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# THE IMMOVABLE OBJECT VERSUS THE IRRESISTIBLE FORCE: RETHINKING THE RELATIONSHIP BETWEEN SECURED CREDIT AND BANKRUPTCY POLICY

*Lawrence Ponoroff\**  
and *F. Stephen Knippenberg\*\**

*And then, with the coming of the night the north wind was again loosed, while the rain still beat against the windows and pattered down from the low Dutch eaves.*

*When it was light enough Johnsy, the merciless, commanded that the shade be raised.*

*The ivy leaf was still there.*

— O. Henry<sup>1</sup>

## INTRODUCTION

The last leaf in O. Henry's classic short story was hanging by a delicate thread, but it never fell. It never fell, of course, because it wasn't real; Old Behrman had painted it (and caught pneumonia for his trouble) in order to give Johnsy the will to live. The Supreme Court's decision in *Dewsnup v. Timm*<sup>2</sup> is also hanging by a thread, following a barrage of scholarly criticism and more than four years of limiting case law and legislative incursions on the case's core conceptual rationale. But the holding in *Dewsnup*, unlike the last leaf, is very real. It has had, and continues to have, a deleterious effect on the ability of many individual debtors to obtain meaningful relief and a truly "fresh start" in bankruptcy.

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\*\* Professor of Law, University of Oklahoma Law Center. J.D. 1980, University of Tulsa; LL.M. 1987, Temple. — Ed. We would like to thank Professor Margaret Howard for her thoughtful comments and suggestions on an earlier draft of this article. Professor Howard has been the most vocal and certainly the most articulate critic of the Supreme Court's decision in *Dewsnup v. Timm*, 502 U.S. 410 (1992). Therefore, while we do not by any means intend to imply her concurrence with either the approach taken or all of the ideas expressed by us in this article, her input was particularly welcome and appropriate.

1. O. HENRY, *The Last Leaf*, in *THE BEST SHORT STORIES OF O. HENRY* 308, 313-14 (1994).

2. 502 U.S. 410 (1992).

This article urges Congress, as it considers the recommendations of the National Bankruptcy Review Commission,<sup>3</sup> to sever the last thread and consign the Supreme Court's 1992 decision to its rightful role as a historical anomaly. In taking this action, Congress could clarify once and for all the nature and status of security and secured claims in bankruptcy.<sup>4</sup> The advantages to be attained from doing so are considerable, not the least of which includes establishing the contours of the fresh start for individual debtors in chapter 7 in a manner that raises fresh-start policy to a level of dignity commensurate with the policy of efficient debt collection.<sup>5</sup>

The treatment of secured claims in bankruptcy, and, in particular, partially secured claims, has been a controversial subject<sup>6</sup> since

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3. The National Bankruptcy Review Commission Act, Pub. L. No. 103-394, tit. VI, §§ 601-610, 108 Stat. 4147 (1994), established the National Bankruptcy Review Commission to "investigate and study issues and problems relating to title 11 [of the] United States Code." National Bankruptcy Review Commission Act, Pub. L. No. 103-394, tit. VI, § 603(1), 108 Stat. 4147, 4147-48 (1994). The Commission is also directed to prepare and submit a report not later than two years after the date of its first meeting containing a detailed statement of its findings and conclusions, and to make recommendations to Congress, the Chief Justice, and the President for appropriate legislative or administrative action. See National Bankruptcy Review Commission Act, Pub. L. No. 103-394, tit. VI, §§ 603(3), 608, 108 Stat. 4147, 4147, 4149 (1994). The Commission, whose final report is due in October, 1997, has recommended that debtors in chapter 13 cases be permitted to strip down undersecured second mortgage residential loans, but has taken no action to repeal *Dewsnup*. See Bankruptcy Review Commn., Summary of Consumer Bankruptcy Framework Proposals #11-12 (June 10, 1997 draft) (forthcoming October, 1997, on file with authors). The National Bankruptcy Review Commission Act is part of the larger Bankruptcy Reform Act of 1994, Pub. L. No. 103-394, 108 Stat. 4106 (codified as amended in scattered sections of 11 U.S.C., 12 U.S.C., 18 U.S.C., and 28 U.S.C., which we will refer to in the remainder of this article as the "1994 Amendments." The current law of bankruptcy is found in title 11 of the United States Code. See 11 U.S.C. §§ 101-1330 (1994). Its foundation is the Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (effective Oct. 1, 1979) (codified as amended at 11 U.S.C. §§ 101-1330 (1994)). The Bankruptcy Reform Act of 1978, as amended, is commonly referred to as the "Bankruptcy Code" or the "Code," a convention that is followed in this work, such that references to the "Bankruptcy Code" or the "Code" are to title 11 of the United States Code as amended through October 22, 1994, the effective date of the 1994 Amendments. See Bankruptcy Reform Act of 1994, Pub. L. No. 103-394, § 702, 108 Stat. 4106, 4150 (establishing the effective date of the 1994 Amendments).

4. Defining the rights of secured creditors in bankruptcy has proved to be an ongoing challenge for bankruptcy theorists. See generally Margaret Howard, *Secured Claims in Bankruptcy: An Essay on Missing the Point*, 23 CAP. U. L. REV. 313, 313 (1994) (noting that despite the passage of 16 years, we are still "groping for answers to a basic question that should have been laid to rest long ago — what, exactly, are the rights of secured creditors in bankruptcy?"); Mary Josephine Newborn, *Undersecured Creditors in Bankruptcy: Dewsnup, Nobelman, and the Decline of Priority*, 25 ARIZ. ST. L.J. 547, 573-81 (1993) (comparing the treatment of secured claims under the former Bankruptcy Act and the Code).

5. Parting company with early Anglo-American law, which regarded bankruptcy solely as a creditors' collection remedy, the Code identified collective distribution as only one of its two major functions, the other being to ensure a generous fresh start for the bankrupt debtor. See Charles G. Hallinan, *The 'Fresh Start' Policy in Consumer Bankruptcy: A Historical Inventory and an Interpretive Theory*, 21 U. RICH. L. REV. 49, 85-86 (1986) (describing the Code's assurance of a fresh start).

6. See generally David Gray Carlson, *Secured Creditors and the Eely Character of Bankruptcy Valuations*, 41 AM. U. L. REV. 63 (1991) [hereinafter Carlson, *Eely Character*];

the enactment of the current Bankruptcy Code in 1979.<sup>7</sup> For example, a fundamental tension has always existed between the state-law rules — which facilitate a single creditor's ability to fence off all of the debtor's existing and after-acquired property — and bankruptcy's fresh-start and rehabilitative policies.<sup>8</sup> Nevertheless, the combination of contemporary scholarship examining the purposes of secured credit<sup>9</sup> and nearly ten years of case law devoted to working through the Code's approach to secured and unsecured claims<sup>10</sup> demonstrate that *Dewsnup* was more than just another manifestation of that traditional tension. As we argue in this article, *Dewsnup* was not only a historical anomaly in terms of the Supreme Court's established methodology in its approach to bankruptcy

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David Gray Carlson, *Undersecured Claims Under Bankruptcy Code Sections 506(a) and 1111(b): Second Looks at Judicial Valuations of Collateral*, 6 BANKR. DEVS. J. 253 (1989); [hereinafter Carlson, *Undersecured Claims*]; Theodore Eisenberg, *The Undersecured Creditor in Reorganizations and the Nature of Security*, 38 VAND. L. REV. 931 (1985). The question that lies at the bottom of the controversy about treatment of partially secured claims in bankruptcy may be stated as follows: What rights, if any, beyond those of a general unsecured creditor, does a partially secured creditor enjoy with respect to the judicially established unsecured portion of its claim (that portion in excess of the judicially determined value of the collateral securing the claim)? Resolution of that issue implicates certain unresolved tensions between the state-law rules and policies governing asset-based financing, on the one hand, and the fresh start and rehabilitative policies that animate, respectively, the consumer and business provisions of the Federal Bankruptcy Code, on the other.

7. As discussed *supra* note 3, the foundation of the current law of bankruptcy is the Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (effective Oct. 1, 1979) (codified as amended at 11 U.S.C. §§ 101-1330 (1994)).

8. See *infra* text accompanying notes 107-23. See generally Steve H. Nickles, *Consider Process Before Substance, Commercial Law Consequences of the Bankruptcy System: Urging the Merger of the Article 9 Drafting Committee and the Bankruptcy Commission*, 69 AM. BANKR. L.J. 589 (1995) (discussing the inherent tension between bankruptcy policy and state commercial law).

