Annual Survey of Virginia Law: Bankruptcy Law

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BANKRUPTCY LAW

Michael A. Condyles*

I. INTRODUCTION

This survey article reviews and analyzes legislative and judicial developments that have occurred in bankruptcy law between April, 1991 and April, 1992. The article is intended to alert the general practitioner to significant recent developments in the bankruptcy area. Legislative changes made to Virginia statutory law and federal bankruptcy decisions issued within the Fourth Circuit are the focus of this article.

Several United States Supreme Court decisions have been handed down that clarify areas of bankruptcy law where judicial opinions had conflicted. Those decisions addressed in this article affect the treatment of claims of secured creditors. However, neither legislative nor judicial developments have markedly altered existing law. This article will survey developments which will affect both debtors and creditors in connection with the administration of bankruptcy cases.

II. TREATMENT OF SECURED CLAIMS

Several bankruptcy decisions rendered during the survey period affect the manner in which a secured creditor’s claim will be treated in a bankruptcy case. Of particular interest is Johnson v. Home State Bank,¹ in which the United States Supreme Court addressed the treatment of a mortgagee’s claim in connection with multiple bankruptcy filings by a debtor. In addition, in Dewsnup v. Timm,² the Court addressed the ability of a debtor to “strip down” a secured creditor’s lien against real estate that has been abandoned as an asset of the bankruptcy estate. Other judicial deci-

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sions have discussed the treatment of an assignment of rents clause contained in a deed of trust, and a debtor's ability to avoid a judicial lien which impairs an exemption against real estate. The following analysis reviews these developments.

A. Treatment of a Mortgagee's Claim in Connection with a Debtor's Multiple Filings

Prior to the U.S. Supreme Court's ruling in Johnson v. Home State Bank, a conflict existed among the federal circuit courts over whether a debtor could file a Chapter 13 petition in order to pay off arrearages on his mortgage, despite having received a discharge for the debt in a prior Chapter 7 case. The filing of a Chapter 13 bankruptcy petition by a debtor, following the same debtor's prior filing of a Chapter 7 case, is often referred to by courts as a Chapter 20. Because the Bankruptcy Code fails to impose any restrictions on multiple filings, courts have determined that they are

4. See In re Johnson, 904 F.2d 563 (10th Cir. 1990), rev'd, 111 S. Ct. 2150 (1991); In re Saylors, 869 F.2d 1434, 1436 (11th Cir. 1989); In re Metz, 820 F.2d 1495, 1498 (9th Cir. 1987).
6. 11 U.S.C. § 109(g) (1988) does restrict eligibility for filing a bankruptcy case in certain instances. For example, § 109(g) prevents an individual or a family farmer from filing a bankruptcy petition when such person has been a debtor in a case during the prior 180 days, if the prior case was dismissed by the court because the debtor willfully failed to abide by the orders of the court or to appear before the court in proper prosecution of the case. This limitation is intended to apply narrowly to only those debtors who intentionally obtain a dismissal of their bankruptcy case in order to file another case or who consciously abuse the bankruptcy system. 5 COLLIER ON BANKRUPTCY, ¶1300.40, at 1300-88 (15th ed. 1992).
Section 109(g) also prevents a debtor from filing a new case where the debtor voluntarily requests and obtains a dismissal of a prior case within the 180 days preceding the filing of a request for relief from the automatic stay provided by 11 U.S.C. § 362. This limitation is designed to prevent a debtor from abusing the bankruptcy system. A debtor cannot file new bankruptcy cases and re-invocate the automatic stay immediately after a creditor has sought or obtained relief from the automatic stay in a prior case. Id. The 180-day limitation is intended to provide a creditor with sufficient time to obtain relief from the stay and to take the necessary action to foreclose on its collateral while still affording a debtor the opportunity to seek bankruptcy relief. Id.

Certain limitations on a debtor's ability to file a bankruptcy case are also imposed under 11 U.S.C. § 727. Section 727(a)(8) provides that a debtor shall not be granted a discharge under Chapter 7 of the Bankruptcy Code if that debtor has been granted a discharge under the same section or under Chapter 11 of the Bankruptcy Code in a case commenced within six years of the date of the filing of the subsequent petition. Section 727(a)(9) also limits a
not improper *per se*.

Instead, to determine the appropriateness of a Chapter 13 filing in such instances courts have evaluated whether a mortgagee maintains a "claim" as defined by the Bankruptcy Code that can be included in the Chapter 13 proceeding. The term "claim" is broadly defined under the Bankruptcy Code. In *Johnson* the Court determined that there are two components to the enforcement of a claim. First, an *in personam* action can be brought against the debtor individually to impose personal liability for the amount owed. Second, an *in rem* action can be brought to collect the amounts owed by executing against the property which serves as collateral.

In *Johnson*, the Court also found that a Chapter 7 discharge only extinguishes the right to proceed against the debtor personally. Since the right to execute against the collateral still exists, the creditor still maintains a claim which can be made subject to the Chapter 13 provisions of the Bankruptcy Code.

