

**NOT SELECTED FOR PUBLICATION**

**UNITED STATES BANKRUPTCY COURT  
FOR THE DISTRICT OF COLORADO**  
Bankruptcy Judge Elizabeth E. Brown

In re: )  
)  
RODNEY FERDINAND JACKSON, ) Bankruptcy Case No. 09-15137 EEB  
) Chapter 13  
Debtor. )  
\_\_\_\_\_)  
)  
In re: )  
)  
BRIAN LEE KEATE, ) Bankruptcy Case No. 09-15769 EEB  
DAWN MARIE KEATE, ) Chapter 13  
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Debtors. )

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**ORDER**

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THIS MATTER is before the Court on confirmation of Debtors' proposed chapter 13 plans. Although there were no objections to confirmation in either case, the Court raised concerns regarding two of the provisions in these plans. One provision purports to strip liens on personal property without giving the affected creditors specific notice. The other establishes a procedure for the Debtors to know whether they are current on their mortgages before they complete their plans and obtain their discharges. Having considered the parties' briefs, the Court hereby FINDS and CONCLUDES:

**I. THE 506 PROVISION**

The first provision attempts to value liens on personal property (other than cars) at zero and deem such claims unsecured through the confirmation process (the "506 Provision"). In both plans, it reads as follows:

If a creditor files a proof of claim alleging a security interest in personal property other than a vehicle, and for which claim is not presently and expressly provided for under Class Two or Class Three or the plan, and if the creditor fails to object timely to confirmation of the plan, the creditor's claim will be deemed to have an allowed secured value of zero (\$0) pursuant to 11 U.S.C. §506, and the claim will be deemed unsecured. This provision does not apply to creditors secured by interest in real property.

Although both proposed plans contain the 506 Provision, the Keates have agreed to remove this language from their plan because an Order has already entered in their case valuing the only personal property lien at issue at zero. On the other hand, Jackson seeks confirmation of his plan with the 506 Provision intact.

The 506 Provision is a generic “scream or die” provision. It automatically reclassifies a lien creditor as an unsecured claim, unless the unidentified creditor objects to confirmation of the plan. But no specific personal property or creditors are identified in this provision. It merely deems the value of *any* claim secured by *any* personal property (other than a vehicle) not specifically provided for in the plan to be zero.

This Court has questioned the propriety of this provision on the basis of a perceived lack of due process to lien holders. In response, Jackson argues that the effect of this provision is the equivalent of a claim objection, seeking to reclassify the claim. But what Jackson fails to acknowledge is that a claim objection is directed to a specific creditor, identified in the objection, and served on the creditor. The 506 Provision contains none of these due process safeguards.

The Bankruptcy Code provides other means of stripping creditors of their liens. For example, Section 506(a) provides for the determination of the secured status of a claim secured by property in which the estate has an interest in conjunction with any hearing on a plan. But Bankruptcy Rule 3012 specifies that the court may make such determination “on motion of any party in interest and after a hearing on notice to the holder of the secured claim . . . .” Pursuant to Rule 7001(2), a party may file an adversary proceeding to “determine the validity, priority or extent of a lien,” but an adversary proceeding triggers the heightened service and notice requirements of Rule 7004. Section 522(f) allows avoidance of liens on personal property impairing an exemption. Rules 4003(d) and 9014 specify that a proceeding under §522(f) “shall be” by motion with reasonable notice and opportunity for hearing afforded to the party against whom relief is being sought. All of these statutes and rules contemplate specific notice and opportunity to object directed to the particular creditor whose lien is to be avoided or valued at zero.

In the Chapter 11 world, the debtor commonly sets forth in its plan of reorganization a listing of all the classes of claims and their proposed treatment. Typically, the secured claims are separately classified. Then a general provision provides that all estate property will revert in the debtor on confirmation, free and clear of any claims, liens, or other interests, except as otherwise provided in the plan. Under this general formula, if a particular secured claim is left out, that is to say that if it is not provided for in a specific class, then the general vesting language might arguably result in the loss of the secured creditor’s lien. But nothing in the typical plan language expressly purports to ambush secured creditors in this fashion and seeks the Court’s blessing in doing so.

