UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF NEW YORK

IN RE:

DONALD E. PHILLIPS and
SUSAN D. PHILLIPS,

Debtors.

BK. NO. 92-21849

CHAPTER 13

DECISION AND ORDER

BACKGROUND

On July 2, 1992 the debtors, Donald E. and Susan D. Phillips (the "Debtors"), filed a petition initiating a Chapter 13 case. In their Chapter 13 Statement the Debtors listed their ownership, as tenants by the entirety, of real property known as 159 Pomona Drive, Rochester, New York ("Pomona Drive"). The statement listed Pomona Drive as having a current market value of $70,000, Fleet Mortgage Corp. ("Fleet") as having a purchase money mortgage with an outstanding balance of $67,855 and American General Finance ("American General") as having a home equity loan mortgage with an outstanding balance of $10,321. By motion dated September 19, 1992 and made returnable on September 30, 1992, the Debtors moved pursuant to Sections 1322(b)(2) and 506 and In re Bellamy, 962 F.2d 176 (2d Cir. 1992), for a determination by the Court that: (1) pursuant to Section 506(a) the value of Pomona Drive is $63,240, representing the $68,000 fair market value of the property according to a current appraisal obtained by the Debtors less a hypothetical expense of sale of 7%; (2) pursuant to Section 506(a) the allowed claim of Fleet is a secured claim to the extent of the proposed $63,240 value and an unsecured claim for the balance; (3) pursuant to Section 506(a) the allowed claim of American General is an unsecured claim; and (4) pursuant to Section 506(d) to the extent the claims of Fleet and American General are unsecured, the liens securing those claims are void.

In its response American General asserted that: (1) according to its appraisal, Pomona Drive has a current fair market value of $78,000; (2) no hypothetical expense of sale should be deducted from the fair market value in determining the value of Pomona Drive pursuant to Section 506(a), since the Debtors' Chapter 13 plan does not contemplate the sale of the property as part of the plan; and (3) the avoidance of any portion of American General's mortgage lien should be contingent on the Debtors completing a confirmed Chapter 13 plan, and to the extent any portion of the lien is avoided, it should be rein-stated in the event the plan is not completed and the case is converted to a Chapter 7 case.

At the return date of the motion the Debtors and American General stipulated that the fair market value of Pomona Drive was $72,814 and that pursuant to In re Bellamy and Section 506(a), notwithstanding Section 1322(b)(2), American General's allowed claim was a partially unsecured claim. Therefore, the Court was asked only to decide whether a hypothetical expense of sale should be deducted from the fair market value in determining American General's secured claim and whether the resulting bifurcation and partial avoidance of American General's mortgage lien would be contingent on the successful completion by the Debtors of a confirmed Chapter 13 plan.

DISCUSSION

The statutory guideline for determining the secured status of an allowed claim is 11 U.S.C. § 506(a):

> 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. Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest.

There is no specific requirement in Section 506(a) that a deduction be made for the hypothetical expenses of selling the property to be valued. In interpreting "valuation" in this section when a debtor proposes to keep the secured collateral, Bankruptcy Courts have reached conflicting results. The conflict stems from the ambiguous language of Section 506. In re Dinsmore, 141 B.R. 499, 509 (Bankr. W.D.Mich. 1992).

The first sentence in Section 506(a) states that the Court is to value the creditor's secured claim in light of that creditor's interest in the collateral. Some courts have focused on this language and have concluded that a creditor's interest is limited to what could be obtained by that creditor upon liquidation and therefore hypothetical disposition costs should be deducted. Id.; In re Coker, No. 91-1240, 1992 U.S. App. Lexis 18677, at *2 (4th Cir. August 13, 1992). Other courts have focused on the second sentence which states that any valuation must be made in light of the proposed disposition or use of the property. Dinsmore, 141 B.R. at 59; In re Coker, No. 91-1240, 1992 U.S. App. Lexis 18677 at *2 (4th Cir. August 13, 1992); In re Usry, 106 B.R. 759, 761 (Bankr. M.D.Ga. 1989); In re 222 Liberty, 105 B.R. 798, 804 (Bankr. E.D.Pa. 1989). In most Chapter 13 proceedings, the debtor's plan proposes to retain and use the secured property and liquidation is not contemplated. When that is the case, considering the costs of selling the property is not in line with the stated use of the property. In re Coker, No. 91-1240, 1992 U.S. App. Lexis 18677, at *2 (4th Cir. August 13, 1992). If the first sentence of Section 506(a) "were interpreted to mean that the value must be fixed at the amount which the creditor would receive on foreclosure, then the last sentence of the statute . . . would be surplusage." In re Courtright, 57 B.R. 495, 497 (Bankr. D.Or. 1986). The United States Court of Appeals for the Fourth Circuit found that hypothetical costs should not be deducted from the fair market value and stated,