9. While there is a long history to academic attempts at normative justification of secured financing, going back in the legal literature to Thomas H. Jackson & Anthony T. Kronman, *Secured Financing and Priorities Among Creditors*, 88 YALE L.J. 1143 (1979), the most recent collection of work on the subject is the *Virginia Law Review's* Symposium, *Revision of Article 9 of the Uniform Commercial Code*, 80 VA. L. REV. 1783 (1994). See *infra* Part III.

10. The first major crucible in this respect was the Supreme Court's decision holding that undersecured creditors are not, as part of the adequate protection of their interests, entitled to postpetition interest. See *United Sav. Assn. v. Timbers of Inwood Forest Assocs. (In re Timbers of Inwood Forest Assocs.)*, 484 U.S. 365 (1988); David Gray Carlson, *Bifurcation of Undersecured Claims in Bankruptcy*, 70 AM. BANKR. L.J. 1, 7-9 (1996); *infra* note 136.

cases,<sup>11</sup> but also an untenable exception in the ever-more-clearly emerging course of bankruptcy jurisprudence under the Code.<sup>12</sup>

11. With the exception of its decision in *Dewsnup*, and to a lesser extent its recent decision in *Field v. Mans*, 116 S. Ct. 437 (1995) (concerning the reliance element of 11 U.S.C. § 523(a)(2)(A) (1994)), the Rehnquist Court has followed a strict statutory-construction approach in deciding bankruptcy issues. Several good articles exist exploring the Supreme Court's contemporary bankruptcy jurisprudence. See, e.g., Carlos J. Cuevas, *The Rehnquist Court, Strict Statutory Construction and the Bankruptcy Code*, 42 CLEV. ST. L. REV. 435 (1994); Walter A. Effross, *Grammarians at the Gate: The Rehnquist Court's Evolving "Plain Meaning" Approach to Bankruptcy Jurisprudence*, 23 SETON HALL L. REV. 1636 (1993); Thomas G. Kelch, *An Apology for Plain-Meaning Interpretation of the Bankruptcy Code*, 10 BANKR. DEV. J. 289 (1994); Robert M. Lawless, *Legisprudence Through a Bankruptcy Lens: A Study of the Supreme Court's Bankruptcy Cases*, 47 SYRACUSE L. REV. 1 (1996); Robert K. Rasmussen, *A Study of the Costs and Benefits of Textualism: The Supreme Court's Bankruptcy Cases*, 71 WASH. U. L.Q. 535 (1993); Charles Jordan Tabb & Robert M. Lawless, *Of Commas, Gerunds, and Conjunctions: The Bankruptcy Jurisprudence of the Rehnquist Court*, 42 SYRACUSE L. REV. 823 (1991); see also Adam J. Wiensch, Note, *The Supreme Court, Textualism, and the Treatment of Pre-Bankruptcy Code Law*, 79 GEO. L.J. 1831 (1991) (arguing that the Court's consistent textualist approach to bankruptcy law under the Code is best explained as a product of the comprehensiveness of the Code as compared with earlier bankruptcy law, the importance of commercial certainty, and the Court's general hostility toward the equitable powers of bankruptcy courts).

12. The Supreme Court in *Dewsnup* narrowly limited the precedential value of its holding to the facts of the case, including, specifically, the fact that the matter involved a liquidation proceeding under chapter 7. See *Dewsnup*, 502 U.S. at 416-17. After a period of some uncertainty, there is now a growing consensus accepting the logic of the position that *Dewsnup* has no applicability in reorganization proceedings under chapter 11 or 13. See *Wade v. Bradford*, 39 F.3d 1126 (10th Cir. 1994) (asserting that *Dewsnup* could not be imported into chapter 11 without eviscerating other key provisions and the principles of the reorganization chapter). Compare *Taffi v. United States (In re Taffi)*, 144 B.R. 105, 113-15 (Bankr. C.D. Cal. 1992) (prohibiting avoidance of undersecured tax lien in a chapter 11 case), *revd. on other grounds*, Nos. CV 92-6665 MRP, CV 93-1800 MRP, 1993 WL 558844 (C.D. Cal. Oct. 9, 1993), *modified*, 68 F.3d 306 (9th Cir. 1995), *affd. on reh.*, 96 F.3d 1190 (9th Cir. 1996), *petition for cert. filed*, 65 U.S.L.W. 3433 (U.S. Oct. 31, 1996) (No. 96-881) with *Dever v. IRS (In re Dever)*, 164 B.R. 132, 137-39 (Bankr. C.D. Cal. 1994) (arguing that *Dewsnup* makes no sense in the reorganization context). While residential lenders are given special protection against bifurcation of their claims by virtue of 11 U.S.C. § 1322(b)(2) (1994), lien stripping is also permissible in chapter 13 cases. See, e.g., *Bank One, Chicago, N.A. v. Flowers*, 183 B.R. 509 (N.D. Ill. 1995) (holding that *Dewsnup* does not extend to chapter 13 cases). In *Nobelman v. American Savings Bank*, 508 U.S. 324 (1993), the Supreme Court prohibited strip down of a mortgage on the debtor's principal residence, but its holding was based solely on § 1322(b)(2), implicitly suggesting that strip down is otherwise permitted in chapter 13. Several decisions since *Nobelman* have made the implication explicit. See, e.g., *Howard v. National Westminster Bank (In re Howard)*, 184 B.R. 644 (Bankr. E.D.N.Y. 1995) (allowing strip down of a wholly unsecured judicial lien against the debtor's residence in a chapter 7 case, and concluding that *Dewsnup* did not apply because the lien was nonconsensual and therefore the parties had never bargained to secure the debt with a lien on the property). In *In re Barrett*, 188 B.R. 285 (Bankr. D. Or. 1995), the court, in permitting bifurcation of the creditor's claim into secured and unsecured portions, acknowledged that *Nobelman's* prohibition against strip down rested solely on the special rule in § 1322(b)(2) for creditors secured only by property that was the debtor's personal residence. Moreover, § 1322(c)(2), which was enacted as part of the 1994 Amendments, overrules *Nobelman* to the extent the mortgage falls due during the life of the plan. See *In re Young*, 199 B.R. 643 (Bankr. E.D. Tenn. 1996); see also *Harmon v. United States*, 101 F.3d 574 (8th Cir. 1996) (holding that neither *Dewsnup* nor *Nobelman* operate to limit interpretation of the term "allowed secured claim" in § 1225(a)(5) to the lesser of the amount of the debt or the value of the collateral). Finally, some courts have taken the view that *Nobelman* does not prohibit "strip off" of a claim served by a mortgage that is entirely, as opposed to only partially, unsecured. Compare *In re Geyer*, 203 B.R. 726, 728-29 (Bankr. S.D. Cal. 1996) (holding that wholly unsecured lien may

We begin in Part I by examining the *Dewsnup* holding in the context of contemporaneous legislative and judicial developments relating to the treatment of undersecured claims in bankruptcy. In Part II, we evaluate, and find unconvincing, the most recent apology for the outcome in *Dewsnup*. We conclude from this that *Dewsnup* must to a considerable degree be understood as the product of certain imaginative conceptions about the nature of secured credit. This leads us in Part III to review the most recent positions advanced in the now nearly twenty-year-old debate over the efficiency of secured financing. Our examination reveals that scholars, whether writing from an economics-driven perspective on the law or not, are increasingly reaching the conclusion that secured credit as an institution, and its derivative rule of full priority for secured claims upon insolvency, does not in fact promote systemic efficiency. Nevertheless, the law in this area continues to be guided by the precepts of freedom of contract and free alienability of property rights.<sup>13</sup> It is that normative justification for secured credit — premised on the same principles of party autonomy that form the philosophical underpinnings of both contract and property law — that presents the most serious challenge for the position we advance in this paper.