The Court's determination that a secured creditor maintains a claim in instances where a debtor has been discharged of his personal liability is especially important in the Chapter 13 context. Under the Bankruptcy Code, the Chapter 13 debtor can alter the

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7. *In re Saylors*, 869 F.2d at 1434; *In re Metz*, 820 F.2d at 1495. 11 U.S.C. § 1325(a)(3) requires that as a condition to the confirmation of a Chapter 13 plan of reorganization, the plan must be proposed in good faith. Courts have examined this good faith requirement to determine whether a basis exists to dismiss a Chapter 13 filing that follows a filing of a Chapter 7 case by the same debtor. *See, e.g.*, *In re Saylors*, 869 F.2d at 1434; *In re Metz*, 820 F.2d at 1495. Since Congress did not impose a limitation on repetitive bankruptcies when it enacted the good faith requirement, the filing of a Chapter 13 case shortly after a debtor has obtained a discharge under Chapter 7 is not prohibited by § 1325(a)(3). *In re Saylors*, 869 F.2d at 1434; *In re Metz*, 820 F.2d at 1495. Instead, courts have imposed a limitation only where there is a showing of serious misconduct or abuse after an examination is performed of the "totality of the circumstances." *In re Smith*, 848 F.2d 813 (7th Cir. 1988); *In re Caldwell*, 851 F.2d 852 (6th Cir. 1988); *In re Metz*, 820 F.2d 1495 (9th Cir. 1987); *In re Waldron*, 785 F.2d 936 (11th Cir. 1986); *Barnes v. Whelan*, 689 F.2d 193 (D.C. Cir. 1982); *see Johnson*, 111 S. Ct. at 2150.

8. The Court relied on its ruling in *Pennsylvania Department of Public Welfare v. Davenport*, 110 S. Ct. 2126 (1990), to support its determination that Congress intended to adopt the broadest available definition of the term "claim."


10. *Id.*

11. *Id.*
rights of holders of secured claims in certain instances. For example, a debtor can cure a loan default under a plan and provide for the repayment of any arrearage over the life of such plan. A debtor can also modify a creditor’s rights by reducing a secured claim to reflect the value of the collateral.

In Johnson, the Supreme Court did not directly address whether serial filings under Chapter 7 and Chapter 13 constitute bad faith. Instead, the Court indicated that the totality of the circumstances must be analyzed. The Court’s finding that the debtor may repay a secured claim in connection with a Chapter 13 filing after first having been discharged of any personal liability in connection with a Chapter 7 proceeding produces a favorable result for debtors. This holding may encourage more serial filings under Chapters 7 and 13, and may encourage debtors not to reaffirm their indebtedness to secured creditors in Chapter 7 cases.

B. Assignment of Rents

The treatment of an assignment of rents received from real estate continues to be a developing area of bankruptcy law. In the

12. 11 U.S.C. § 1322(b)(2) (1988). Under § 1322(b)(2), a debtor can modify a secured claim, “other than a claim secured only by a security interest in real property that is the debtor’s principal residence.” Id.

13. 11 U.S.C. § 1322(c) provides that a Chapter 13 plan may not allow for payments over a period that is longer than three years, unless the court, for cause, approves a period that is not longer than five years.


15. Johnson, 111 S. Ct. at 2156.

16. Id. The Court in Johnson stated:

Congress has expressly prohibited various forms of serial filings. . . . The absence of a like prohibition on serial filings of Chapter 7 and Chapter 13 petitions, combined with the evident care with which Congress has fashioned these express prohibitions, convinces us that Congress did not intend categorically to foreclose the benefit of Chapter 13 reorganization to a debtor who has previously filed for Chapter 7 relief. Id.

17. 11 U.S.C. § 524(c) provides that the debtor and the holder of a claim can enter into an agreement whereby the debtor will retain personal liability for the debt if certain conditions are met. 11 U.S.C. § 524(c) (1988). Generally, a debtor enters into this kind of agreement as a condition to retaining possession of certain property he has provided as collateral to a creditor.
1990 Annual Survey of Virginia Law article on bankruptcy law, the author analyzed the then-recent Virginia bankruptcy court opinion, In re Townside Partners, Ltd. In re Brandon Assocs., a Virginia bankruptcy court expanded on the court's decision in Townside. In addition, the 1992 Virginia General Assembly enacted a new statute which addresses the perfection of liens or interests in rents and profits received from real estate.

1. In re Brandon Associates

The Virginia Uniform Commercial Code does not apply to the “creation or transfer of an interest in or lien on real estate.” Instead, a secured creditor's interest in rents obtained in connection with real estate is created by an assignment of rents recorded against the real property. A secured creditor's interest in rents created under an assignment of rents clause is governed by state law.