It is questionable if such revesting language in a plan, coupled with the absence of any provision expressly retaining a secured creditor’s lien, can effectively strip a creditor of its lien.

By analogy, a creditor cannot have its lien stripped merely by failing to file a proof of claim. Although secured creditors are allowed to file proofs of claim in a chapter 13 case, Rule 3002<sup>1</sup> only requires unsecured creditors do so. Failure to file a proof of claim may eliminate a creditor's right to participate in plan distributions. But a long line of cases, from the Supreme Court on down, have held that the mere failure to file a claim does not abrogate a secured creditor's lien rights.

A long line of cases, though none above the level of bankruptcy judges since the Bankruptcy Code was overhauled in 1978, allows a creditor with a loan secured by a lien on the assets of a debtor who becomes bankrupt before the loan is repaid to ignore the bankruptcy proceeding and look to the lien for the satisfaction of the debt. See *Long v. Bullard*, 117 U.S. 617, 620-21, 6 S.Ct. 917, 918, 29 L.Ed. 1004 (1886); *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555, 582-83, 55 S.Ct. 854, 859-60, 79 L.Ed. 1593 (1935); *United States Nat'l Bank v. Chase Nat'l Bank*, 331 U.S. 28, 33, 67 S.Ct. 1041, 1044, 91 L.Ed. 1320 (1947) (dictum); *In re Woodmar Realty Co.*, 307 F.2d 591, 594-95 (7th Cir. 1962); *Dizard & Getty, Inc. v. Wiley*, 324 F.2d 77, 79-80 (9th Cir. 1963); *Clem v. Johnson*, 185 F.2d 1011, 1012-14 (8th Cir. 1950); *DeLaney v. City and County of Denver*, 185 F.2d 246, 251 (10th Cir. 1950); *In re Bain*, 527 F.2d 681, 685-86 (6th Cir. 1975); *In re Honaker*, 4 B.R. 415, 416 and n. 3 (Bankr. E.D. Mich. 1980); cf. *In re Reuelta*, 27 B.R. 137, 138-39 (Bankr. N.D. Ga.1983); *In re Hines*, 20 B.R. 44, 48 (Bankr. S.D. Ohio 1982).

*In re Tarnow*, 749 F.2d 464, 465 (7th Cir. 1984). "Unless the collateral is in the possession of the bankruptcy court or the trustee, the secured creditor does not have to file a claim." *Hoxworth v. Blinder*, 74 F.3d 205, 210 (10th Cir. 1996) (citing *Tarnow*, 749 F.2d at 465). But the mere failure to participate in the bankruptcy proceedings by filing a claim does not have the effect of limiting or invalidating the secured creditor's lien rights. In fact, in enacting § 506(d)(2), Congress codified this longstanding judicial interpretation.

[I]n 1984 Congress enacted a new section 506(d)(2), replacing the former 506(d)(1), and the new section preserves the lien if the claim "is not an allowed secured claim due only to the failure of any entity to file a proof of such claim . . . ." Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. 93-353, § 448(b), 98 Stat. 374. The change was intended "to make clear that the failure of the secured creditor to file a proof of claim is not a basis for avoiding the lien of the secured creditor." S. Rep. No. 65, 98th Cong., 1st Sess. 79 (1983).

*Matter of Tarnow*, 749 F.2d 464, 467 (7th Cir. 1984).

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<sup>1</sup> Unless otherwise noted, all references to "Rule" shall refer to the Federal Rules of Bankruptcy Procedure.

Whether failure to participate in the bankruptcy proceeding by not objecting to a plan of reorganization should be afforded the same treatment as failing to file a claim remains to be determined. This Court does not have to resolve this issue in the present cases. But the Court will not knowingly allow the Debtors to strip secured creditors of their liens without due process. Like the discharge of student loans by plan declaration disapproved of by the Tenth Circuit in *In re Mersmann*, 505 F.3d 1033 (10th Cir. 2007), the 506 Provision simply does not provide secured creditors with the kind of notice and opportunity to object that due process requires.<sup>2</sup>

## II. The Mortgage Provisions

The Debtors' plans in these cases include additional language to establish a procedure by which the Court may determine at the end of their plans whether the Debtors are in fact current on their mortgage obligations (the "Mortgage Provisions"). The perceived need for the Mortgage Provisions stems from two primary concerns. First, the Debtors worry that their mortgage holders will not apply their payments in the proper method required by the terms of the plan. Second, they fear that the lenders may impose hidden fees and charges. If either occurs, then the mortgages may be rendered in default without the Debtors' knowledge and despite their full performance of their plan obligations. Their attempts to reorganize in bankruptcy and save their homes would be rendered futile.