In Part IV, therefore, we examine this “conveyance model” of the security interest in the bankruptcy setting and find that it fails to account adequately for certain unique but fundamental bankruptcy policies, including, in consumer cases, the fresh-start policy. This leads us to the conclusion that, notwithstanding the utility of a property-based understanding of security interests in a variety of other contexts, what is called for in the bankruptcy context is an alternative to the conceptualization of the secured claim as “property.” Part V examines recent work in the cognitive sciences on which such an alternative conceptualization might be built. That work has revealed that abstract concepts, such as legal concepts, are understood metaphorically. The principal insight of that learning, that concepts are not direct reflections of some external reality independent of the reasoner, has important ramifications for legal analysis and legal reform. The significance of that insight is nowhere better demonstrated than in the context of the topic at

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be “stripped off”) with *Barnes v. American Gen. Fin.* (*In re Barnes*), 207 B.R. 588, 592-93 (Bankr. N.D. Ill. 1997) (ruling that “strip off” is precluded under § 1322(b)(2) and *Nobelman*).

13. See generally Steven L. Harris & Charles W. Mooney, Jr., *A Property-Based Theory of Security Interests: Taking Debtors' Choices Seriously*, 80 VA. L. REV. 2021, 2047-53 (1994).

hand, the way in which we have come to conceptualize secured credit.

Finally, having unpacked the metaphors by which our thinking about security has been both advanced and constrained, in Part VI we critique the metaphor that implicitly dictated the result in *Dewsnup*. We then offer, and consider the practical applications of, an alternative characterization of security interests in bankruptcy that conceptualizes the security interest as a claim to property, rather than as an indefeasible right in the property itself.

## I. AVOIDANCE OF UNDERSECURED CLAIMS IN BANKRUPTCY

Consider as a starting point for discussion a chapter 7 debtor with a homestead exemption of \$15,000 and a residence valued at \$120,000. Assume this property is subject to, in order of priority, a \$100,000 nonavoidable first mortgage, a \$15,000 judicial lien, and a \$20,000 nonavoidable second mortgage. Section 522(f)(1)(A) of the Bankruptcy Code authorizes the debtor to avoid the fixing of the lien on the debtor's property to the extent that such lien impairs an exemption to which the debtor would otherwise have been entitled.<sup>14</sup> Section 522(f)(2)(A), added to the Code by the 1994 Amendments, now defines *impairment*<sup>15</sup> to make it clear that the entire judicial lien impairs the exemption and, therefore, may be set aside *in toto*.<sup>16</sup> By focusing on the dollar amount of liens against

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14. See, e.g., *Farrey v. Sanderfoot*, 500 U.S. 291 (1991); *Owen v. Owen*, 500 U.S. 305 (1991).

15. Section 303 of the 1994 Amendments adopts a simple mathematical calculation for determining the extent to which a lien impairs an exemption. See Bankruptcy Reform Act of 1994, Pub. L. No. 103-394, § 303, 108 Stat. 4106, 4132 (codified as amended at 11 U.S.C. § 522(f)(2) (1994)). Specifically, a lien is deemed to impair to the extent that the sum of (i) the lien, (ii) all other liens against the property, and (iii) the amount of the exemption that the debtor could claim if there were no liens against the property, exceeds the value that the debtor's interest in the property would have in the absence of any liens — *i.e.*, the fair market value of the debtor's interest. Under 11 U.S.C. § 522(f)(2)(B) (1994), in the case of property subject to more than one lien, a lien previously avoided is to be excluded from the calculation under subparagraph (A). The effect of this formulation is to permit avoidance of the "unsecured" portion of a judicial lien, regardless of whether the debtor has any equity in the property over and above the sum of the nonavoidable consensual liens.

16. On the facts of the hypothetical, the calculation would go as follows: (i) \$15,000 plus (ii) \$120,000 plus (iii) 15,000 = \$150,000 minus \$120,000 = \$30,000. Since the lien is less than the amount of the impairment, it would be avoidable in its entirety. See *Jones v. Mellon Bank, N.A.* (*In re Jones*), 183 B.R. 93 (Bankr. W.D. Pa. 1995) (avoiding entire judicial lien in the amount of \$10,954.29, even though debtor's equity in her personal residence was equal to exactly the amount of the applicable homestead exemption, \$7,500.00); *In re Thomsen*, 181 B.R. 1013 (Bankr. M.D. Ga. 1995) (avoiding \$60,000 judgment lien where it was stipulated that property had a value of either less than the first mortgage, or less than the sum of the first mortgage and the debtor's \$10,800 statutory homestead claim). But see *In re Seltzer*, 185 B.R. 116 (Bankr. E.D.N.Y. 1995) (holding that because, under New York law, a debtor is not entitled to a homestead exemption unless there is equity in the property, where consensual liens exceed the value of the property any subsequent judicial liens do not impair an exemp-

the property and the value of the exemption, the new statutory formula for measuring impairment effectively overrules those cases that refused to permit avoidance unless there was an execution pending on the lien at the time the bankruptcy was filed.<sup>17</sup> It also negates the continuing viability of those decisions holding that there can be no impairment where state law requires a minimum bid equal to the amount of the homestead exemption in order for a forced sale to be valid.<sup>18</sup>

Because of the existence of the unavoidable second mortgage, however, the above scenario presents another interpretational issue that is not resolved by the text of the 1994 Amendments to the Code.<sup>19</sup> Unless the benefit of the avoidance is preserved for the debtor, it inures entirely to the junior mortgagee.<sup>20</sup> This raises the

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tion and, thus, are not voidable under 11 U.S.C. § 522(f)). The legislative history to the 1994 Amendments indicates that in adopting the new definition of impairment, Congress essentially intended to adopt the formula set forth in *In re Brantz*, 106 B.R. 62, 68 (Bankr. E.D. Pa. 1989), in which the court concluded that a debtor could avoid all judicial liens in excess of the amount produced by subtracting from the fair market value of the property the sum of all nonavoidable liens and the debtor's allowable exemption. See H.R. REP. NO. 103-835, at 52-54 (1994), reprinted in 1994 U.S.C.C.A.N. 3340, 3361-63. Codification of the *Brantz* interpretation of § 522(f) represents a rejection of the pre-1994 Amendment approach, which several courts of appeals had taken, of avoiding a judicial lien only to the extent that the lien "impaired" the exemption, as measured by the debtor's equity in the property or the amount of the exemption, whichever was less. See authorities cited *infra* note 22. For further elaboration of this view and its application, see 2 DAVID G. EPSTEIN ET AL., *BANKRUPTCY* § 8-28, at 560-67 (1992).

17. See *In re Lynch*, 187 B.R. 536 (Bankr. E.D. Ky.) (exposing the fallacy, in light of the 1994 Amendments, in the Sixth Circuit's reasoning in *Resolution Trust Corp. v. Moreland (In re Moreland)*, 21 F.3d 102 (6th Cir. 1994) (holding that no homestead exemption exists unless execution sale is pending), cert. denied, 513 U.S. 956 (1995)). For additional discussion of the operation of the new definition of "impairment," see David Gray Carlson, *Security Interests on Exempt Property After the 1994 Amendments to the Bankruptcy Code*, 4 AM. BANKR. INST. L. REV. 57, 64-69 (1996); Margaret Howard, *Avoiding Powers and the 1994 Amendments to the Bankruptcy Code*, 69 AM. BANKR. L.J. 259, 268-77 (1995); Scott Everett, Comment, *Debtors' Delight? Bankruptcy Reform Act of 1994: How Revisions to 11 U.S.C. § 522(f) Affect Debtors' Ability to Avoid Liens Which Impair Texas Personal Property Exemptions*, 26 TEX. TECH L. REV. 1331 (1995).

18. See *In re Allard*, 196 B.R. 402, 410-11 (Bankr. N.D. Ill.) (rejecting as irrelevant after the 1994 Amendments the reasoning of the court in *In re Harrison*, 164 B.R. 611 (Bankr. N.D. Ill. 1994), to the effect that because the homestead exemption amount must be paid off as part of valid forced sale, judicial lien could not impair the exemption), *affd. sub nom. Great S. Co. v. Allard*, 202 B.R. 938 (N.D. Ill. 1996).

19. *But see infra* note 20 (referring to the legislative history that does address this issue but that, unfortunately, did not find its way into the text of the statute itself).