18. Condyles, supra note 14, at 618.

Upon recordation, pursuant to § 55-106, in the county or city in which the real property is located, of any deed, deed of trust or other instrument granting, transferring or assigning the interest of the grantor, transferor, assignor, pledgor or lessor in leases, rents or profits arising from the real property described in such deed, deed of trust or other instrument, the interest of the grantee, transferee, pledgee or assignee shall be fully perfected as to the assignor and all third parties without the necessity of (i) furnishing notice to the assignor or lessee, (ii) obtaining possession of the real property, (iii) impounding the rents, (iv) securing the appointment of a receiver, or (v) taking any other affirmative action. The lessee is authorized to pay the assignor until the lessee receives written notification that rents due or to become due have been assigned and that payment is to be made to the assignee.

Id.

23. Butner v. United States, 440 U.S. 48 (1979). In Butner, which was decided under the former Bankruptcy Act, the Court addressed the interaction of state law and federal law regarding the relationship of the interests of a secured creditor and a debtor under an assignment of rents clause. Generally, state law governs the relationship between secured creditors and debtors. With respect to assignment of rents, the Court specifically stated:

The constitutional authority of Congress to establish 'uniform Laws on the subject of Bankruptcies throughout the United States' would clearly encompass a federal statute defining the mortgagee's interest in the rents and profits earned by property in a bankrupt estate. But Congress has not chosen to exercise its power to fashion any such rule. . . . Congress has generally left the determination of property rights in assets of a bankruptcy estate to state law.

Id. at 54 (citing U.S. CONST. art. I, § 8, cl. 4) (footnotes omitted).
The property interest granted a secured creditor under an instrument creating an assignment of rents is important in a bankruptcy context since the issue determines the debtor's right to use such property in a Chapter 11 reorganization. Under Chapter 11, the debtor has broad authority to use estate property for the operation of its business in the ordinary course. However, the Bankruptcy Code provides a secured creditor with special protection when the creditor's collateral is in the form of "cash collateral." Specifically, a debtor is prohibited from using cash collateral without first obtaining the creditor's consent or court authority. By affording a creditor this protection, the Bankruptcy Code prevents the creditor from becoming an involuntary lender.

In *Townside*, the debtor acquired an apartment complex against which a deed of trust, containing an assignment of rents clause, was executed and properly recorded. In finding that the clause granted an absolute assignment of rents, the court distinguished the facts of *In re Vienna Park Properties*, a New York bankruptcy court decision interpreting Virginia law. The court noted that the assignment of rents clause contained in the *Vienna Park* deed of trust required further action to be taken by the creditor in order to obtain the rents; therefore, a present and irrevocable assignment of rents did not exist.

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25. The Bankruptcy Code defines cash collateral broadly to mean:
   cash, negotiable instruments, documents, documents of title, securities, deposit accounts or other cash equivalents whenever acquired in which the estate and an entity other than the estate have an interest[, including] the proceeds, products, offspring, rents or profits of property subject to a security interest as provided in § 552(b) . . . whether existing before or after the commencement of a case under [the Bankruptcy Code].
26. Id. § 363(c)(2).
28. In distinguishing *Vienna Park*, the court in *Townside* stated:
   Further, there is nothing in the Wrap Deed of Trust which indicates that the secured creditor would be required to do anything further to perfect its lien in the rents. Unlike the deed of trust in *Vienna Park*, . . . the provisions for assignment of rents in the Wrap Deed of Trust do not contain language which would indicate that the ruling in *Frayser's* case should control. In *Vienna Park*, the assignment of rents provision recited that the rents were additional security and provided that upon acceleration of the deed of trust the lender was entitled to take possession of the property and manage it and collect the rents.
29. Id. at 11. The *Townside* court stated that:
In *Brandon*, the same Virginia bankruptcy court found that the assignment of rents language contained in two deeds of trust held by different creditors did not contain the same absolute language found in *Townside*. Instead, the court decided that the assignment of rents language indicated the parties intended to follow Virginia case law which provides “that a mortgagor is entitled to the rents until the mortgagee either takes possession of the premises or obtains the appointment of a receiver.” The failure of the assignment of rents provision to grant the secured creditor a present entitlement to the rents appears to be the basis for the court's distinction between the facts of *Brandon* and those of *Townside*.

Based on the assignment of rents clause language, the bankruptcy court found that the secured creditors and the debtor in *Brandon* maintained an interest in the rents from the property. The court found that the interest granted to the secured creditors was perfected as to the debtor and third parties as a result of the recordation of the deed of trust. However, because of the automatic stay imposed by section 362 of the Bankruptcy Code, the creditors were not permitted to enforce their interests against the debtor. The court ultimately did conclude that the creditors' interests constituted cash collateral.

