No. 11-4014

IN THE
UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

IN RE KENNETH WOOLSEY AND STEPHANIE WOOLSEY
Chapter 13 Debtors

KENNETH WOOLSEY AND STEPHANIE WOOLSEY
Debtors - Appellants,

--- v.---

CITIBANK, N.A.,
Defendant - Appellee

&

KEVIN R. ANDERSON
Chapter 13 Trustee - Appellee

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF UTAH, NO. 2:10-cv-1097
THE HONORABLE JUDGE BRUCE S. JENKINS

SUPPLEMENTAL BRIEF OF APPELLEE
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TABLE OF CONTENTS

TABLE OF CONTENTS ii

TABLE OF AUTHORITIES iii

SUPPLEMENTAL BRIEF 1

I. Summary of Argument. 1

II. *In Rem* Rights of a Residential Trust Deed Holder are Protected from Modification by § 1322(b)(2) 2

III. Cases Allowing the Strip-Off of Undersecured Mortgages Focus on § 506(a) Rather than the Property-Rights Analysis of *Nobelman*. 7

IV. *Dewsnup* Applies in Chapter 13. 9

V. Eradicating *In Rem* Property Rights Creates Anomalous Outcomes. ... 9

CONCLUSION 10

TABLE OF AUTHORITIES

Cases

Armstrong v. United States, 364 U.S. 40 (1960) 3

Dewsnup v. Timm, 502 U.S. 410 (1992) ..... passim

First Sec. Bank of Utah, N.A. v. Banberry Crossing, 780 P.2d 1253 (Utah 1989) ...3

In re Ballard, 526 F.3d 634 (10th Cir. 2008) 5

In re Barnes, 207 B.R. 588 (Bankr. N.D. Ill. 1997) 1, 9

In re Bartee, 212 F.3d 277 (5th Cir. 2000) 7

In re Bellamy, 962 F.2d 176 (2d Cir.1992).....9

In re Lane, 280 F.3d 663 (6th Cir. 2002).....7

In re Nichols, 440 F.3d 850 (6th Cir. 2006) 2, 3

In re Victorio, 454 B.R. 759 (Bankr. S.D. Cal. 2012) 1, 9

In re Winitzky, 2009 Bankr. LEXIS 2430 (Bankr .C.D. Cal. May 7, 2009).....10

Johnson v. Home State Bank, 501 U.S. 78 (1991).....4

Louisville Joint Stock Land Bank v. Radford, 295 U.S. 555 (1935).....3, 4

McNeal v. GMAC Mortgage, No. 11–11352 2012 WL 1649853 (11th Cir. May 11, 2012).....9

Nobelman v. American Savings Bank, 508 U.S. 324 (1993) ..... passim

RadLAX Gateway Hotel, LLC v. Amalgamated Bank, 132 S.Ct. 2065, 2070-71 (2012).....6

United States v. Craft, 535 U.S. 274 (2002).....2

United States v. Security Indus. Bank, 459 U.S. 70 (1982) 2

Statutes

11 U.S.C. § 101(5) 6

11 U.S.C. § 103(a) 9

11 U.S.C. § 348(f)(1)(C)(i) 5

11 U.S.C. § 349 5

11 U.S.C. § 362 3

11 U.S.C. § 502 5

11 U.S.C. § 506 ..... passim

11 U.S.C. § 1322(b)(2) ..... passim

UTAH CODE ANN. § 57-1-20. 3

UTAH CODE ANN. § 57-1-23 4

UTAH CODE ANN. § 57-1-27(a)(1) 4

UTAH CODE ANN. § 57-1-33.1(1)(A) 4

Treatises

KEITH M. LUNDIN & WILLIAM H. BROWN, CHAPTER 13 BANKRUPTCY, (4th ed. 2012) 5, 7, 8

SUPPLEMENTAL BRIEF

I. Summary of Argument.

The Court directed briefing on the following question: "*Does 11 U.S.C. § 1322(b)(2) independently authorize a Chapter 13 debtor to remove a lien on his principal residence if the lien is wholly unsecured by value in the collateral*?" The short answer is, no. Indisputably, the majority of Circuits side with Appellants on this question (see analysis of majority and minority cases in *In re Victorio*, 454 B.R. 759 (Bankr. S.D. Cal. 2012)). However, unlike elections and Supreme Court decisions, being in the majority does not *per se* make one right.