The Code itself does not provide a mechanism for determining prior to discharge and closing of a case whether the cure and mortgage payments made during the plan period have been properly applied, or whether additional fees and charges have been tacked onto the mortgage. The Debtors in these cases have attempted to bridge this gap by inserting into their plans the following language:

### NOTICE OF FINAL CHAPTER 13 CURE PAYMENT.

1. Within 30 days of making the final payment of any cure amount made on a claim secured by a security interest in the debtor's real property, the trustee in a chapter 13 case shall file and serve upon the claimant of record, the claimant's counsel, the debtor, and debtor's counsel a notice stating that the amount required to cure the default has been paid in full.
2. If the debtor contends that the final cure payment has been made and the trustee does not file and serve the notice within the specified time period, the debtor may file and serve upon the claimant of record, claimant's counsel, last known servicer and the trustee a notice stating that the amount required to cure the default has been paid in full.

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<sup>2</sup> The Court notes that proposed Local Bankruptcy Rule 3012-1(b), which will become effective on December 1, 2009, will require that any request for a determination of secured status under §506 made in a proposed plan include "a description of the affected property and any identifying information with respect to the underlying contract or transaction."

#### MOTION TO DEEM PRE-PETITION ARREARS CURED.

1. Within 30 days of service of the notice, the debtor may file a Motion to Deem Pre-Petition Arrears Cured and a Notice of Opportunity for a Hearing pursuant to L.B.R. 202. The Notice shall provide 30 days, plus three days for mailing, for the claimant of record to respond. Debtor shall serve the Motion and Notice upon the Chapter 13 trustee, the claimant of record and the claimant's counsel.
2. If the claimant of record objects to the Motion to Deem Pre-Petition Arrears Current, it shall file with its objection a statement of the outstanding pre-petition arrears or any other payment to be paid through the Chapter 13 Plan, including attorneys' fees and costs with supporting documentation.
3. If the claimant of record does not object, the court shall enter an order that all pre-petition amounts required by the underlying agreement and applicable non-bankruptcy law in connection with the security interest have been paid in accordance with the Chapter 13 Plan and as of the date the Verified Motion to Deem Pre-Petition Arrears Cured was filed.

#### MOTION TO DEEM LOAN CURRENT

1. Prior to discharge, the debtor may file a Verified Motion to Deem Loan Current and a Notice of Opportunity for Hearing pursuant to L.B.R. 202. The Notice shall provide 30 days, plus three days for mailing, for the claimant of record to respond. Debtor shall serve the Motion and Notice upon the claimant of record, claimant's counsel, last known servicer and the trustee.
2. If the claimant of record or Trustee, should Trustee pay post-petition amounts pursuant to the plan, objects to the Motion to Deem Loan Current, it shall file with its objection a statement of past due amounts, including attorneys' fees and costs with supporting documentation.
3. If the claimant of record does not object, the court shall enter an order that all post-petition amounts required by the underlying agreement and applicable non-bankruptcy law in connection with the security interest have been paid as of the date the Verified Motion to Deem Loan Current was filed.