20. Some courts and commentators resolve the issue by taking the position that the fresh-start objectives of § 522 are thwarted by an approach that permits junior lienors, rather than the debtor, to benefit when an exemption-impairing lien is avoided. See *Losieniecki v. Thrift Consumer Discount Co. (In re Losieniecki)*, 17 B.R. 136, 139-40 (Bankr. W.D. Pa. 1981); 2 EPSTEIN ET AL., *supra* note 16, § 8-28, at 566 (relying as well on the trustee's power under § 549(a) to set aside postpetition transfers); John T. Cross, *The Application of Section 522(f) of the Bankruptcy Code in Cases Involving Multiple Liens*, 6 BANKR. DEV. J. 309, 333-35 (1989); Margaret Howard, *Multiple Judicial Liens in Bankruptcy: Section 522(f)(1) Simplified*, 67 AM. BANKR. L.J. 151, 180-84 (1993).



question of whether the junior unavoidable lien simply fills the vacuum created by the avoidance of the judicial lien or whether the concept of preservation of avoided liens for the benefit of the estate under 11 U.S.C. § 551 can be imported into 11 U.S.C. § 522(f) in order to allow the debtor to rely on section 522(i)(2) to claim an exemption out of the avoided lien. Permitting the junior lien to claim the priority formerly occupied by the avoided judicial lien might be defended as corresponding more or less with the result under state law.<sup>21</sup> Furthermore, there is an arguable theoretical benefit to the debtor attendant to the avoidance of the judicial lien, even if the nonavoidable junior lien is not subordinated to the exemption.<sup>22</sup> In the final analysis, however, it is a result that serves

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For examples of decisions concluding that the junior consensual liens are not altered by the elimination of the judicial lien, with the result that they simply move up in priority as a result of the avoidance, see *Simonson v. First Bank (In re Simonson)*, 758 F.2d 103 (3d Cir. 1985) (refusing to construe § 522(g) to allow the debtor to improve its position at the expense of the holder of a nonavoidable lien); *Kenpack Converters, Inc. v. Patterson (In re Patterson)*, 139 B.R. 229, 231 (Bankr. 9th Cir. 1992). The 1994 amendments, by dictating the manner in which impairment is measured, overrule cases like *Simonson* to the extent they stand for the proposition that unavoidable liens can be cumulated to wipe out any equity, and thereby any impairment in the first place. Amended § 522 does not, however, expressly address the preservation and priority issues when an avoidable judicial lien is sandwiched between unavoidable liens. Nevertheless, the legislative history of the amendments indicates that they adopt the dissent's position in *Simonson*. See H.R. REP. NO. 103-835, at 52-54, reprinted in 1994 U.S.C.C.A.N. at 3361-63. Importantly, one of the points made in that dissent was that the lien in question should not only be avoided, but also *preserved*, for the debtor's benefit under § 522(i)(2).

21. See *Patterson*, 139 B.R. at 231 (justifying awarding the value of the avoided lien to the junior consensual lien on the basis that state-law priority rules ought to be preserved except where expressly inconsistent with the terms of the Code); *In re Shafner*, 165 B.R. 660, 662 (Bankr. D. Colo. 1994) (suggesting that avoidance of a "sandwiched" judicial lien would impermissibly disturb the "established order of priority of the encumbrances"), *aff'd*, 82 F.3d 426 (10th Cir. 1996). Actually, under state law this situation presents a sort of circular priority problem — the homestead exemption is "senior" to the judicial lien, and the judicial lien is senior to the second mortgage, but, because of the operation of law or an explicit subordination or waiver provision in the mortgage, the second mortgage is senior to the exemption. Therefore, it is not at all clear that allowing the junior unavoidable lien to move up in priority in fact corresponds, as the court maintained in *Patterson*, with state law. See *infra* text accompanying notes 172-82. Given this uncertainty, as well as the idiosyncrasies of state law, it seems that a uniform solution, derived from a normative view of the scope of the fresh start, might make more sense than attempting to decide the issue by abiding the principle of leaving state-law priorities undisturbed.

22. By eliminating the judicial lien, the debtor may effectively redeem the property for its current value, thereby attaining full value of future appreciation and eliminating any hold-up value the judicial lienor might have extracted as a condition to releasing its lien, should the debtor wish to alienate the property in a voluntary transaction. Prior to the 1994 Amendments, even this limited benefit would not have been available in jurisdictions that "carved" the exception out of the lien but otherwise left the balance of the lien intact. See, e.g., *Wrenn v. American Cast Iron Pipe Co. (In re Wrenn)*, 40 F.3d 1162, 1166 (11th Cir. 1994) (per curiam) (holding that under former § 522(f), the maximum extent to which a debtor could avoid a judicial lien was defined by the dollar amount of the exemption). In *Holloway v. John Hancock Mutual Life Insurance Co. (In re Holloway)*, 81 F.3d 1062, 1069-70 (11th Cir. 1996), a case in which the debtors had no equity in their homestead, the court acknowledged that *Wrenn* had been overruled by the 1994 Amendments. Nevertheless,

rather poorly the humanitarian impulses that accounted for the adoption of the debtor avoiding power in the first instance.<sup>23</sup> The other, and candidly, more logical, alternative would be to permit the debtor to use 11 U.S.C. section 506(d) in tandem with section 522(f)(1)(A) to set aside the second consensual mortgage in the bankruptcy proceeding to the extent of that creditor's unsecured deficiency.<sup>24</sup> The problem, of course, is that *Dewsnup* foils this neat solution, forcing debtors to resort to far more costly and convoluted schemes for accomplishing the same result.<sup>25</sup>

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because the case was filed before the effective date of the 1994 Amendments, the court felt constrained to apply *Wrenn* and leave the lien intact. This pre-1994 practice of carving the exemption out of the unsecured portion of the lien but otherwise leaving the lien intact as a continuing encumbrance against the property, resulted in what Professor Howard aptly termed an "empty exemption" for the debtor. See Howard, *supra* note 20, at 166, 174-80 (using as an example of this phenomenon the decision in *Kruger v. Beneficial Commercial Corp.* (In re *Kruger*), 77 B.R. 785 (Bankr. C.D. Cal. 1987)).

23. Section 522(f)'s avoidance power is an important component in the Code's overall objective in consumer bankruptcy cases of affording a financial fresh start to the debtor. See H.R. REP. NO. 95-595, at 362 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6318 ("Subsection (f) [of § 522] protects the debtor's exemptions, his discharge, and thus his fresh start by permitting him to avoid certain liens on exempt property."). The discharge and the exemption provisions of the Code are perhaps the two most critical elements of the Code's fresh-start policy. See Lawrence Ponoroff & F. Stephen Knippenberg, *Debtors Who Convert Their Assets on the Eve of Bankruptcy: Villains or Victims of the Fresh Start?*, 70 N.Y.U. L. REV. 235, 239-41 (1995); see also Cross, *supra* note 20, at 338-39 (explaining that Congress singled out nonpurchase money security interests and judicial liens because neither type of interest represents a true "reliance" claim, and because of their tendency to interfere with the fresh start by undermining the debtor's exemptions).

24. Section 506(a) requires a partially secured creditor to bifurcate its claim into a secured and unsecured portion based on the value of the collateral. On its face, § 506(d) then seems to allow for avoidance of the lien to the extent it is unsupported by value. This makes a great deal of sense, given that the claim represented by that portion of the lien is being allowed and adjusted as an unsecured claim in the ensuing bankruptcy proceeding. Application of this approach to the facts of our hypothetical would require avoiding the \$15,000 unsecured portion of the mortgage under § 506(d) and then avoiding the judicial lien pursuant to § 522(f) so that the property is left with \$105,000 in encumbrances and the debtor enjoys the full \$15,000 homestead exemption. Avoidance of the judicial lien under § 522(f), even if the lien is preserved for the benefit of the debtor, still leaves the property subject to \$120,000 in encumbrances if nothing is done about the second mortgage. Thus, this approach allows the debtor to enjoy the benefit of the homestead exemption not only in the event of foreclosure but also on immediate transfer. It also preserves for the debtor the benefit of future appreciation. In a chapter 11 case, the creditor has the ability to defeat that kind of lien stripping by electing to have its claim treated as fully secured under 11 U.S.C. § 1111(b) (1994), although the debtor-in-possession can dilute the benefits of such an election with a minimum of effort. See Carlson, *Unsecured Claims*, *supra* note 6, at 291-92 (explaining the orthodox interpretation of the § 1111(b) election, but demonstrating how, by extending the payment period, the economic value of this election nearly always can be defeated by the debtor-in-possession). In a chapter 7 case, there is no such statutory restraint. See Margaret Howard, *Stripping Down Liens: Section 506(d) and the Theory of Bankruptcy*, 65 AM. BANKR. L.J. 373 (1991) (urging, pre-*Dewsnup*, that lien stripping under § 506(d) should be permitted as a fair accommodation of the tension between the bankruptcy fresh-start policy and the secured creditor's entitlement to the value of its claim in bankruptcy).

