

Eleventh Circuit Decision Changes the Landscape for Chapter 7 Strip Offs

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A recent unpublished opinion by a three judge panel of the United States Court of Appeals for the Eleventh Circuit in *McNeal v. GMAC Mortgage, LLC (In re McNeal)* held that a Chapter 7 debtor may strip off a wholly unsecured mortgage. This holding dramatically changes the lien stripping landscape for both debtors and lenders. Debtors who previously filed Chapter 13 cases solely to strip off an unsecured mortgage may now file a Chapter 7 case to achieve the same result. Unsecured lenders, who previously did not need to be concerned when a borrower filed a Chapter 7 bankruptcy that its lien may be stripped, must now devote resources to monitoring those cases and preparing defenses to lien stripping efforts by debtors.

Ms. McNeal filed a Voluntary Petition under Chapter 7 of the United States Bankruptcy Code. In her Petition, she disclosed that the fair market value of her home was \$141,416 and that it was encumbered by two mortgages: a first mortgage owed to HSBC in the amount of \$176,413 and a second mortgage owed to GMAC Mortgage, LLC (“GMAC”) in the amount of \$44,444. She sought to “strip off” GMAC’s mortgage pursuant to Sections 506(a) and 506(d) of the Bankruptcy Code. Section 506(a) provides that “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.” The parties did not dispute that GMAC held an allowed claim. However, they disagreed on whether Section 506(d), 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...”, permitted Ms. McNeal to strip off GMAC’s wholly unsecured lien.

Prior to *McNeal*, it had been widely held that Chapter 7 debtors could not strip off wholly unsecured mortgage liens. Instead, debtors had to file a Chapter 13 case, which is not as attractive as a Chapter 7 filing for a number of reasons including, potentially committing to a Chapter 13 repayment plan for a period of three (3) to five (5) years, a delay in the receipt of a Chapter 13 discharge, dismissal of the case (and therefore no lien stripping) if a debtor defaults on their Chapter 13 plan payments, and increased attorneys' fees. This holding by many lower courts developed after the Supreme Court’s decision in *Dewsnup v. Timm*, 502 U.S. 410 (1992), which disallowed a strip down of a *partially* secured mortgage. According to many lower courts, including the lower courts in *McNeal*, *Dewsnup* abrogated the existing law in the Circuit, *Folendore v. U.S. Small Bus. Admin.*, 862 F. 2d 1537 (11th Cir. 1989), which held that an allowed claim that was wholly unsecured was voidable under the plain language of 11 U.S.C. § 506(d).

However, the Eleventh Circuit noted that the Supreme Court specifically limited its decision to the precise issues raised by the facts of the case. “Because *Dewsnup* disallowed only a ‘strip down’ of a partially secured mortgage lien and did not address a ‘strip off’ of a wholly unsecured lien, it is not ‘clearly on point’ with the facts in *Folendore* or with the facts at issue in this appeal.” Accordingly, the Court concluded *Folendore* was still the controlling precedent in this district and therefore GMAC’s lien was voidable under Section 506(d).

The impacts of the *McNeal* decision (presuming it is not challenged on appeal) are significant. Chapter 7 debtors may now discharge wholly unsecured mortgages and, in most cases, will pay nothing or very little to unsecured creditors. The lien could be stripped in as little as six (6) months compared to the three (3) to five (5) years necessary to effectuate a lien strip in a Chapter 13 case. Lenders who formerly did not need to track Chapter 7 cases will want to monitor those filings more closely. In fact, in the Middle District of Florida, the bankruptcy court has already implemented a negative notice procedure for lien stripping motions in Chapter 7 cases.

This issue is ripe for further review. There are several appeals pending in other states including New York, Utah and Illinois. However, in the meantime, Florida debtors can take advantage of the easier path to strip wholly unsecured liens if they otherwise qualify for a Chapter 7 filing.

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