The Trustee agrees with *In re Barnes*, 207 B.R. 588 (Bankr. N.D. Ill. 1997) and contends that a studied reading of *Nobelman v. American Savings Bank*, 508 U.S. 324 (1993) establishes that the anti-modification clause of § 1322(b)(2) applies to any claim secured by a "**security interest** in . . . the debtor's principal residence" (as opposed to a claim secured by value in collateral), and that the *in rem* rights of such a "security interest" are protected from modification under § 1322(b)(2) without regard to the effect of 11 U.S.C. § 506(a) and whether the claim is wholly secured, partially secured, or undersecured. Further, the logic of *Dewsnup v. Timm*, 502 U.S. 410 (1992) applies to Chapter 13, and § 506(a) should be uniformly interpreted so that a debtor cannot do indirectly in "Chapter 20" what the Supreme Court directly prohibited in Chapter 7.

II. *In Rem* Rights of a Residential Trust Deed Holder are Protected from Modification by § 1322(b)(2) .

A trust deed creditor holds an array of rights colloquially referred to as a "bundle of sticks" to symbolize both their discrete powers and that the removal of one does not necessarily vitiate the power of the others. *United States v. Craft*, 535 U.S. 274, 278 (2002). The sticks in the bundle include: (1) the contractual right to repayment of the debt (*in personam*); and (2) the property right of recourse against the collateral (*in rem*). *In re Nichols*, 440 F.3d 850, 854 (6th Cir. 2006) (citing *United States v. Security Indus. Bank*, 459 U.S. 70, 74 (1982). *In personam* and *in rem* rights in bankruptcy are determined by state law. *Nobelman*, 508 U.S. at 329. Bankruptcy law honors the distinction between these rights because the "[Supreme Court] cases recognize, as did the common law, that [in bankruptcy] the contractual right of a secured creditor to obtain repayment of his debt may be quite different in legal contemplation from the property right of the same creditor in the collateral." *United States v. Security Indus. Bank*, 459 U.S. 70, 74 (1982). The difference between *in personam* and *in rem* rights has created a "long-recognized tension between permitting the impairment of contractual obligations [in bankruptcy] while maintaining the integrity of the property rights." *In re Nichols*, 440 F.3d 850, 854 (6th Cir. 2006) (citing *Security Indus. Bank*, 459 U.S. at 75).)

The contractual *in personam* rights of a residential mortgagee may be limited in bankruptcy, such as by the automatic stay of § 362 or by the cure of a

prepetition mortgage arrearage under § 1322(b)(5), but these "limitations on the lender's rights . . . are independent of the debtor's plan or otherwise outside § 1322(b)(2)'s prohibition." *Nobelman*, 508 U.S. at 330. However, a creditor's *in rem* rights generally survive the effects of bankruptcy. *Dewsnup*, 502 U.S. at 419 ("Subsection (d) [of § 506] permits liens to pass through the bankruptcy unaffected."). Nonetheless, if the bankruptcy modification of a creditor's *in rem* right "goes so far as to constitute 'total destruction' of the value in the property held by a creditor, it violates the Fifth Amendment and may not stand." *Nichols*, 440 F.3d at 854 (citing *Armstrong v. United States*, 364 U.S. 40, 48 (1960)); *see also Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555, 590 (1935) (using its bankruptcy powers, Congress may impair contractual obligations, but the taking of a mortgagee's rights in real property is subject to Takings Clause).