25. One of these more "costly and convoluted schemes" is to resort to the device known as a "chapter 20," a technique involving the rapid-fire filing of a chapter 13 case as soon as the debtor receives a discharge under chapter 7. See *Johnson v. Home State Bank*, 501 U.S.

How did we arrive at this curious state of affairs? As always, through the most circuitous of routes. Our story begins not at the beginning but at what we gather (and hope) is nearly the end. Prior to the 1994 Amendments, several courts, including at least four circuit court of appeals panels,<sup>26</sup> had ruled that in order to be subject to the debtor's avoiding power in 11 U.S.C. section 522(f)(1),<sup>27</sup> the debtor had to have equity in the property over at least the amount of senior nonavoidable liens.<sup>28</sup> Accordingly, if the judicial lien were completely unsecured (in the bankruptcy sense of the word), it was nonavoidable because it did not, to use the language of the statute, impair an exemption to which the debtor would otherwise be entitled.<sup>29</sup> Thus, on the facts of the hypothetical posed earlier, the

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78 (1991) (declining to adopt an absolute bar to the chapter 20 technique); *infra* text accompanying notes 246-51; *see also* Newborn, *supra* note 4, at 579-81 (explaining that the issue in *Johnson* was not lien avoidance, but the effect of discharge on the underlying claim, and that, therefore, *Johnson* is not authority for the proposition for which it was cited in *Dewsnup*, namely, that liens pass through bankruptcy unaffected).

26. *See* Wrenn v. American Cast Iron Pipe Co. (*In re* Wrenn), 40 F.3d 1162 (11th Cir. 1994) (*per curiam*); Menell v. First Natl. Bank (*In re* Menell), 37 F.3d 113 (3d Cir. 1994); City Natl. Bank v. Chabot (*In re* Chabot), 992 F.2d 891 (9th Cir. 1993); Wachovia Bank & Trust Co. v. Opperman (*In re* Opperman), 943 F.2d 441 (4th Cir. 1991). One of the first Code cases to adopt this approach was *Day v. Boteler* (*In re* Boteler), 5 B.R. 408 (Bankr. S.D. Ala. 1980).

27. As originally enacted, § 522(f)(1) of the Code referred solely to the debtor's power to avoid a judicial lien to the extent that the lien impaired an exemption. *See* Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, sec. 101, § 522(f)(1), 92 Stat. 2549, 2589 (codified at 11 U.S.C. § 522(f)(1) (1994)). Section 522(f)(2) then conferred a similar power on debtors with respect to nonpossessory, nonpurchase money security interests in certain types of consumer collateral, professional tools, and health aids. *See* Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, sec. 101, § 522(f)(2), 92 Stat. 2549, 2589 (codified at 11 U.S.C. § 522(f)(2) (1994)). The 1994 Act collapsed both provisions into § 522(f)(1), as subparagraphs (A) & (B), respectively, and carved out, in subparagraph (A), an exception to the power to avoid a judicial lien where the lien was given to secure a debt to a spouse, former spouse, or child, for alimony, maintenance, or support. *See* 11 U.S.C. § 522(f)(1) (1994). Section 522(f)(2) now contains the statutory formula for determining the extent to which a lien will be considered to impair an exemption. *See* 11 U.S.C. § 522(f)(2) (1994); *supra* note 15.

28. In addition, some courts included junior nonavoidable liens in the determination of whether the debtor had any equity in the property that might be impaired by the judicial lien. *See* Simonson v. First Bank (*In re* Simonson), 758 F.2d 103 (3d Cir. 1985) (discussed *supra* note 20). The corollary of the view that a debtor could not avoid a lien if it did not attach to equity having monetary value, was that even when equity existed, avoidance would be limited to the lesser of the monetary value of the equity or the amount of the exemption. *See, e.g., Menell*, 37 F.3d at 115 (holding that only the part of the lien that interferes with the exemption may be avoided); *Chabot*, 992 F.2d at 895. The effect of this approach was that when the amount of the lien exceeded the exemption value, the unvoided (and unsecured) portion of the lien would remain as a charge against the property. The most generous view was that the statutory exemption amount set the outer limit of impairment. *See, e.g., West v. West* (*In re* West), 68 B.R. 647, 648-49 (Bankr. C.D. Cal. 1986). In light of postbankruptcy realities in most cases, this rendered the debtor's exercise of the § 522(f) avoiding power an essentially meaningless act. *See supra* note 15.

29. Many bankruptcy courts reached the opposite result, permitting total avoidance when the debtor's equity was insufficient to satisfy both the exemption amount and the judicial lien. *See, e.g., In re* Cross, 164 B.R. 496, 497-98 (Bankr. E.D. Pa. 1994); *Osborne v. Dominion Bank, N.A.* (*In re* Osborne), 156 B.R. 188, 191 (Bankr. W.D. Va. 1993), *revd.*, 165 B.R. 183 (W.D. Va. 1994); *LaPointe v. Snelling & Snelling, Inc.* (*In re* LaPointe), 150 B.R. 92, 94-95

entire judicial lien might have survived because the debtor had no equity in the property over and above the sum of the nonavoidable liens.<sup>30</sup> This line of authorities, which in part was seen as offering a preferred construction of the statute because of its consistency with the Supreme Court's holding in *Dewsnup*,<sup>31</sup> has now also been overruled by the statutory formula for determining "impairment" that was added to the Code by the 1994 Amendments.<sup>32</sup> The avoidance power in section 522(f)(1)(A), however, is limited to judicial liens.<sup>33</sup> Thus, while it surely calls into question the holding in

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(Bankr. D. Conn. 1993); *In re Magosin*, 75 B.R. 545, 547 (Bankr. E.D. Pa. 1987). *But see In re Corio*, 190 B.R. 498 (E.D.N.Y. 1995) (affirming the bankruptcy court's order that a judicial lien could not be avoided as impairing the debtor's homestead exemption because the debtor had no equity in the property, and, therefore, no exemption to be impaired).

30. A possible exception existed, in the view of some courts, where one or more of the unavoidable liens was junior to the judicial lien under attack. *See Silver v. Savings Bank (In re Fiore)*, 27 B.R. 48, 50 (Bankr. D. Conn. 1983) (holding that junior, unavoidable liens are not considered in determining impairment). In effect, this approach would produce, in some cases, an equity figure where none would otherwise exist. In other cases, it would produce an equity figure sufficient to cover both the judicial lien and the exemption, thereby depriving the debtor of her right to avoid any portion of the judicial lien under § 522(f). *See In re Shafner*, 165 B.R. 660, 662 (Bankr. D. Colo. 1994), *aff'd.*, 82 F.3d 426 (10th Cir. 1996); 2 EPSTEIN ET AL., *supra* note 16, § 8-28, at 564-65.

31. *See Chabot*, 992 F.2d at 895 ("Our holding [precluding avoidance of the lien in excess of the amount of the exemption] is consistent with . . . *Dewsnup v. Timm*."). *But see Wrenn v. American Cast Iron Pipe Co. (In re Wrenn)*, 40 F.3d 1162, 1165-66 (11th Cir. 1994) (*per curiam*) (observing that avoidance of the entire lien would not be inconsistent with *Dewsnup* if one were to accept the debtor's argument that the discharge of the underlying claim effectively disallowed the creditor's claim). In addition, there was the view that the prohibition against lien stripping in *Dewsnup* did not extend to the avoidance of an "underwater" judicial lien that impaired exempt property. *See Howard, supra* note 20, at 165.