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[t]he language of the Wrap Deed of Trust in the case at bar clearly distinguishes it from the *Vienna Park* case and dictates a different result. At the time of the filing of the petition for relief in the case at bar, the debtor was merely serving as an agent for the beneficiaries of the Wrap Deed of Trust to collect rent and pay the rent proceeds as directed by the terms of the Wrap Deed of Trust. The assignment was present and irrevocable. The only condition which would remove the assignment was payment of the obligation secured by the deed of trust.

*Id.*


31. See *id.* at 731. The language of the deeds of trust in *Brandon* provided that the secured creditor received an assignment of rents upon the execution of the deeds of trust but that the entitlement to actually receive the rent would remain with the grantor unless a default under the instrument occurred. *Id.*

32. *Id.* at 733.

33. *Id.*

34. *Id.* at 733-34. Section 362 of the Bankruptcy Code provides that the filing of the debtor's bankruptcy petition stays "any act to create, perfect, or enforce any lien against property of the estate." 11 U.S.C. § 362(a)(4) (1988).

35. *In re Brandon Assocs.*, 128 B.R. at 733-34. To determine whether an unenforceable interest in rents constitutes cash collateral, the *Brandon* court first reviewed the decision in *In re Raleigh/Spring Forest Apartments Assocs.*, 118 B.R. 42 (Bankr. E.D.N.C. 1990). In *Raleigh*, the court held that while the assignments of rents were perfected, they were also conditional. Some further action by the creditors was required before the creditors could enforce their entitlement to the rents. *Id.* at 45. The *Raleigh* court found that the creditors'
Although rents may constitute cash collateral in certain situations, a debtor may retain control over the use of the rents if the creditor’s interest is adequately protected.\textsuperscript{36} In *Brandon*, the court held that a creditor’s right to adequate protection could not rise higher than the protection given to a creditor under state law where no bankruptcy was involved.\textsuperscript{37} Absent bankruptcy, the court found that the secured creditor or a receiver would apply rents first to maintenance and to costs of preserving the property. Accordingly, the court permitted the debtor to use cash collateral for such purposes without granting the creditor any further protection.\textsuperscript{38}

2. Section 55-220.1 of the Code of Virginia

The 1992 Session of the Virginia General Assembly enacted a new statute which is intended to clarify existing state law regarding assignment of rents.\textsuperscript{39} Section 55-220.1 provides that an assignment of an interest in rents or profits arising from real property shall be fully perfected as to the assignor and all third parties upon recordation pursuant to section 55-106 of the Code of Virginia.\textsuperscript{40} Upon recordation, the assignment is perfected and the creditor does not need to take any additional measures such as furnishing notice to the assignor or the lessee, obtaining possession of the real property, impounding the rents or securing the appointment of a receiver. However, the perfected secured creditor is not entitled to

unenforceable interests were “too remote to qualify as cash collateral.” *Id.* Despite the factual similarities between *Brandon* and *Raleigh*, the *Brandon* court declined to follow the *Raleigh* court’s holding. Instead, the court adopted the view taken in *In re KNM Roswell Ltd. Partnership*, 126 B.R. 548 (Bankr. N.D. Ill. 1991). In *KNM Roswell*, the court held that a creditor’s perfected but inchoate interest in rents constituted cash collateral under § 363(a) of the Bankruptcy Code. 126 B.R. at 556.


37. *In re Brandon Assocs.*, 128 B.R. at 734.

38. *Id.*


40. See supra note 21.
possession of the rents until the lessee is provided written notification directing future payments to be made to the assignee.\textsuperscript{41}

It appears that section 55-220.1 was modeled after a similar Tennessee law.\textsuperscript{42} As a result, judicial interpretations of this section of the Tennessee Code should influence how courts apply the new Virginia statute.

In \textit{In re McCutchen},\textsuperscript{43} a Tennessee bankruptcy court analyzed the Tennessee assignment of rents statute to determine whether certain rents from real estate constituted cash collateral. Like Virginia's statute, Tennessee's law provides that an assignee's interest in rents is fully perfected upon the recording of the instrument where the real estate is located, without the assignee taking any other affirmative action. In addition, the Tennessee Code provides that the secured creditor is not entitled to possession of rents until proper notice is given to the lessee of the property.\textsuperscript{14}

Interpreting the Tennessee statute, the bankruptcy court found the perfection of the security interest in the rents was not at issue, since the instrument was properly recorded. However, since the lessee was not given pre-petition notice in accordance with the statute, the secured creditor was not entitled to possession of the rents.\textsuperscript{45} Furthermore, since the secured creditor was not entitled to the rents pre-petition, the automatic stay enjoined the creditor from taking action to enforce its lien or to obtain possession of the rents. The court noted, however, that the creditor's lack of entitlement to the rents did not preclude a determination that the rents constituted cash collateral.\textsuperscript{46}