In Utah, a trust deed creates the following *in rem* rights: (1) the right "to secure the performance of an obligation"[1]; (2) a title-interest in the trust property[2]; (3) the borrower's present or subsequent "right title, interest and claim" in the trust property[3]; (4) the right to retain the lien until the "obligation secured by a trust deed has been satisfied"[4]; (5) upon a breach, the power to "cause the trust property

[1] UTAH CODE ANN. § 57-1-20.
[2] First Sec. Bank of Utah, N.A. v. Banberry Crossing, 780 P.2d 1253, 1256 (Utah 1989) (trust deed is a conveyance of title to real property).
[3] UTAH CODE ANN. § 57-1-20.
[4] UTAH CODE ANN. § 57-1-33.1(1)(A).

to be sold"[5]; and (6) the right to credit bid at a trustee's sale.[6]

These are the *in rem* "bundle of sticks" granted by Utah law to the trust deed holder that are consensually bargained for by the borrower and lender. *Nobelman*, 508 U.S. at 329-30. These *in rem* rights are neither based on nor mitigated by the value of the real property, and the creditor retains its titled interest in the property until the debt is paid. *See supra* notes 2–7; *Dewsnup*, 502 U.S. at 417 (creditor's lien remains on real property until foreclosure because "[t]hat is what was bargained for by the mortgagor and the mortgagee."); *see also Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555, 579 (1935) (mortgagee could not be compelled to "relinquish the property to the mortgagor free of the lien unless the debt was paid in full."). Even if a lien holder's *in personam* rights are discharged in bankruptcy, its *in rem* rights remain. *Johnson v. Home State Bank*, 501 U.S. 78, 84 (1991). While the trust deed lien may be undersecured at confirmation, the *in rem* rights associated therewith retain value, such as the creditor's right to any "increase [in the collateral] over the judicially determined valuation during bankruptcy . . . ." *Dewsnup*, 502 U.S. at 417. The other beneficial aspects of *in rem* rights in bankruptcy are summarized as follows:

> In most states, even a mortgage holder with no value in the collateral can ride the property in hopes of future appreciation or can exercise the right to foreclose its lien and sell the property. The unsecured

[5] *Id.* § 57-1-23.
[6] *Id.* § 57-1-27(a)(1).

> lienholder may not receive any proceeds from the foreclosure sale, but it can force such a sale **for whatever strategic advantages it may realize under its contract or state law**.

KEITH M. LUNDIN & WILLIAM H. BROWN, CHAPTER 13 BANKRUPTCY, § 128.1 at ¶ 5 (4th ed. 2012) (emphasis added).

In addition, § 506(a) bifurcates the "status"[7] of claims into secured and unsecured components. *In re Ballard*, 526 F.3d 634, 637 (10th Cir. 2008) and *Nobelman*, 508 U.S. at 331. However, § 506(a) does not disallow claims, which is the singular bailiwick of § 502, such that if the lien is undersecured its "status" is a secured claim in the amount of $0.00 and an unsecured claim for the debt. The retention of a secured claim with a value of $0.00 as of confirmation may seem curious, but it makes sense in the context of § 349 regarding the effect of a dismissal, and especially in light of BAPCPA's amendments to § 348(f)(1)(C)(i) that protect the creditor's security interest during the life of the Chapter 13 case in the event of conversion to Chapter 7:

> [T]he claim of any creditor holding security as of the date of the filing of the petition **shall continue to be secured by that security** unless the full amount of such claim determined under applicable nonbankruptcy law has been paid in full as of the date of conversion, **notwithstanding any valuation or determination of the amount of an allowed secured claim** made [under § 506(a)] for the purposes of the case under chapter 13. (Emphasis added.)

Note that the predicate for such protection is only a "creditor holding security as of

[7] The title of 11 U.S.C. § 506 is "Determination of secured status."

the date of the filing of the petition" (as opposed to a "secured claim"), and that its prophylactic purpose is effectual in spite of a valuation under § 506(a). Rules of statutory construction further require that the general provision of § 506(a) ("allowed claim of a creditor secured by a lien") should not prevail over the very specific provision of § 1322(b)(2) ("claim secured only by **a security interest** in . . . the debtor's principal residence"). (Emphasis added.) See *RadLAX Gateway Hotel, LLC v. Amalgamated Bank*, 132 S.Ct. 2065, 2070-71 (2012) (specific statutory text trumps general text in determining confirmation of Chapter 11 plan).

