

[13, 14] The Second Circuit has added a further element in determining whether a prior order should be given the effect of *res judicata* in a bankruptcy case. Courts must also consider whether an independent judgment in a separate proceeding would “impair, destroy, challenge, or invalidate the enforceability or effectiveness” of the plan of reorganization. *In re Layo*, 460 F.3d at 292, citing *Corbett*, 124 F.3d at 87; *see also Browning v. Levy*, 283 F.3d 761 (6th Cir.2002) (legal malpractice and related breach of fiduciary duty claims barred due to failure to raise them in course of bankruptcy proceeding).

In the present case the Debtors confirmed a Chapter 11 plan that failed to disclose a possible claim against Great American and to deal with the distribution of the proceeds of any such claim to creditors.³ The Plan instead provides for the expeditious liquidation of all assets; the only potential lawsuit disclosed is a joint suit with certain class action plaintiffs that has nothing to do with Great American. Although the Creditors have stated that they “would advance the cost of prosecuting the adversary proceeding on behalf of the Debtors’ Estates and would seek reimbursement of said costs only if a recovery is obtained from [Great American]” (Creditor’s Motion, ¶ 22), keeping the case open would subject the Debtor to various costs. Moreover, professional fees awarded are already substantial, and “even if there was a recovery from the Proposed Action, the Debtors’ outstanding professional fees would first have to be paid before any funds would be available for general unsecured creditors.” (Statement of Debtors,

3. It was disclosed that Great American’s fees were subject to Court approval; however, as discussed above, there is a significant difference between a proceeding on reduction or disallowance of fees and one which would make the applicant potentially liable for all creditor losses.

¶ 9.) Fees would be even higher if Great American claimed over against the Debtors or their counsel. The fact that pursuit of the litigation against Great American would be inconsistent with “the effectiveness of the Plan” is a further reason to give *res judicata* effect to the fee order and to deny the present motion.⁴

CONCLUSION

The Creditors’ motion for derivative standing to bring a malpractice claim against Great American is denied. The Debtors are directed to settle an order on three days’ notice.



In the matter of John T.
KEMP, Debtor.

No. 08-18700/JHW.

United States Bankruptcy Court,
D. New Jersey.

July 17, 2008.

Background: Chapter 13 debtor moved to reclassify secured claim arising from second mortgage on his residence as unsecured claim.

Holding: The Bankruptcy Court, Judith H. Wizmur, Chief Judge, held that debtor could reclassify claim without filing adversary proceeding.

Motion to reclassify claim granted.

4. Moreover, the Plan releases professionals from claims not founded on gross negligence or malpractice, and the Creditors’ claims against Great American would have to be based thereon and not on simple negligence.

1. Bankruptcy ⇔2156

Chapter 13 debtor could reclassify secured claim arising from second mortgage on his residence as unsecured claim, by stripping creditor's lien based on residence's value, without filing adversary proceeding, given that lien stripping did not challenge either validity or extent of lien. Fed.Rules Bankr.Proc.Rule 7001(2), 11 U.S.C.A.

2. Bankruptcy ⇔2156

As used in bankruptcy rule indicating that adversary proceeding is required to determine validity, priority, or extent of a lien, "validity" means existence or legitimacy of lien itself, "priority" means lien's relationship to other claims to or interests in collateral, and "extent" means the scope of property encompassed by or subject to lien. Fed.Rules Bankr.Proc.Rule 7001, 11 U.S.C.A.

See publication Words and Phrases for other judicial constructions and definitions.

Steven N. Taieb, Esq., Mt. Laurel, NJ,
for the Debtor.

**OPINION ON MOTION TO
RECLASSIFY SECURED
CLAIM**

JUDITH H. WIZMUR, Chief Judge.

This matter raises the issue of whether a Chapter 13 debtor's quest to reclassify a wholly unsecured mortgage on his residence as an unsecured claim must be brought by adversary proceeding, or whether it may be determined on the debtor's motion. In the recent Third Circuit decision in *In re Mansaray-Ruffin*, 530 F.3d 230 (3d Cir.2008), the court held that a Chapter 13 debtor may not invalidate a lien through a Chapter 13 plan provision, but must file an adversary proceeding to do so. Because the *Mansaray-Ruffin* de-

cision drew a distinction between challenging the validity of a lien and valuing the collateral to which that lien attaches to determine the amount of the secured claim, I conclude that the filing of an adversary proceeding is not mandated here. The debtor's motion to reclassify the secured claim may be granted.

FACTS

The debtor filed his Chapter 13 bankruptcy on May 9, 2008. He listed his residence in Audubon, New Jersey as having a value of \$200,000. Following the filing, the debtor obtained a broker's price opinion valuing the property at \$194,500. The payoff of his first mortgage with J.P. Morgan Chase is \$227,429.66. He listed a second mortgage against the Audubon property held by HSBC in the amount of \$48,549.26.

