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U.S. BANKRUPTCY COURT  
EASTERN DISTRICT OF WASHINGTON

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UNITED STATES BANKRUPTCY COURT  
EASTERN DISTRICT OF WASHINGTON

|                        |   |                             |
|------------------------|---|-----------------------------|
| In Re:                 | ) |                             |
|                        | ) | No. 01-01342-W13            |
| DAN and BONNIE SCHILL, | ) |                             |
|                        | ) | MEMORANDUM DECISION RE:     |
|                        | ) | LITTON LOAN SERVICING'S     |
| Debtor(s).             | ) | MOTION FOR RELIEF FROM STAY |

10 THIS MATTER came on for hearing before the Honorable  
 11 Patricia C. Williams on March 15, 2002 upon Litton Loan Servicing's  
 12 Motion for Relief From Stay. Debtors were represented by Gregory  
 13 Heline and creditor Litton Loan Servicing was represented by  
 14 Katherine Kent. The court reviewed the files and records herein,  
 15 heard argument of counsel, and was fully advised in the premises.  
 16 The court now enters its Memorandum Decision.

17 This case presents the question of whether hypothetical costs  
 18 of sale should be considered when determining if an inferior lien  
 19 on a Chapter 13 debtor's home is totally unsecured.

20 This Chapter 13 was filed on February 22, 2001. As of  
 21 October, 2001, the first position lien creditor was owed \$96,899.  
 22 Regular payments on the first lien were current at the time the  
 23 case was commenced and remain so. Litton Loan Servicing has an  
 24 inferior secured lien on the debtors' home, which has a principal  
 25 balance of \$45,437.73 and is in default. The debtors' plan  
 26 proposes to continue the regular monthly mortgage payments to the  
 27 first lien holder "outside" the plan and to treat Litton Loan  
 28 Servicing as a general unsecured creditor. The basis for this

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1 treatment is the debtors' appraisal on the home which concludes  
2 that the fair market value is \$87,000. Litton Loan Servicing,  
3 however, has an appraisal which reflects a fair market value  
4 between \$98,000 and \$100,000. Even assuming the highest value,  
5 i.e., \$100,000, if hypothetical costs of sale were deducted, there  
6 would not be sufficient equity in the home to even satisfy the  
7 first lien holder.

8       11 U.S.C. § 1322(b)(2) bars a Chapter 13 debtor from modifying  
9 the rights of holders of claims secured by a debtor's home. The  
10 Supreme Court in *Nobelman v. American Sav. Bank*, 508 U.S. 324, 113  
11 S.Ct. 2106, 124 L.Ed.2d 228 (1993) discussed this subsection of the  
12 Code which refers to "rights of holders" of claims rather than the  
13 claims themselves. In Chapter 13 plans, this subsection controls  
14 rather than § 506(a) which would ordinarily limit the amount of any  
15 secured claim to the value of the collateral resulting in the  
16 bifurcation of a claim into secured and unsecured portions. Under  
17 11 U.S.C. § 1322(b)(2), the claim of a holder of a lien on the  
18 debtors' home cannot be bifurcated.

19       The Ninth Circuit Bankruptcy Appellate Panel concluded in *In*  
20 *re Lam*, 211 B.R. 36 (B.A.P. 9<sup>th</sup> Cir. 1997) that *Nobelman* is not  
21 applicable when there is no value in the property to which the lien  
22 can attach. In other words, if the value of the property is such  
23 that there is no portion of the lien which could be secured in a  
24 bifurcation situation under 11 U.S.C. § 506(a), the entire lien  
25 under 11 U.S.C. § 1322(b)(2) is unsecured. There must be some  
26 value in the property for the lien to attach. Holders of claims  
27 under 11 U.S.C. § 1322(b)(2) must have some rights in estate  
28 property rather than simply holding a lien. If there is absolutely

1 no value in the estate property to which the lien may attach, due  
2 to the existence of superior lien or any other reason, there is no  
3 secured claim. Under *Lam*, if it is undisputed that the value of the  
4 property is less than the balance due the superior lien  
5 creditor(s), an inferior lienholder does not qualify as the holder  
6 of a claim under 11 U.S.C. § 1322(b)(2) and may be treated as a  
7 totally unsecured creditor.

8 In this case, assuming the highest value of \$100,000, there  
9 would be some equity which would secure the lien of Litton Loan  
10 Servicing. If hypothetical costs of sale (typically 10% of price  
11 in this area) were deducted in determining market value, there  
12 would be no value above the first lien. Therefore, Litton Loan  
13 Servicing's lien would not attach.

14 The Ninth Circuit addressed this issue of hypothetical cost of  
15 sale even before the *Lam* decision. *In re Taffi*, 96 F.3d 1190 (1996)  
16 involved a federal tax lien on a Chapter 11 debtor's home. The  
17 debtor proposed to retain the home. Although the reference to  
18 Chapter 13 debtors is dicta, the court's holding at page 1192 of  
19 the opinion determined that hypothetical costs of sale should not  
20 be deducted in determining fair market value.

21 When a Chapter 11 debtor or a Chapter 13 debtor intends  
22 to retain property subject to a lien, the purpose of a  
23 valuation under section 506(a) is not to determine the  
24 amount the creditor would receive if it hypothetically  
25 had to foreclose and sell the collateral. Neither the  
26 foreclosure value nor the costs of repossession are to be  
27 considered because no foreclosure is intended. Instead,  
28 when the proposed use of the property is continued  
retention by the debtor, the purpose of the valuation is  
to determine how much the creditor will receive for the  
debtor's continued possession. Hypothetical sales costs  
are not to be considered because no sale is intended.

28 *Id.* at 1192. Although the *Taffi* decision was focused on the

1 determination of a secured claim under 11 U.S.C. § 506(a) and the  
2 *Nobelman* and *Lam* decisions focus on the rights of holders of claims  
3 under 11 U.S.C. § 1322(b)(2), the same rationale would apply. The  
4 debtor in this case proposes to retain the home. Under such  
5 circumstances hypothetical costs of sale should not be deducted to  
6 determine the amount of a secured claim under 11 U.S.C. § 506(a) or  
7 the rights of a holder of a lien under 11 U.S.C. § 1322(b)(2). If  
8 the home has any value to which Litton Loan Servicing's lien rights  
9 attach, Litton Loan Servicing qualifies for treatment under 11  
10 U.S.C. § 1322(b)(2). That lien attaches before the question of any  
11 sale costs arises, and if the home is to be retained, the question  
12 of sale costs never arises.

13 Due to the dispute regarding the fair market value of the  
14 home, it will be necessary to conduct an evidentiary hearing in  
15 this case. If the debtor succeeds in demonstrating that the fair  
16 market value is \$87,000 or indeed anything less than the \$96,899  
17 due the first position lien holder, Litton Loan Servicing may be  
18 treated in the plan as any other holder of a general unsecured  
19 claim. If Litton Loan Servicing demonstrates that the fair market  
20 value is between \$98,000 and \$100,000, its mortgage must be paid as  
21 required by 11 U.S.C. § 1322(b)(2). Counsel are to contact  
22 chambers staff to schedule the evidentiary hearing.

23 DATED this 3<sup>rd</sup> day of April, 2002.

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26 PATRICIA C. WILLIAMS, Bankruptcy Judge  
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