Nobelman also holds that § 1322(b)(2) refers to a "claim" that is a broadly-defined term of art[8] that includes secured and unsecured claims, and thus it is "plausible to read 'a claim secured only by a [homestead lien]' as referring to the lienholder's entire claim, including both the secured and the unsecured components of the claim." *Nobelman*, 508 U.S. at 331 (insertion in original).

In short, "**the predicate** for Justice Thomas's protection of rights analysis [in *Nobelman*] **is the existence of a lien**, not the presence of value to support that lien." LUNDIN, 128.1 at ¶ 4 (emphasis added). Thus, § 1322(b)(2) operates to protect the *in rem* rights of a residential trust deed holder from modification without regard to § 506(a) and whether the value of such lien is fully secured, partially secured, or undersecured.

[8] 11 U.S.C. § 101(5).

III. Cases Allowing the Strip-Off of Undersecured Mortgages Focus on § 506(a) Rather than the Property-Rights Analysis of *Nobelman*.

After *Nobelman*, the Collier treatise on bankruptcy conjectured the following points: (1) the outcome would be different "if a lien is completely undersecured;" (2) the presence of some value protected the creditor's lien; and (3) if the lien was undersecured, "the creditor would not have been a 'holder of a secured claim' entitled to protection by section 1322(b)(2)." *In re Lane*, 280 F.3d 663, 667 (6th Cir. 2002) (citing 8 Collier on Bankruptcy ¶ 1322.06[1][a][i] (15th ed. rev. 2001)). The majority decisions intonate the Collier interpretation; however, one could argue that such courts give the words of Collier more weight than the *Nobelman* opinion itself. After the Fifth Circuit revisited this in *In re Bartee*, 212 F.3d 277 (5th Cir. 2000), Judge Lundin critically commented:

> This is an odd reading of Justice Thomas's opinion in *Nobelman.* Justice Thomas avoided the textural conflict between §§ 506(a) and 1322(b) (2) . . . by focusing on the phrase "claim secured . . . by" in § 1322(b)(2). That Congress *did not* use the term of art "secured claim" in § 1322(b)(2) allowed Justice Thomas to conclude that the prohibition against modification included the unsecured claim held by the undersecured mortgagee. The Fifth Circuit [in *Bartee*] turns this phrase parsing by Justice Thomas on its head.
>
> These courts do not explain why Justice Thomas went to such pains to link the protection from modification in § 1322(b)(2) to the existence of an "unqualified … claim" secured by a lien on a debtor's principal residence if, in addition, the creditor must have an allowable secured claim.

LUNDIN, 128.1 at ¶¶ 7-8; *see also* LUNDIN,118.1.

Indeed, *Nobelman* is inapposite to Collier when it iterates and then discards

the debtors' arguments that the bankruptcy court must first look to a valuation under § 506(a) because the anti-modification clause of § 1322(b)(2) applies only to the mortgagee's "secured claim." *Nobelman,* 508 U.S. at 328. The Court rejects these arguments as placing too much emphasis on the valuation under § 506(a) and not adequately focusing on the rights of the residential mortgagee. The Court then rules that "[b]y virtue of its mortgage contract with petitioners, the bank is indisputably the holder of a claim secured by a lien on petitioners' home," and that a § 506(a) valuation "does not necessarily mean that the 'rights' the bank enjoys as a mortgagee, which are protected by § 1322(b)(2), are limited by the valuation of its secured claim." *Id*. at 328-29.

Furthermore, Congress enacted the anti-modification clause of § 1322(b)(2) to protect residential mortgagees in Chapter 13cases to encourage such loans to consumers. Allowing a Chapter 13 plan to eviscerate the *in rem* rights of a residential mortgagee is inapposite to the purpose of § 1322(b)(2).