On June 12, 2008, the debtor filed a motion to reclassify the claim of HSBC as wholly unsecured. He relied appropriately on the case of *In re McDonald*, 205 F.3d 606 (3d Cir.), *cert. denied*, 531 U.S. 822, 121 S.Ct. 66, 148 L.Ed.2d 31 (2000) for the proposition that a wholly unsecured mortgage on a Chapter 13 debtor's residence may be reclassified as unsecured and treated with other unsecured creditors in the Chapter 13 plan. The motion is unopposed.

DISCUSSION

[1] The issue presented is whether the debtor may avail himself of the relief he seeks, i.e., the reclassification of the HSBC second mortgage from its secured status to treatment as an unsecured creditor, without filing an adversary proceeding in the case. In pertinent part, Fed.R.Bankr.P. 7001 provides as follows:

An adversary proceeding is governed by the rules of this Part VII. The following are adversary proceedings:

...

(2) a proceeding to determine the validity, priority, or extent of a lien or other interest in property, other than a proceeding under Rule 4003(d).

Fed.R.Bankr.P. 7001(2).

In *Mansaray-Ruffin*, the Chapter 13 debtor sought to rescind a mortgage held by EMC Mortgage Corporation against her property. She claimed numerous violations of the Truth-in-Lending Act ("TILA"), 15 U.S.C. § 1501 *et seq.* in connection with the origination of the mortgage. The mortgagee did not file a proof of claim in the case. The debtor filed an unsecured claim in the amount of \$1,000 on behalf of EMC, and filed an amended Chapter 13 plan in which she proposed that the mortgagee's claim would be

fixed as an unsecured claim in the amount of \$1000 unless it is able to object to this claim, the Debtor will cease making payments to EMC, and EMC will be obliged to satisfy its mortgage against the Debtor's home upon the discharge of its debt as filed or allowed.

530 F.3d at 232. The amended plan was noticed to EMC, which did not object to the confirmation of the plan. The plan was confirmed. Nine months later, EMC commenced an adversary proceeding in

the bankruptcy court seeking a determination that under Fed.R.Bankr.P. 7001(2), a lien could only be invalidated through an adversary proceeding, and that the debtor's confirmed plan did not affect its mortgage.

The Court of Appeals agreed with the bankruptcy court and the district court that EMC's mortgage was not invalidated by the confirmation of the debtor's plan. Emphasizing that the Federal Rules of Bankruptcy Procedure "are binding and courts must abide by them unless there is an irreconcilable conflict with the Bankruptcy Code", the court held that the mortgagee did not waive its right to challenge the invalidation of its mortgage by failing to object to plan confirmation. *Id.* at 234-35. Because the adversary proceeding rule is mandatory, and is grounded in constitutional due process principles, the court determined that the policy of finality for confirmed Chapter 13 plans, as codified in 11 U.S.C. § 1327,¹ "must yield to the principle that a plan cannot violate a mandatory provision of the Code," or in this case, a Bankruptcy Rule. *Id.* at 238.

The *Mansaray-Ruffin* court drew a critical distinction between the invalidation of a lien, e.g., under TILA rescission provisions, and so-called "lien stripping", whereby a Chapter 13 debtor may reduce or eliminate the amount due on a lien based on the value of the collateral to which the lien attached.² *Id.* at 235-36. See 11

1. Section 1327 provides:

(a) The provisions of a confirmed plan bind the debtor and each creditor, whether or not the claim of such creditor is provided for by the plan, and whether or not such creditor has objected to, has accepted, or has rejected the plan.

(b) Except as otherwise provided in the plan or the order confirming the plan, the confirmation of a plan vests all of the property of the estate in the debtor.

(c) Except as otherwise provided in the plan or in the order confirming the plan, the property vesting in the debtor under subsection (b) of this section is free and clear of any claim or interest of any creditor provided for by the plan.

11 U.S.C. § 1327.

2. "'Stripping off' a lien is a variant of 'stripping down' a lien. The distinguishable characteristic is that in a strip off, the entirety of the lien is negated while in a strip down, the

U.S.C. § 506(a). The court noted that the concept of “lien stripping” is related to the valuation of collateral, not the validity of the lien. Therefore, cases that allow lien stripping through a confirmed Chapter 13 plan without filing an adversary proceeding “have no bearing on whether Mansaray–Ruffin could invalidate EMC’s lien by using a provision to that effect in her plan”. *Id.* Similarly, the court distinguished cases in which a debtor successfully fixed the amount of a secured claim in a Chapter 13 plan in an amount less than the creditor otherwise asserted, noting that such cases “do not involve a challenge to the validity of the lien itself”. *Id.* A further distinction was drawn by the court between the lien invalidation sought by Mansaray–Ruffin and the circumstances outlined in the case of *In re Fesq*, 153 F.3d 113 (3d Cir.1998), *cert. denied*, 526 U.S. 1018, 119 S.Ct. 1253, 143 L.Ed.2d 350 (1999). In *Fesq*, the Court of Appeals refused to revoke an order of confirmation where the Chapter 13 bankruptcy plan provided for full satisfaction of the creditor’s \$70,000 judgment lien with a single payment of \$7,050. In the absence of fraud, the court refused to revoke the order of confirmation. Again, the *Mansaray–Ruffin* court highlighted the difference between lien invalidation and the modification of a secured claim to comport with the value of the collateral in a lien stripping case. *Id.* at 241–42.