\begin{itemize}
\item \textsuperscript{43} 115 B.R. 126 (Bankr. W.D. Tenn. 1990).
\item \textsuperscript{44} TENN. CODE ANN. § 66-426-116 (Cum. Supp. 1991).
\item \textsuperscript{45} \textit{In re McCutchen}, 115 B.R. at 132.
\item \textsuperscript{46} Id. The McCutcheon court adopted the analysis contained in \textit{In re Pavilion Place Assocs.}, 89 B.R. 36 (Bankr. D. Minn. 1988), and quoted the Pavilion decision as follows: "An enforceable interest regarding an assignment of rents arises in favor of the assignee upon the creation of a security interest. The right to actual enforcement, however, is subject to the occurrence of statutory and contractual conditions precedent. While the conditions precedent might not have occurred as of filing regarding the Pavilion rents, that does not change the fact that the post-petition rents are subject to the Fund's security interest and become its cash collateral under 11 U.S.C. § 363. It is true that the automatic stay prevents the Fund from undertaking steps to enforce its rights in the cash collateral. However, it is equally true that the Debtor is prohibited from using the same cash collateral without first obtaining an order allowing the use pursuant to 11 U.S.C. § 363."
\end{itemize}

\textit{In re McCutchen}, 115 B.R. at 132 (quoting \textit{In re Pavilion Place Assocs.}, 89 B.R. at 39).
The court’s holding in *McCutchen* is remarkably similar to the *Brandon* court’s ruling, which was rendered prior to Virginia’s enactment of the assignment of rents statute. In both instances, a secured creditor maintained a perfected security interest in the rents. In addition, both courts found that the rents constituted cash collateral to which the creditors would be entitled only after they obtained relief from the automatic stay. Both debtors were entitled to the use of the cash collateral only upon a showing that the creditors were adequately protected.

The bankruptcy court’s decision in *Brandon* and the General Assembly’s enactment of section 55-220.1 clarifies Virginia law regarding assignment of rents. In addition, the new statute entitles a secured creditor to rents if the contractual condition precedents have occurred and written notice to the lessee has been provided. This change parallels section 8.9-318(3) of the Code of Virginia regarding the assignment of accounts receivable and greatly benefits secured creditors. Accordingly, the changes that have occurred with respect to assignment of rents clauses strengthen the ability of secured creditors to collect debts that are due.

### C. Voiding Liens

Prior to the U.S. Supreme Court’s decision in *In re Dewsnup*, a split of authority existed over whether a Chapter 7 debtor could void the undersecured portion of a lien on abandoned real property. Section 506(d) of the Bankruptcy Code created the basis for debtors voiding the undersecured portion of a lien. This section 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. . . .”

A majority of courts have held that section 506(d) allows the Chapter 7 debtor to void the portion of the lien that exceeds the value of the property, regardless of whether the estate has aban-
doned the property. A strong minority of courts ruling on the issue, represented by the Tenth Circuit Court of Appeals' decision in *In re Dewsnup,* have decided that section 506(d) cannot be used to void liens on abandoned property. The U.S. Supreme Court recently affirmed the Tenth Circuit's decision in *Dewsnup,* thus endorsing the minority view.

In *Dewsnup,* the debtor owed approximately $120,000.00 to a creditor. This debt was secured by a deed of trust on two parcels of real estate. The debtor sought to void the undersecured portion of the lien pursuant to section 506(d) of the Bankruptcy Code. At the trial level, the bankruptcy court determined that the value of the land subject to the deed of trust was $39,000.00. Since the real estate had been abandoned by the trustee, the bankruptcy court held that section 506(d) could not be used to void the undersecured portion of the creditor's lien. The U.S. district court affirmed the bankruptcy court's ruling. This decision was subsequently affirmed by the Tenth Circuit Court of Appeals.

In determining that the undersecured portion of a lien cannot be voided when the real estate has been abandoned, the U.S. Supreme Court found that Congress, in drafting section 506(d), did not intend "to depart from the pre-Code rule that liens passed through bankruptcy unaffected." The Court found that, unless a creditor's lien is fully protected until the creditor decides to foreclose, the property abandoned by the trustee under 11 U.S.C. § 554 is not "property in which the estate has an interest" under the language of § 506(a) and as a result no portion of the lien may be voided under § 506(d); (2) allowing a lien to be voided inequitably gives debtors more in Chapter 7 than debtors receive in reorganization chapters; and (3) allowing a lien to be voided under § 506(d) renders 11 U.S.C. § 722 redundant; this section provides that a debtor has the right to redeem personal property but not real property. *In re Dewsnup,* 908 F.2d 589 (7th Cir. 1990).

52. See *Gaglia v. First Fed. Sav. & Loan Ass'n,* 889 F.2d 1304 (3d Cir. 1989); *In re Brouse,* 110 B.R. 539 (Bankr. D. Colo. 1990); *In re Moses,* 110 B.R. 962 (Bankr. N.D. Okla. 1990); *In re Zlogar,* 101 B.R. 1 (Bankr. N.D. Ill. 1989); *In re Tanner,* 14 B.R. 933 (Bankr. W.D. Pa. 1981); see also *In re Folendore,* 862 F.2d 1537 (11th Cir. 1989); *In re Lindsey,* 823 F.2d 189 (7th Cir. 1987).