32. *See* 11 U.S.C. § 522(f)(2)(A) (1994) (discussed *supra* note 15). Recent cases construing the operation and effect of this new formula for determining impairment include *Zeigler Engg. Sales, Inc. v. Cozad (In re Cozad)*, 208 B.R. 495 (Bankr. 10th Cir. 1997); *Pepper v. Pub. Serv. Employees Credit Union, No. 97-10574 CEM*, 1997 Bankr. LEXIS 902 (Bankr. D. Colo. June 27, 1997); *Corson v. Fidelity and Guar. Ins. Co. (In re Corson)*, 206 B.R. 17 (Bankr. D. Conn. 1997); *Marshall v. Suntrust Bank, Savannah N.A. (In re Marshall)*, 204 B.R. 838 (Bankr. S.D. Ga. 1997); *In re Jakubowski*, 198 B.R. 262 (Bankr. N.D. Ohio 1996); *In re Allard*, 196 B.R. 402 (Bankr. N.D. Ill.), *aff'd. sub nom. Great S. Co. v. Allard*, 202 B.R. 938 (N.D. Ill. 1996); *In re Todd*, 194 B.R. 893 (Bankr. D. Mont. 1996). *See also Butler v. Southern O Corp. (In re Butler)*, 196 B.R. 329, 330-31 (Bankr. W.D. Va. 1996) (reviewing in detail the legislative history to § 522(f)(2), concluding that *Dewsnup* is no barrier to avoidance of a judgment lien where the lien impairs an exemption, and noting that the Amendments overruled cases such as *Chabot*; *In re Cavenaugh*, No. CIV.A.95-4408, 1995 U.S. Dist. LEXIS 14962 (E.D. Pa. Oct. 11, 1995). *See generally* Carlson, *supra* note 17, at 67-69; *supra* note 18. In dictum, the Ninth Circuit itself has conceded that, for cases filed on or after the effective date of the 1994 Amendments, *Chabot* has been overruled. *See Jones v. Heskett (In re Jones)*, 106 F.3d 923, 924 n.2 (9th Cir. 1997); *Wynns v. Wilson (In re Wilson)*, 90 F.3d 347, 350 (9th Cir. 1996); *see also Higgins v. Household Fin. Corp. (In re Higgins)*, 201 B.R. 965, 967 (Bankr. 9th Cir. 1996) ("Congress has made it clear in amending Section 522 that a lien will be deemed to impair an exemption, even when there is no equity in the property . . .").

33. "Judicial liens" are defined in § 101(36) of the Code as "lien[s] obtained by judgment, levy, sequestration or other legal or equitable process or proceeding." 11 U.S.C. § 101(36) (1994). They are distinguished from both consensual liens and statutory liens. *See* 11 U.S.C. § 101(51), (53) (1994). Curiously, the 1994 Amendments also added a new subsection (f)(3) to § 522 of the Code, which purports to give the states a limited opportunity to opt out of

*Dewsnup*, it does not compromise the continuing viability of that holding — at least not directly.<sup>34</sup>

If and when permitted, the power to avoid “underwater” liens<sup>35</sup> has value to the debtor in at least three circumstances. First, before creditors can foreclose, the debtor may be able to scrounge up enough cash from other sources to redeem the property by paying off all nonavoided liens. In the example used previously, the property could be redeemed for, at most, exactly its judicially determined value: \$120,000, and, with full lien stripping, that value less the amount of the exemption, or \$105,000. Alternatively, if the debtor is otherwise able to stave off foreclosure, market factors may create equity in the property in the future that will inure to the debtor’s benefit and not to the benefit of an undersecured lienor. While lenders might understandably regard the reallocation of future appreciation as unfair, the nature of bankruptcy is such that any postpetition gain properly belongs to the debtor.<sup>36</sup> Finally, and most problematic, the court may have undervalued the property, resulting in the debtor’s immediate enjoyment of existing wealth at the expense of secured creditors as soon as the property is abandoned or the bankruptcy case is closed.<sup>37</sup> In all three cases, the

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subsection (f)(1)(A) when the collateral is worth more than \$5,000. See Bankruptcy Reform Act of 1994, Pub. L. No. 103-394, § 310(2), 108 Stat. 4106, 4137-38 (codified as amended at 11 U.S.C. § 522(f)(3) (1994)). This new provision is awkwardly worded, and its full effect is not yet fully understood. See Carlson, *supra* note 17, at 76-84. There are only a few cases so far attempting to give meaning to the convoluted linguistic meanderings of § 522(f)(3). See *In re Ehlen*, 202 B.R. 742 (Bankr. W.D. Wis. 1996), *affd.*, 207 B.R. 179 (W.D. Wis. 1997); *In re Parrish*, 186 B.R. 246 (Bankr. W.D. Wis. 1995); *In re Zimmel*, 185 B.R. 786 (Bankr. D. Minn. 1995).

34. Of course, it is our position that the 1994 Amendments indirectly call into question the wisdom of that decision because, along with other developments, they reflect how aberrant *Dewsnup* really was, insofar as contemporary bankruptcy jurisprudence is concerned. See *infra* notes 174-83 and accompanying text.

35. A lien is considered to be “underwater” to the extent it is unsupported by value. See *Dewsnup v. Timm*, 502 U.S. 410, 424 (1992) (Scalia, J., dissenting); Howard, *supra* note 20, at 165.

36. See *infra* notes 216-24 and accompanying text.

37. Distrust of judicial valuation, coupled with the belief that markets do a better job of establishing values, has been a central theme in the writings of a loosely associated group of bankruptcy scholars who have approached the subject area using the tools of economic analysis and corporate finance. For a survey of that literature, see John D. Ayer, *The Role of Finance Theory in Shaping Bankruptcy Policy*, 3 AM. BANKR. INST. L. REV. 53 (1995). Much of this writing has been aimed at reform, or outright elimination, of the present system in chapter 11 for court-supervised reorganizations of financially distressed business entities. See generally Barry E. Adler, *Bankruptcy and Risk Allocation*, 71 CORNELL L. REV. 439 (1992); Philippe Aghion et al., *The Economics of Bankruptcy Reform*, 8 J.L. ECON. & ORG. 523 (1992); Douglas G. Baird, *The Uneasy Case for Corporate Reorganizations*, 15 J. LEGAL STUD. 127 (1986); Lucian Arye Bebchuk, *A New Approach to Corporate Reorganizations*, 101 HARV. L. REV. 775 (1988); Michael Bradley & Michael Rosenzweig, *The Untenable Case for Chapter 11*, 101 YALE L.J. 1043 (1992); Robert K. Rasmussen & David A. Skeel, Jr., *The Economic Analysis of Corporate Bankruptcy Law*, 3 AM. BANKR. INST. L. REV. 85 (1995);

judicial lienor in our hypothetical, never a true reliance creditor to begin with,<sup>38</sup> is now wholly eliminated. Ideally, the junior lienor would also be relegated to what, under these circumstances, the Code in section 506(a) determined a party in that position to be all along anyway; namely, an unsecured creditor to the tune of \$15,000.

How does this result square with *Dewsnup*, and with the characterization of secured claims in bankruptcy implied by Justice Blackmun in his majority opinion in that case? Not very well. In *Dewsnup*, the debtors, husband and wife, argued that pursuant to Code sections 506(a) and 506(d), they were entitled to reduce the balance of a \$120,000 judgment lien against their nonexempt farm property to the judicially determined value of that property, or \$39,000.<sup>39</sup> The debtors lost at the bankruptcy court, district court, and court of appeals levels,<sup>40</sup> despite favorable authority from other jurisdictions authorizing debtor lien avoidance (so-called lien stripping) in these circumstances pursuant to section 506(d).<sup>41</sup> By this

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Mark J. Roe, *Bankruptcy and Debt: A New Model for Corporate Reorganization*, 83 COLUM. L. REV. 527 (1983). However, the same suspicion of misvaluation of an individual debtor's real property also fuels the case in favor of prohibiting strip down in chapter 7 and preserving the holding in *Dewsnup*. See *infra* text accompanying notes 57-61.

38. The fact that judicial lienors are nonreliance creditors is an important part of the justification for the debtor-avoiding-power provision, in § 522(f)(1)(A), in circumstances where the lien has actual economic value. It is not essential, however, to the related issue of whether strip down should be permitted under § 506(d), as, in those instances, the lien has no current economic value. However, to the extent that the defense of *Dewsnup* is cast in terms of the bargain metaphor, see *infra* note 43 and accompanying text, it is a factor that appears to weigh more heavily in actuality than we think it should.

39. The judgment lien arose from a default by the debtors for amounts due under the terms of two mortgages that the debtors had granted to a private lending group in 1978 in order to finance acquisition of additional farmland. The sad plight of the Dewsnups is recounted in detail in Margaret Howard, *Dewsnapping the Bankruptcy Code*, 1 J. BANKR. L. & PRAC. 513, 513-14 (1992).