Initially, this Court questioned whether the Mortgage Provisions were necessary and permissible. Section 1322(b)(3) prohibits a chapter 13 plan from modifying the rights of holders of claims secured solely by a lien on a debtor's principal residence. Despite this prohibition, §1322(b)(5) allows a chapter 13 plan to provide for the curing of any default on a mortgage over time, as well as the maintenance of regular payments while the case is pending. In applying Section 1325(b)(5), courts have required lenders to credit regular post-petition payments to the loan as if no pre-petition default had occurred. *See, e.g., In re Jones*, 366 B.R. 584 (Bankr. E.D. La. 2007); *In re Wines*, 239 B.R. 703 (Bankr. D. N.J. 1999); *In re Rathe*, 114 B.R. 253 (Bankr. D. Idaho 1990); *see also* H.R. Rep. No. 835 at 55 (1994), *reprinted in* 1994 U.S.C.C.A.N. 3340 ("It is the Committee's intention that a cure pursuant to a plan should operate to put the debtor in the same position as if the default had never occurred."). In addition, recently amended §524(i) now renders a creditor potentially liable if it fails to apply the payments in this fashion.

The willful failure of a creditor to credit payments received under a plan confirmed under this title, unless the order confirming the plan is revoked, the plan is in default, or the creditor has not received payments required to be made under the plan in the manner required by the plan (including crediting the amounts required under the plan), shall constitute a violation of an injunction under subsection (a)(2) if the act of the creditor to collect and failure to credit payments in the manner required by the plan caused material injury to the debtor.

Thus, § 524(i) already provides a remedy for a debtor materially injured as a result of a secured creditor's failure to credit payments in the manner required by the confirmed plan. But it is only available after the debtor obtains a discharge. Except in certain limited circumstances, §1328 does not entitle a chapter 13 debtor to a discharge until completion of all payments under the confirmed plan. Thus, §524(i) is not available to a chapter 13 debtor until after the end of the case. Moreover, it does not address the problem of hidden fees and charges.

Without the ability to force this issue, a debtor may emerge from bankruptcy thinking that he has cured his mortgage default only to find that the lender is still foreclosing. Or the debtor may discover hidden fees and costs were assessed during the life of the plan when the debtor is at the closing table, attempting to refinance or sell his home. At that point, the debtor is faced with the very real dilemma of either accepting the previously undisclosed charges or losing the sale or refinancing. These problems may well occur after the bankruptcy despite any court ruling at the end of the case, if hidden charges are assessed *after* the case. Bankruptcy courts cannot police the debtor-creditor relationship throughout the entire life of the mortgage. Congress and/or state legislatures will have to fill this gap. But a bankruptcy court can at least give a debtor an accurate assessment of where he stands at the time that he emerges from bankruptcy.

This new provision imposes a "speak now or forever hold your peace" requirement on the mortgage lender. It begins with a notice and motion in which the Debtors will assert that their mortgages are now cured and completely current. The burden then shifts to the lender to come forward with evidence to the contrary, failing which an Order will enter deeming the loan cured and current. The Orders contemplated by the Mortgage Provisions will also give the Debtors a head start should they later have to seek relief for a discharge injunction violation under §524(i), by providing them with a prior judicial determination that their mortgages were current as of a certain date.

This Court finds that the Mortgage Provisions are permissible and that they serve a useful purpose. They do not impermissibly modify the rights of the mortgage holders or the terms of the underlying mortgages. They simply provide a procedural framework for the Debtors to find out whether they are emerging from bankruptcy with a current mortgage, or whether any undisclosed and potentially impermissible fees and charges have been assessed.

Nor do the contemplated procedures improperly extend the Court's jurisdiction. Both the Motion to Deem the Pre-Petition Arrears Cured and the Motion to Deem the Loan Current are

required to be filed during the pendency of the plan and prior to discharge. Thus, unlike similar proposed plan provisions this Court has seen, the Mortgage Provisions in these plans do not attempt to extend the Court's jurisdiction to examine fees and charges imposed by mortgage holders indefinitely into the future.

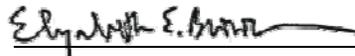
### III. CONCLUSION

For the foregoing reasons, the Court hereby:

- A. DENIES the confirmation of the Jackson plan in its present form. By separate Order, the Court will schedule a status conference to determine how Jackson wishes to proceed.
- B. ORDERS that the Keates shall file a corrected chapter 13 plan removing the 506 Provision, along with a verification of confirmable plan, **within 10 days of the date of this Order**. Upon filing, the Court will act on the plan by consent without further notice or hearing.

DATED this 31st day of August, 2009.

BY THE COURT:



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Elizabeth E. Brown,  
United States Bankruptcy Judge