54. See id; *In re Lange,* 120 B.R. 132 (9th Cir. BAP 1990); *In re Mammoser,* 115 B.R. 758 (Bankr. W.D.N.Y. 1990); *In re Shrum,* 98 B.R. 995 (Bankr. W.D. Okla. 1989); *In re Maitland,* 61 B.R. 130 (Bankr. E.D. Va. 1986). There are three basic reasons asserted by these courts to support the determination that an undersecured lien should not be voided against property under § 506(d). These are: (1) property abandoned by the trustee under 11 U.S.C. § 554 is not "property in which the estate has an interest" under the language of § 506(a) and as a result no portion of the lien may be voided under § 506(d); (2) allowing a lien to be voided inequitably gives debtors more in Chapter 7 than debtors receive in reorganization chapters; and (3) allowing a lien to be voided under § 506(d) renders 11 U.S.C. § 722 redundant; this section provides that a debtor has the right to redeem personal property but not real property. *In re Dewsnup,* 908 F.2d at 589-90.

55. 11 U.S.C. § 554 provides that "the trustee may abandon any property of the estate that is burdensome to the estate or that is of inconsequential value and benefit to the estate." *Id.* The abandonment of property of the estate by the debtor provides for the revestment of the asset with the debtor.

56. *Dewsnup,* 112 S. Ct. of 778.
the secured creditor would lose the benefit of any increase in the value of the collateral that may occur prior to foreclosure. In that circumstance, any increase in value would accrue to the benefit of the debtor and constitute a windfall. Explaining, the Court stated: "[a]ny increase over the judicially determined valuation during bankruptcy rightly accrues to the benefit of the creditor, not to the benefit of the debtor and not to the benefit of other unsecured creditors whose claims have been allowed and who had nothing to do with the mortgagor-mortgagee bargain."

In addition, because section 506(d) may have other applications in different fact patterns, the Court concluded that its holding should be limited to the facts currently before it.

The Court’s decision in Dewsnup affirmed In re Hargrove, a Virginia federal district court decision. In Hargrove, the district court reversed the bankruptcy court's decision and found that section 506(d) did not allow for the voidance of the undersecured portion of a lien against abandoned real estate. To support its ruling, the Court cited a similar finding by a Virginia bankruptcy court in In re Maitland. Although the Dewsnup Court relied on different grounds for its decision, the Court’s holding is in accord with the Hargrove and Maitland rulings.

Assuming the Dewsnup decision is limited to its particular facts, the case will not greatly alter existing bankruptcy law. However, because of the broad language used and the basis upon which the Court made its decision, this case could potentially affect other Bankruptcy Code provisions. For instance, the term “allowed secured claim” is referred to in several provisions of the Bankruptcy

57. Id.
58. Id. Specifically, the court stated that
[hypothetical applications that come to mind and those advanced at oral argument illustrate the difficulty of interpreting the statute [11 U.S.C. § 506(d)] in a single opinion that would apply to all possible factual situations. We therefore focus upon the case before us and allow other facts to await a legal resolution on another day.

Id.
61. In Hargrove and Maitland, the courts relied on the three traditional reasons asserted by courts for limiting the application of § 506(d). See supra note 54. In Dewsnup, the U.S. Supreme Court instead relied on the meaning of the term “allowed secured claim” contained in § 506(d). The Court found that this term was not intended to refer to § 506(a), which provides that an allowed claim is a secured claim to the extent of the value of the creditor’s interest in the property. Dewsnup, 112 S. Ct. at 778. An allowed secured claim is not governed by the bifurcation provisions of § 506(a); instead, the allowance of claims provision of § 502 of the Bankruptcy Code is controlling. Id.
Code. If *Dewsnup* is interpreted as defining this term as it applies to all Code provisions, the effect of the decision may be of greater consequence.

D. **Avoidance of Judicial Liens**

Section 522(f) of the Bankruptcy Code provides that a debtor may avoid a judicial lien on property to the extent that the "lien impairs an exemption to which the debtor would have been entitled." Section 522(b) of the Bankruptcy Code further authorizes individual debtors to exempt certain property interests from the bankruptcy estate. This section allows a state to "opt out" of the federal bankruptcy exemptions and to adopt separate exemptions. Virginia has "opted out" pursuant to this provision.

Two recent Virginia bankruptcy court decisions have interpreted the provisions of section 522(f) to determine whether, in order to avoid a judicial lien, an exemption must have been claimed by the debtor. In *In re Wall* and *In re Tarpley*, the respective bankruptcy courts determined that section 522(f) could not be used to avoid a judicial lien which impaired an exemption that the debtor had not properly claimed. In *Wall*, the debtor moved to avoid a judgment lien against his residence on the basis that it impaired a homestead exemption he was entitled to claim. Because the debtor failed to claim the homestead exemption within the appropriate time, the court had to determine whether the debtor could avoid liens on property not properly claimed as exempt.