40. The bankruptcy court concluded that because the property had been abandoned, the estate no longer had an interest in the property and § 506(d), by its terms, was inapplicable. See *Dewsnup v. Timm (In re Dewsnup)*, 87 B.R. 676, 683 (Bankr. D. Utah 1988), *affd. per curiam*, 908 F.2d 588 (10th Cir. 1990), *affd.*, 502 U.S. 410 (1992). The court also expressed the view that, as a matter of policy, to permit strip down in these circumstances would constitute an unwarranted intrusion on the rights of secured creditors. See *Dewsnup*, 87 B.R. at 683. The district court affirmed without a separate opinion, while the Tenth Circuit added to the bankruptcy court's rationale that to allow strip down would be to permit a de facto redemption of real property in apparent contravention of 11 U.S.C. § 722 (1994), which limits redemptions to personal property intended primarily for personal, family, and household use. See *Dewsnup*, 908 F.2d at 592 (10th Cir. 1990), *affd.*, 502 U.S. 410 (1992). The court also opined that lien avoidance under § 506(d) would create an anomalous situation in which debtors would receive more in liquidation than they would in reorganization under chapter 11 or 13 because of the prohibitions against modification in, respectively, 11 U.S.C. §§ 1111(b) and 1322(b)(2) (1994). See *Dewsnup*, 908 F.2d at 592.

41. See, e.g., *Gaglia v. First Fed. Sav. & Loan*, 889 F.2d 1304 (3d Cir. 1989). The pre-*Dewsnup* authorities pro and con are collected in Howard, *supra* note 24, at 374 n.2 (indicating that a majority of the decisions hold that a chapter 7 debtor may use § 506(a) and (d) to avoid liens unsupported by value).

time, LaMar Dewsnup had died and his widow Aletha Dewsnup's last stop was the United States Supreme Court. When she arrived there, the reception was no warmer than it had been in the lower courts.

In the majority opinion, Justice Blackmun offered a variety of rationales to justify the denial of Ms. Dewsnup's claim,<sup>42</sup> reflecting perhaps a concern that any one alone was not a sufficiently sound analytic structure upon which to rest the majority's decision. Among these rationales, and of principal interest for purposes of this article, was the assertion that permitting lien stripping under section 506(d) would deprive undersecured creditors of access to postvaluation appreciation in the encumbered property in violation of the prepetition *bargain* that had been struck between mortgagor and mortgagee.<sup>43</sup> Relying primarily upon case law decided under the former Act, and taking that case law wholly out of context,<sup>44</sup> Justice Blackmun and the Justices who joined him in the majority opinion adopted *bargain* as the appropriate metaphor for conceptualizing the nature of security and secured claims in bankruptcy.

In a dyspeptic dissenting opinion,<sup>45</sup> Justice Scalia chided the majority for engaging in what he regarded as a wholly untenable construction of the clear language of the statute.<sup>46</sup> He did not, how-

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42. The majority offered several justifications. First, under the Bankruptcy Act of 1898, Pub. L. No. 55-541, § 67d, 30 Stat. 544 (repealed 1978), unavowed liens passed through bankruptcy unaffected. See *Dewsnup v. Timm*, 502 U.S. 410, 418 (1992). Second, Congress was presumed to have enacted § 506(d) with a full understanding of the fact that under pre-Code law, involuntary debtor lien avoidance was not permitted. See *Dewsnup*, 502 U.S. at 418-19. Third, there was no indication in the legislative history of the Code to suggest that § 506(d) should be interpreted to permit lien avoidance. See *Dewsnup*, 502 U.S. at 419-20.

43. See *Dewsnup*, 502 U.S. at 417-18. The Court assumed that this would be the result if the mortgagor elected to remain aloof from the proceeding, and thus could "see no reason why his acquiescence in that proceeding should cause him to experience a forfeiture of the kind the debtor proposes." 502 U.S. at 418. Of course, since even the debtor can file a proof of claim on a creditor's behalf, see 11 U.S.C. § 501(b) (1994), the point really adds very little. See *In re Penrod*, 50 F.3d 459, 462 (7th Cir. 1995) ("A secured creditor may be dragged into the bankruptcy involuntarily, because the trustee or debtor . . . may file a claim on the creditor's behalf."). The bottom line remains that the majority in *Dewsnup* considered it a "windfall" for the debtor to enjoy the benefit of any subsequent increase in the value of the property. It is difficult, however, to understand how the "windfall" attributable to postfiling appreciation differs fundamentally, for example, from the "windfall" the debtor enjoys by being able to retain postpetition earnings free from prepetition contractual obligations. And yet, while not always a feature of American bankruptcy law, today no one seriously questions that the law should contain some system for discharging debts. See, e.g., Charles Jordan Tabb, *The Historical Evolution of the Bankruptcy Discharge*, 65 AM. BANKR. L.J. 325 (1991).

44. See *infra* note 51.

45. See *Dewsnup*, 502 U.S. at 420 (Scalia, J., dissenting). Justice Souter joined in the dissent, while Justice Thomas did not participate, making it a 6-2 vote for the appellees.

46. "The Court makes no attempt to establish a textual or structural basis for overriding the plain meaning of § 506(d), but rests its decision upon policy intuitions of a legislative character . . . ." *Dewsnup*, 502 U.S. at 422 (Scalia, J., dissenting).

ever, respond directly to the policy-based aspects of the majority's opinion,<sup>47</sup> comfortable presumably in his conviction that the unarguable meaning of the statutory text rendered such discussions superfluous, however interesting they might be in another context.<sup>48</sup> With all deference to Justice Scalia, we believe the majority's articulated concern over upsetting the secured creditor's bargain merits a response since the implications of that conception of security extend beyond simply the issue of lien stripping in chapter 7.

Other commentators have already called into question Justice Blackmun's reliance on *Long v. Bullard*<sup>49</sup> and *Louisville Joint Stock Land Bank v. Radford*<sup>50</sup> as authority for the proposition that a secured creditor is entitled not just to the value of its collateral in bankruptcy, but also to have its *rights* in the collateral protected in perpetuity.<sup>51</sup> The proposition itself remains the subject of considerable disagreement. Scholars associated with the law and economics mode of analysis have argued most vigorously, and not unpersuasively, that bankruptcy law should not modify state-law property interests except in extraordinary circumstances.<sup>52</sup> As a general

47. Justice Scalia did, however, at least intimate that these policy intuitions might have been served without "evisceration" of the language in § 506(d). See *Dewsnup*, 502 U.S. at 422 n.1 (Scalia, J., dissenting).

48. The dissent pointed to the Court's holdings in *Union Bank v. Wolas*, 502 U.S. 151 (1991), and *United States v. Ron Pair Enterprises*, 489 U.S. 235 (1989), as examples of how the majority's opinion was totally at odds with the Court's established "plain meaning" method of interpretation in previous Bankruptcy Code cases. See *Dewsnup*, 502 U.S. at 433-35 (Scalia, J., dissenting); see also *supra* note 11.

49. 117 U.S. 617 (1886).

50. 295 U.S. 555 (1935).

51. See *Dewsnup*, 502 U.S. at 418-19. Professor Howard explains that the Court's reliance on *Radford* as apparent authority for the view that strip down would raise constitutional concerns was misplaced. See Howard, *supra* note 39, at 524-25. First, she notes that while *Radford* involved a successful challenge to the Frazier-Lemke Act amendments, Pub. L. No. 73-486, 48 Stat. 1289 (1934) (expired 1949) to the Bankruptcy Act, the problem with those provisions was that they were given retroactive effect and permitted farmer-debtors to purchase property for less than its judicially established fair market value. After Frazier-Lemke was amended in 1935 to assure creditors of the full value of their collateral, attempts to challenge its constitutionality as an impermissible taking failed. See *Wright v. Vinton Branch*, 300 U.S. 440 (1937); Howard, *supra* note 39, at 525 & n.60; see also Howard, *supra* note 4, at 314-15; Newborn, *supra* note 4, at 580-81 (pointing out that *Long v. Bullard* "stands only for the proposition that bankruptcy discharge extinguishes only the debtor's personal liability for the debt" and that there was pre-Code precedent for the practice of lien avoidance). While the Supreme Court's decisions in *Radford* and *Long* do not, therefore, stand in the way of lien avoidance generally, *Radford* in particular does carry some implications for liquidations under the Code that would need to be addressed were *Dewsnup* repealed. See *infra* note 273 and accompanying text.

