bankr. N.D. Ohio 1996); *In re Flowers*, 175 B.R. 698 (Bankr. N.D. Ill. 1994); *In re Murry-Hudson*, 147 B.R. 960 (Bankr. N.D. Cal. 1992).

The Court would find the debtors' argument more persuasive if they could rely on §506(d). With certain exceptions not relevant here, §506(d) provides that a lien is void "[t]o the extent that [it] secures a claim against the debtor that is not an allowed secured claim." In conjunction with §506(a), this provision might be read to wipe out an undersecured creditor's lien to the extent the creditor's claim exceeds the value of the creditor's collateral. Nothing else in the Bankruptcy Code appears to apply so directly to liens securing undersecured claims. However, in *Dewsnup v. Timm*, 502 U.S. 410, 415-20 (1992), the Supreme Court ruled that §506(d) enables a debtor to void only a lien securing a disallowed claim, not the unsecured portion of a lien securing an undersecured claim. The Court refused to read the phrase "allowed secured claim" in §506(d) as having been defined in §506(a), but instead applied the words "allowed" and "secured" separately so that no lien is voided unless the claim it secures is disallowed. While the Court suggested its interpretation of those words would not necessarily apply to all possible fact situations or in other Bankruptcy Code provisions, 502 U.S. at 416-17 & n. 3, and some lower courts have relied on this dictum to support a conclusion that *Dewsnup* does not apply to reorganization cases, this view cannot be reconciled with §103(a), which provides that chapter 5 of the Bankruptcy Code applies to all cases under chapter 7, 11, 12, and 13 (except chapter 11 railroad cases). Section 506 is part of chapter 5, so the *Dewsnup* Court's construction of §506(d) itself, at least, must apply in chapter 13 cases. Any doubts on this point should

have been dispelled by the Supreme Court's later decision in *Nobelman v. American Savings Bank*, 508 U.S. 324, 330-32 (1993), where the Court ruled that although §1322(b)(2), a chapter 13 provision, could be read as a matter of grammar to use "secured claim" to refer only to a secured claim as defined in §506(a), it should instead be read to extend its prohibition against modifying a homestead lien to both the secured and unsecured portions of such a lien that is undersecured. Thus, the Supreme Court has twice indicated its reluctance to interpret a provision in the Bankruptcy Code to sever security interest rights from the "unsecured" portions of undersecured claims when another interpretation is possible.

The Court believes none of the provisions relied on by the debtors or otherwise found in chapter 13 directly resolves the question whether a debtor may require a secured creditor to release its lien upon payment of its allowed secured claim or only when the debtor receives a discharge. Many of the courts deciding this question have relied on the general bankruptcy policy of providing the debtor a "fresh start" to support their conclusion that the earlier time is permissible. *See, e.g., Johnson*, 213 B.R. at 557; *Murry-Hudson*, 147 B.R. at 962-64. In this Court's view, however, the entry of a discharge is the event that marks the debtor's right to a fresh start. Any earlier relief providing a partial step toward the fresh start should be limited to relief explicitly available before the discharge is granted, for example, the ability to sell property free and clear of liens under §363(f). For chapter 13 cases, Congress fixed the time when the debtor is entitled to the full fresh start as, ordinarily, the time when the debtor completes his or her plan, *see* §1328(a), in contrast to chapter 11 cases, where the discharge occurs when the plan is confirmed, *see* §1141(d). Since Congress so clearly and expressly postponed the main marker of the debtor's fresh start until the completion of the plan, the Court finds it

incongruous to conclude Congress nevertheless chose to grant an earlier, partial fresh start implicitly through provisions that do not specify when the relief they authorize must take effect.

Courts reaching the conclusion that release of the lien securing a fully-paid allowed secured claim must await the debtor's completion of the plan and receipt of a discharge have generally supported that result by pointing to the debtor's virtually unfettered right under §1307(a) to dismiss his or her bankruptcy case and the effect of dismissal as fixed by §349. *See, e.g., In re Thompson*, 224 B.R. 360, 365-67 (Bankr. N.D. Tex. 1998); *In re Scheierl*, 176 B.R. 498, 504-05 (Bankr. D. Minn. 1995). Section 349 provides in pertinent part:

- (b) Unless the court, for cause, orders otherwise, a dismissal of a case . . . —
 - (1) reinstates—
 - . . .
 - (C) any lien voided under section 506(d) of this title;
 - . . . and
 - (3) reverts the property of the estate in the entity in which such property was vested immediately before the commencement of the case under this title.