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64. *Id.* § 522(b).
65. *Id.* § 522(b)(1).
68. *In re Wall*, 127 B.R. at 355-56.
69. *In re Tarpley*, 123 B.R. at 744.
70. The homestead exemption is one of the primary exemptions available to debtors in Virginia. The exemption grants a debtor the right to claim as exempt any property, real or personal, up to $5,000.00 in value. *Va. Code Ann.* § 34-4 (Repl. Vol. 1990).
71. The homestead exemption must be claimed "on or before the fifth day after the date initially set for the meeting of creditors." *Id.* § 34-17.
Although the court recognized that "on its face § 522(f) might be construed not to require that the exemption actually be taken," it ruled that a lien cannot be avoided in such instances. The court found that the purpose behind section 522(f) is to promote the fresh start policy of the Bankruptcy Code. This policy would not be furthered by debtors avoiding liens on property that is not properly claimed to be exempt in bankruptcy. Similarly, the court in Tarpley concluded that Chapter 13 debtors also must properly claim exemptions before they may avoid judgment liens against their property.

III. Objections to the Dischargeability of Debts

Several recent decisions have addressed whether a debtor is entitled to a discharge of debts in connection with his bankruptcy case. Two Virginia bankruptcy courts examined whether a divorce decree creates an obligation of the debtor that is in the nature of "alimony, maintenance, or support" so that the debt would not be discharged in bankruptcy. In both In re Welborn and In re Ferbee, the courts relied on the Fourth Circuit Court of Appeals' decision in Melichar v. Ost. Both bankruptcy courts determined that the parties' intention to treat payments due under a divorce decree as "alimony, maintenance, or support" rather than as a property settlement controlled whether the debts were dischargeable.

73. Id. at 355-56.
74. Id.
75. In re Tarpley, 123 B.R. at 744.
76. Section 523(a)(5) of the Bankruptcy Code provides, in pertinent part, that an individual debtor is not discharged of any debt:

   (5) to a spouse, former spouse, or child of the debtor, for alimony to, maintenance for, or support of such spouse or child, in connection with a separation agreement, divorce decree or other order of a court of record, determination made in accordance with State or territorial law by a governmental unit, or property settlement agreement, but not to the extent that —

   (B) such debt includes a liability designated as alimony, maintenance, or support, unless such liability is actually in the nature of alimony, maintenance, or support.

79. 661 F.2d 300 (4th Cir. 1981).
80. In Welborn, the bankruptcy court stated that "[t]he Fourth Circuit has made clear that '[t]he proper test of whether the payments are alimony lies in proof of whether it was
In *Welborn*, the bankruptcy court found that it was not the mutual intent of both spouses to treat an indemnification provision contained in their divorce settlement agreement as “alimony, maintenance, or support.” In *Ferebee*, on the other hand, the court concluded that the characterization used by the parties in the settlement agreement was highly probative of the parties’ mutual intent to treat the obligations in the agreement as “alimony, maintenance, or support.” As a result, the *Ferebee* court found that the debtor spouse’s obligation was not dischargeable. A comparison of the two decisions illustrates the importance of drafting divorce settlement agreements that clearly indicate the parties’ intentions to treat obligations as “alimony, maintenance, or support,” and not as a property settlement.

In *Hudgins v. Davidson*, a Virginia federal district court addressed whether a Chapter 7 trustee was barred from bringing an action to revoke a debtor’s discharge under the doctrine of res judicata on the basis that a creditor had already sought to raise similar grounds in connection with an action to deny the debtor a discharge. The creditor had filed a complaint objecting to the debtor’s discharge on the grounds of debtor fraud and misrepresentation of assets. The bankruptcy court found in favor of the debtor and granted a discharge. Subsequently, the Chapter 7 trustee filed a complaint to revoke the discharge.

The court, in addressing whether the doctrine of res judicata precluded the trustee’s action, analyzed whether the creditor and the trustee were in privity in the case. The court noted that “privity exists for purposes of res judicata where two parties represent the interests of the same entity, and this relationship may exist

the intention of the parties that the payments be for support rather than as a property settlement.” In re *Welborn*, 126 B.R. at 950 (quoting *Melichar*, 661 F.2d at 303).

81. Id. at 950-51. (“[T]he intent of the parties to that agreement is determinative of whether the obligation is in the nature of alimony, maintenance or support.”).