> Chapter 13 is a reorganization mechanism for individuals. One of its advantages to the homeowner debtors is that they may retain their home by reaffirming the mortgage debt. Were we to permit the deduction of hypothetical sale costs in the face of the Cokers' stated intention, an intention that is subject to the bankruptcy court's approval, we would create an anomalous situation indeed. On the one hand, the debtors have

> submitted their plan, which includes a pledge to continue their mortgage payments in full . . . On the other hand, the Cokers want the court to value Sovran's [creditor's] claim as if the very event that Chapter 13 permits them to avoid has occurred, i.e., a foreclosure. If the "proposed use or disposition" provision is to have any meaning, the debtor should not be permitted to "eat with the hounds and run with the hares."

In re Coker, No. 91-1240, 1992 U.S. App. Lexis 18677, at *2 (4th Cir. August 13, 1992) (citing In re Crockett, 3 B.R. 365, 367 (Bankr. N.D.Ill. 1986)).

This Court agrees that in a Chapter 13 case there should not be a deduction for the hypothetical expenses of selling the property to be valued where the property is the debtor's residence which the debtor intends to retain. In this case, the Debtors intend to retain Pomona Drive during the plan. Therefore, in valuing the property the Debtors should not be able to deduct a hypothetical 7% expense of sale.

American General asserts as an additional issue that if it is not clearly provided that its mortgage lien is to be reinstated in the event of a conversion of the Debtors' case to a Chapter 7 case, the result would be that a debtor, who first files a Chapter 13 case and has a mortgage lien partially avoided and then converts to a Chapter 7 case without completing a plan, would be able to "strip" down a creditor's mortgage lien on real property, something which that debtor could not have done if it had just filed a Chapter 7 case according to the United States Supreme Court's recent decision in Dewsnup v. Timm, ____ U.S. ____, 112 S.Ct. 773, 116 L.Ed.2d 903 (1992). The Supreme Court in Dewsnup v. Timm held that in a Chapter 7 case Sections 506(a) and 506(d) could not be utilized to bifurcate the lien of a mortgage holder on a debtor's residential real estate and that such mortgage liens pass through a Chapter 7 bankruptcy case. 112 S.Ct. at 778, 116 L.Ed.2d at 911.

Under Section 349, if the Debtors' Chapter 13 case was not completed and their case was dismissed in accordance with Section 1307, then any lien which was avoided under Section 506(d) would be rein-stated. 11 U.S.C. § 349(b)(1)(c) provides that, "unless the court, for cause orders otherwise, a dismissal of a case other than under Section 742 of this title . . . reinstates . . . any lien voided under Section 506(d)."

On the other hand, Section 348 which deals with the effect of conversion does not contain a similar specific provision reinstating any liens avoided under Section 506(d) in the proceedings under a prior chapter. Therefore, the Debtors could achieve a different result than the holding of Dewsnup v. Timm if they converted to a Chapter 7, since the lien would not be automatically reinstated and they would have avoided a lien which they could not have avoided if they had filed a Chapter 7 in the first instant.

The Court agrees with American General's concerns. Therefore the order partially avoiding the lien of American General in connection with the Debtors' confirmed Chapter 13 plan shall specifically provide that should the plan not be completed and the case be converted to a Chapter 7 case or dismissed, the lien of American General shall be reinstated in full.

DECISION

For purposes of the Debtors' confirmed Chapter 13 plan, the value of the Debtors' Pomona Drive property is determined to be $72,814, and the claim of American General is found to be an allowed secured claim to the extent of $5,000 and an unsecured claim for the balance. Should the Debtors' confirmed Chapter 13 plan not be completed as confirmed and the Chapter 13 case be converted to a Chapter 7 case or dismissed, the lien of American General on the Pomona Drive property shall be reinstated as security for the full amount of the then outstanding balance owed to American General, less any payments received by it in connection with the Chapter 13 plan or otherwise.

IT IS SO ORDERED.

/s/
HON. JOHN C. NINFO, II
UNITED STATES BANKRUPTCY JUDGE

Dated: October 23, 1992