In summary, cases allowing the "stripping" of homestead liens focus too much on the bifurcation under § 506(a) and too little on the specifically-defined rights of a claim holder "secured only by **a security interest** in real property that is the debtor's principal residence." *Id*. at 328 and *In re Barnes*, 207 B.R. 588, 592 (Bankr. N.D. Ill. 1997) (disagreeing with "dicta-based holdings" allowing lien strips). Shifting the focus from the value of collateral to the trust deed rights in

collateral clarifies the intent of *Nobelman* that § 1322(b)(2) protects the *in rem* rights of creditors with only a security interest in the debtor's principal residence.

IV. *Dewsnup* Applies in Chapter 13.

Courts have declined to apply the Chapter 7 case of *Dewsnup* to Chapter 13 cases. *In re Bellamy*, 962 F.2d 176 (2d Cir.1992). However, this distinction is not compelling because § 103(a) makes § 506(a) equally applicable to "a case under Chapter 7, 11, 12, or 13 of this title . . . ." *Nobelman*, 508 U.S. at 328 n.3. Thus, a § 506(a) valuation does not operate one way in Chapter 7 and another way in Chapter 13. *In re Victorio*, *454* B.R. 759 (Bankr. S.D. Cal. 2011) (containing a thorough discussion of *Dewsnup* and *Nobelman* and their impact on Chapter 13 lien-strips). *But see McNeal v. GMAC Mortgage,* No. 11–11352 2012 WL 1649853 (11th Cir. May 11, 2012) (allowing Chapter 7 debtor to strip undersecured mortgage because *Dewsnup* limited to partially secured claims).

V. Eradicating *In Rem* Property Rights Creates Anomalous Outcomes.

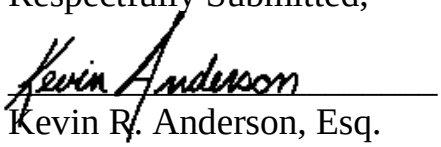
An obvious anomaly is the disparity of consequences arising from the imprecise art of hypothetical valuations. While § 506(a) impacts a homestead lien on a sliding scale of value, there is nothing to suggest that Congress intended § 1322(b)(2) to strictly operate in the binary mode of all or nothing, such that a penny of equity warrants total protection from modification while a penny of negative equity warrants total evisceration of *in personam* and *in rem* rights in real

property. Second, the contrary interpretations of *Dewsnup* and *Nobelman* allow "Chapter 20" debtors to do indirectly what *Dewsnup* ruled could not be done directly by obtaining a discharge in Chapter 7 and then immediately filing under Chapter 13 to strip the residential trust deed. *In re Winitzky*, 2009 Bankr. LEXIS 2430 (Bankr .C.D. Cal. May 7, 2009).

CONCLUSION

The evisceration of historically inviolable *in rem* real property rights, based solely on the valuation of the collateral, at best raises interpretative inconsistencies as to the operation of § 506(a), the Congressional intent behind § 1322(b)(2), and the meaning of *Dewsnup* and *Nobelman*; at worst it raises questions under the Takings Clause of the Fifth Amendment. This Court should find that § 1322(b)(2) does not independently authorize a Chapter 13 debtor to remove a lien on his principal residence if the lien is wholly unsecured based on the value of the collateral.

Respectfully Submitted,



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CERTIFICATE OF COMPLIANCE

As required by Fed. R. App. P. 32(a)(7)(c), I certify that this brief is proportionally spaced in Times New Roman14-point font, and contains 2,476 words as calculated by Microsoft Word 2010.

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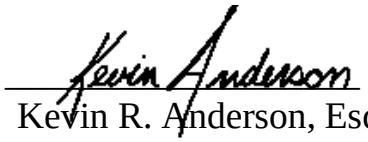
By: 

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CERTIFICATE OF SERVICE

I hereby certify that on July 17, 2012, I electronically filed the foregoing document with the Clerk of the Tenth Circuit Court of Appeals by using the CM/ECF system.

I further certify that the party of record to this appeal, as identified below, is a registered CM/ECF users and will be served through the CM/ECF system.

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