84. Id. at 7. In the complaint brought by the creditor objecting to the debtor’s discharge, the creditor had moved to amend his complaint to allege additional grounds of fraud. The bankruptcy court denied the creditor’s request and the case proceeded to trial. The trustee, in its complaint to revoke the debtor’s discharge, alleged essentially the same facts that the bankruptcy court had precluded the creditor from raising in his complaint. Id. As a result, the facts asserted by the trustee had not previously been considered by the bankruptcy court. The court determined that the doctrine of res judicata prohibits not only the relitigation of issues actually decided previously, but also the relitigation of matters which could have been presented for determination where the same parties or their privies are involved. Id. at 8.
between a creditor and a trustee in some cases. In this instance, however, the district court found that the creditor was acting mainly, if not completely, in his individual capacity and that the trustee was not in privity with the creditor.

As a result, the court held that the remaining creditors’ interests, which were being represented by the trustee with respect to the complaint to revoke discharge, should not be affected by the prior action brought by a single creditor. The district court found that the doctrine of res judicata did not apply and allowed the trustee’s action to proceed. The court, however, reserved ruling on whether the principles of res judicata would affect the creditor’s entitlement to any benefit from the trustee’s efforts to revoke the debtor’s discharge in the event the trustee was successful.

IV. Property Exemptions

Several recent decisions have determined a debtor’s rights regarding property exemptions in bankruptcy. In Wissman v. Pittsburgh National Bank, the Fourth Circuit Court of Appeals held that a debtor’s property can be exempt from the estate without abandonment of the property by the trustee. In Wissman, the debtor claimed as exempt a cause of action against a creditor bank arising out of the bank’s foreclosure on certain collateral. A timely objection to the debtor’s exemption was not filed and the debtor proceeded in federal district court to enforce its claim. The district court granted the bank’s motion to dismiss on the basis that, under the Bankruptcy Code, formal abandonment of the cause of action by the trustee was necessary for the debtor to be entitled to raise the cause of action. However, the Fourth Circuit reversed the district court’s decision and found the abandonment of property by

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85. Id. at 8.
86. Id. The court stated that
   [i]t cannot be said in this case that the trustee had an opportunity to litigate this claim previously, nor that the interests of all creditors were represented by a single creditor’s suit to deny discharge. Therefore, the court finds that identity of the parties has not been established, and the claim of the trustee is not precluded by the doctrine of res judicata.

87. Id. at 9.
88. See also text accompanying notes 65-69.
89. 942 F.2d 867 (4th Cir. 1991).
90. Id. at 869-70.
91. See supra note 55.
the trustee not to be a prerequisite to the debtor's enforcement of a properly claimed exemption where no objection had been raised.92

Although the debtor properly claimed the exemption of the cause of action against the bank, no value of the debtor's interest was asserted. Because a statutory limitation existed on the amount that could be exempt, the court found that the debtor's exemption could not exceed the statutory limit. The Fourth Circuit did find that, in order for the debtor to receive an amount in excess of the statutory limit, the trustee would have to first abandon his interest in the claim.93

In In re Spraker,94 a debtor sought to exempt certain shares of stock in a corporation and interests in a partnership from his bankruptcy estate under Virginia's homestead exemption. The Chapter 7 trustee objected to the debtor's exemption on the basis that the trustee had received an offer to purchase all of the debtor's shares of stock and partnership interests. The bankruptcy court held that the debtor was not entitled to exempt only a portion of the stock or partnership interest. Instead, the debtor could be required to accept a cash payment in place of retaining a portion of the stock or partnership interests.95

To support its decision, the bankruptcy court relied on the Virginia Supreme Court's ruling in Hawpe v. Bumgardner.96 In Hawpe, the court found that a special commissioner could sell real estate subject to an individual's homestead exemption and satisfy the exemption from any proceeds remaining after all superior liens were satisfied.97 The Spraker court stated that "[t]he Hawpe deci-

92. 942 F.2d at 869.
93. Id. at 872. Based on the United States Supreme Court's more recent ruling in Taylor v. Freeland & Kronz, 112 S. Ct. 1644 (1992), it would appear that the debtor would be entitled to receive an amount in excess of the statutory limit of the exemption, even if the claim was not abandoned, if the debtor had exempted the full amount of the claim. In Taylor the Supreme Court held that where an objection to an exemption has not been filed within the period prescribed by Fed. R. BANKR P. 4003(b), an amount in excess of the statutory limit can be exempted from the bankruptcy estate even though the debtor had no colorable basis for claiming the excess amount as exempt. Id. at 1647-48.
95. Id. at 728. Virginia's homestead exemption provides that "[e]very householder shall be entitled . . . to hold exempt from creditor process arising out of a debt, real and personal property, or either, to be selected by the householder, including money and debts due the householder not exceeding $5,000.00 in value." VA. CODE ANN. § 34-4 (Repl. Vol. 1988).
96. 103 Va. R. 91, 48 S.E. 554 (1904).
97. Id. at 97, 48 S.E. at 556-57.
sion holds that a debtor's property may be sold and the homestead paid in cash rather than in kind." It is unclear from the facts in Spraker, however, if the court gave any consideration to the Chapter 7 trustee's ability to sell only that portion of the stock or partnership interests that exceeds the debtor's homestead exemption.