[2] Here, the debtor is not seeking to invalidate the lien of HSBC. Rather, the debtor seeks to strip the HSBC lien based on the value of the collateral. The *Mansaray–Ruffin* court, citing to the Ninth Circuit case of *In re Enewally*, 368 F.3d 1165, 1173 (9th Cir.), *cert. denied*, 543 U.S. 1021, 125 S.Ct. 669, 160 L.Ed.2d 497 (2004), confirmed that Rule 7001 does not require

partially secured lien is bifurcated and only the unsecured portion is removed.” *In re*

a debtor to file an adversary complaint where the debtor seeks to modify the lien amount based on the value of the collateral. *Id.* at 241–42.

Under Rule 7001, the proceedings that require an adversary are those “to determine the validity, priority, or extent of a lien”. “‘Validity’ means the existence or legitimacy of the lien itself, ‘priority’ means the lien’s relationship to other claims to or interests in the collateral, and ‘extent’ means the scope of the property encompassed by or subject to the lien.”

In re Dickey, 293 B.R. 360, 363 (Bankr. M.D.Pa.2003) (quoting *In re King*, 290 B.R. 641, 645–47 (Bankr.C.D.Ill.2003)). See also *In re Bennett*, 312 B.R. at 847. Many courts agree that lien stripping does not constitute either a challenge to the validity or the extent of the lien under Rule 7001(2). The term “extent of the lien” “involves the property itself on which the lien is assertedly fixed. . . . For example, several types of property may be claimed as collateral, but a dispute often arises as to whether the lien in fact exists on all such property.” 10 Lawrence P. King, *Collier on Bankruptcy*, ¶ 7001.03[1] at 7001–10 (15th Ed. Rev.2008). While the term “extent” suggests a reference to the value of the property subject to the lien, which would require the filing of an adversary proceeding to determine value, that interpretation is inconsistent with Rule 3012, which provides that “[t]he court may determine the value of a claim secured by a lien on property in which the estate has an interest on motion of any party in interest.” Fed.R.Bankr.P. 3012. As explained in *Collier*,

Under section 506(a) of the Code, secured claims are to be valued and al-

Bennett, 312 B.R. 843, 846 (Bankr.W.D.Ky. 2004).

lowed as secured to the extent of the value of the collateral and unsecured for the excess over such value. Rule 3012 implements section 506(a) and provides that the court may determine the value of a claim secured by a lien on property in which the estate has an interest on *motion* of any party in interest. One could argue that such a proceeding is one to determine the “extent” of the lien. The Advisory Committee Note to Rule 3012 refutes this notion by making the distinction that a Rule 7001 adversary proceeding “is relevant to the basis of the lien itself” as distinguished from valuation for the purposes given in examples in that Note, such as to determine the issue of adequate protection under section 361, impairment under section 1124 or treatment of the claim in a plan pursuant to section 1129(b). Thus, under the Bankruptcy Rules, valuation is accomplished by motion under Rule 9014, rather than in an adversary proceeding under Rule 7001.

Id. at 7001–11 (footnotes omitted). *See also In re Hudson*, 260 B.R. 421, 433 (Bankr.W.D.Mich.2001) (“Extent”, as used in Rule 7001(2), is not synonymous with collateral valuation, but rather concerns identification of the collateral to which the lien attaches.).

I conclude that Rule 7001(2) does not mandate the filing of an adversary proceeding to accomplish the reclassification of the claim of HSBC to unsecured status in this case. The debtor’s motion seeking that relief is granted.



In re Mark David FRANKEL, Debtor.

Mark David Frankel, Plaintiff

v.

**Brian Strayer, Richard Wix, and
Wix, Wenger & Weidner,
P.C., Defendants.**

**Bankruptcy No. 1–05–bk–09306MDF.
Adversary No. 1–07–ap–00086.**

United States Bankruptcy Court,
M.D. Pennsylvania.

July 14, 2008.

Background: Chapter 13 debtor brought adversary proceeding to recover for alleged willful violation of automatic stay.

Holdings: The Bankruptcy Court, Mary D. France, J., held that:

- (1) stay violation that occurred when creditor and law firm representing him, with knowledge of debtor’s Chapter 13 filing, filed civil complaint in which debtor was named as defendant and monetary judgment was sought against him was “willful” stay violation, regardless of whether complaint was filed as part of deliberate strategy to generate adverse publicity against debtor, or of whether filing was result of clerical error when a complaint that named defendant as defendant, rather than one in which debtor’s name was omitted, was presented for filing;
- (2) debtor was entitled to attorney fee award as damages for stay violation;
- (3) debtor was not entitled to damages award to compensate him for loss of jury trial in pending criminal case, on theory that pretrial publicity surrounding the filing of civil complaint had so infected jury pool that debtor had to dispense with jury trial; and