As indicated above, after the Supreme Court's decision in *Dewsnup*, the unsecured portion of an undersecured lien is not voided by §506(d), so §349(b)(1)(C) is not relevant to the issue before the Court. Courts allowing compulsory early release of a secured creditor's perfected lien have usually recognized that if the case is dismissed after the collateral's value has been paid but before the plan has been completed and a discharge has been granted, then §349(b)(3) seeks to reverse the vesting of property in the debtor that confirmation generally effects under §1327(b), and that the perfection of the lien will be gone if the creditor is forced to release the lien on payment of its allowed secured claim. *E.g., Johnson*, 213 B.R. at 557-58; *Nicewonger*, 192 B.R. at 890; *Murry-Hudson*, 147 B.R. at 962-64. Despite this, they have ruled that the provisions of chapter 13 explicitly call for this interim relief

and that the debtor's right to a fresh start outweighs the potential harm to the creditor. For two main reasons, this Court cannot agree.

First, other than the partial fresh start (which this Court views as premature), the courts have not indicated what appropriate, practical benefit the debtor receives as a result of the early release of the lien. At the hearing where the Court announced its view that the early release cannot be required, the attorney for the McGinleys stated, "[T]he benefit would be the ability to trade the car, to sell it. It's exempt property." A number of other attorneys who frequently represent debtors were also present and offered their views on that point, adding only that by the time a debtor has paid the amount of the allowed secured claim, the vehicle is often worth only a few hundred dollars but the creditor nevertheless refuses to release the lien so the debtor can sell the vehicle. Of course, even assuming that is often the case, this circumstance can hardly justify a blanket rule that would also apply when the vehicle's value is not minimal.

Second, while requiring the creditor to release the lien would allow the debtor to sell the vehicle without the creditor's permission, under this Court's confirmation orders, debtors are not free to sell their vehicles without seeking the Court's permission because the vehicles do not vest in the debtors until they complete their plans. Consequently, requiring creditors to release their liens would give debtors apparently clear titles, making it easier for them to violate the confirmation orders by selling or encumbering their vehicles without seeking permission. Although the vehicles may typically not be worth much by the time the debtors have paid their value as called for by the plan, the Court believes the creditors are nevertheless entitled to have the liens that revest in them under §349(b) in the event of dismissal remain perfected as they would have been outside of bankruptcy. Given the Supreme Court's refusal to read §506(d) to void the unsecured portion of an undersecured lien, this Court

believes no provision in the Bankruptcy Code is explicit enough to require an objecting creditor to release its lien before the debtor receives a discharge of the portion of the creditor's claim that is considered under §506(a) to be unsecured.

Some courts allowing forcible early lien release have suggested that without the release, if the case were converted to chapter 7, the debtor could keep the vehicle only by reaffirming the debt to the creditor or paying the unsecured portion of the creditor's claim to redeem the vehicle. *E.g., Johnson*, 213 B.R. at 557-58. For nearly all chapter 13 debtors before this Court, however, their vehicles are exempt property held for personal or family use. Section 722 allows a chapter 7 debtor to redeem such property by paying only the amount of the creditor's allowed secured claim, and in the hypothetical situation now being considered, the debtor will already have done that before conversion. Section 348(f)(1)(B) provides that the valuation of the vehicle during the chapter 13 phase of the case will apply following conversion, and the creditor's allowed secured claim will be reduced to the extent the debtor paid it through the chapter 13 plan. A debtor who has paid the full allowed secured claim before conversion will therefore be entitled to a declaration that he or she has effectively redeemed the vehicle pursuant to §722. Conversion of the case to chapter 7, then, will have no adverse impact on the debtor.

For these reasons, the Court concludes the debtors' plan cannot be confirmed over FMCC's objection because paragraph F is not authorized by any provision of the Bankruptcy Code. FMCC's objection to that paragraph is hereby sustained.

IT IS SO ORDERED.

Dated at Topeka, Kansas, this _____ day of July, 2000.

JAMES A. PUSATERI
CHIEF BANKRUPTCY JUDGE