52. This proposition is one of the central tenets of the well-known creditors' bargain model developed in the 1980s by Douglas G. Baird and Thomas H. Jackson. According to Baird and Jackson, bankruptcy exists in order to solve the "common pool" problem created by the debtor's insolvency. See THOMAS H. JACKSON, *THE LOGIC AND LIMITS OF*



avowal, the point is virtually unarguable. As always, however, the real action is at the margins,<sup>53</sup> and the view that the protection of a secured creditor's rights includes preserving creditor control over all decisions concerning when and how his or her interest will be foreclosed faces far tougher sledding in the face of numerous bankruptcy provisions that effectively freeze a secured creditor's claims

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BANKRUPTCY LAW 7-19 (1986); Douglas G. Baird, *Loss Distribution, Forum Shopping, and Bankruptcy: A Reply to Warren*, 54 U. CHI. L. REV. 815, 822-24 (1987). Faced with the prospect of a multiplicity of wasteful and expensive individual creditor collection actions, Baird and Jackson maintain that bankruptcy represents the *ex ante* bargain that, had they the opportunity, creditors would have reached had they negotiated in advance over the consequences of financial reversals that would place them in competition with one another for limited assets. Such an agreement necessarily would preclude any reordering of the legal priority of existing claims because the prospect for different patterns of distribution would presumably induce self-interested behavior antithetical to the interest of the common pool. See Baird, *supra*, at 823 (asserting that the priorities that exist under bankruptcy law and nonbankruptcy law should remain parallel; if one changes, so too should the other). This is the problem of "forum-shopping" which plays such a pivotal role in Baird and Jackson's view of bankruptcy. See Douglas G. Baird & Thomas H. Jackson, *Corporate Reorganizations and the Treatment of Diverse Ownership Interests: A Comment on Adequate Protection of Secured Creditors in Bankruptcy*, 51 U. CHI. L. REV. 97, 101 (1984); Baird, *supra*, at 824-28 (arguing that having multiple avenues of enforcement for every substantive right creates special costs and, thus, can only be justified in relation to the reasons for having separate avenues, and not in terms of the substantive rights, under one scheme or the other, of the party affected). To instantiate this justification for a separate bankruptcy system, Baird and Jackson adopt as their fundamental principle the rule that bankruptcy must leave undisturbed the relative entitlements of all creditors under state law. See JACKSON, *supra*, at 20-24, 71-83 (maintaining that changes in substantive rules, unless intended to preserve assets for the common good, run counter to the proper goals of bankruptcy); see also Thomas H. Jackson, *Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain*, 91 YALE L.J. 857, 868-71 (1982). Note that Jackson does not maintain that a bankruptcy system must honor state-law entitlements in every respect; a secured creditor could hardly be permitted to foreclose as it could under state law in the face of the stay rules in 11 U.S.C. § 362(a) (1994). What matters, then, is preserving "relative values" of state-law entitlements. See JACKSON, *supra*, at 29. Moreover, even that principle may be ignored if it can be shown that recognition of a particular right would compromise the collectivizing goal of the bankruptcy process. *Id.* at 29 n.15. Although commentators writing from an economics-based perspective of the law have suggested that the market may be better suited to solve the collective action problems that for Baird and Jackson justify a separate bankruptcy system, all of these theorists, without much question, accept creditor wealth maximization as the sole normative object of any bankruptcy regime. See, e.g., Barry E. Adler, *Financial and Political Theories of American Corporate Bankruptcy*, 45 STAN. L. REV. 311, 319-23 (1993); Randal C. Picker, *Security Interests, Misbehavior, and Common Pools*, 59 U. CHI. L. REV. 645, 647 (1992).

53. Not even the most strident adherents of the view that bankruptcy is designed to maximize creditor returns have called into question the centrality of fresh-start policy in consumer bankruptcy cases. See JACKSON, *supra* note 52, at 225-79 (attempting to offer a normative justification for discharge that, if not exactly consistent, is at least not at odds with the first principles posited under the creditors' bargain model). For further discussion of Jackson's view of discharge in consumer cases, see Ponoroff & Knippenberg, *supra* note 23, at 249-52. Nevertheless, while acceptance of the economic account of bankruptcy, with its limited view of bankruptcy purposes, may predispose one to be sympathetic with the rationale in *Dewsnup*, it does not require acceptance of that rationale. Instead, the issue still comes down to the extent to which one's conceptualization of secured credit outside of bankruptcy is altered by the federal policy of fresh start that is implicated once an individual bankruptcy case is initiated.

and entitlements as of the time of filing or plan confirmation.<sup>54</sup> Moreover, whatever justification one accepts for secured credit generally,<sup>55</sup> one cannot assume necessarily that all of the entailments that derive from that justification carry over unaffected into bankruptcy.<sup>56</sup>

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54. Initially, there was considerable concern about the implications of *Dewsnup* in reorganization proceedings. See, e.g., Howard, *supra* note 4, at 319-36 (addressing the harmful effects of *Dewsnup* in various reorganization proceedings); Newborn, *supra* note 4, at 582-96 (discussing the "damaging legacies of *Dewsnup*"). By and large, that concern has been laid to rest. Subject to the separate limitation in § 1322(b)(2) in chapter 13 cases, and the § 1111(b) election in chapter 11 cases, there is no longer any serious argument that *Dewsnup* alters the widely accepted premise that secured creditors in these proceedings are entitled only to the present value of their secured claim, in the traditional § 506(a) sense of the term, as of the relevant valuation date, although the timing of that valuation remains an unsettled and controversial question. See *infra* notes 112, 223. See generally Jane Kaufman Winn, *Lien Stripping After Nobelman*, 27 LOY. L.A. L. REV. 541, 597-616 (1994) (reviewing the treatment of secured claims under chapters 11, 12, and 13). There are several general Code provisions that reinforce this view of security, in addition to the basic definitional provision in § 506(a) and the exemption impairing lien-avoidance power in § 522(f)(1)(A) already discussed. For example, § 552(a) prevents a security interest containing an after-acquired property clause from attaching to postpetition property. Section 363(f) permits the estate to sell encumbered property free and clear of liens provided *inter alia* that there is equity in the property over and above the value of all liens. Finally, the Supreme Court's earlier decision in *United Savings Assn. v. Timbers of Inwood Forest Associates (In re Timbers of Inwood Forest Associates)*, 484 U.S. 365 (1988), construed the adequate protection requirement that conditions the estate's ability to retain and use property subject to a prepetition security interest as protecting *only* the value of the collateral as of the filing date and not the loss of the creditor's immediate right to possession or foreclosure under state law. Professor Carlson argues, however, that contrary to the implications of *Timbers*, the most logical interpretation of *Dewsnup* is that valuations in bankruptcy are not final unless and until the property is sold at a liquidation sale or a plan of reorganization is confirmed. See Carlson, *supra* note 10, at 22.

55. See *infra* Part III for further discussion of the different positions that have been espoused by commentators attempting to justify a system of secured credit.

56. This is one of the central positions we advance in this work; namely, bankruptcy represents not only a collective debt-collection device but also, in pursuit of the goals of the fresh start, a complete reordering of contractual rights and priorities under state law. See *infra* text accompanying notes 147-51, 216-18. It is a view that is obviously in conflict with the economic account of bankruptcy. See *supra* note 52. In chapter 11, the same debate is framed in terms of whether reorganization is merely intended to maximize the economic value of the estate for creditors with legally cognizable interests under state law, or whether the process is intended to take into account the broader range of interests affected by firm failure. See generally Christopher W. Frost, *Bankruptcy Redistributive Policies and the Limits of the Judicial Process*, 74 N.C. L. REV. 75 (1995) (describing the nature of the debate but concluding that the bankruptcy judicial process is ill suited to redistributing the costs of business failure); Lawrence Ponoroff, *Enlarging the Bargaining Table: Some Implications of the Corporate Stakeholder Model for Federal Bankruptcy Proceedings*, 23 CAP. U. L. REV. 441, 472-86 (1994) (suggesting that public company bankruptcies affect a broader range of constituencies than simply traditional creditor groups and, therefore, that those interests should be taken into account in allocating the losses occasioned by the enterprise's financial collapse); Lawrence Ponoroff & F. Stephen Knippenberg, *The Implied Good Faith Filing Requirement: Sentinel of an Evolving Bankruptcy Policy*, 85 Nw. U. L. REV. 919, 948-66 (1991) (describing and comparing the competing views of bankruptcy policy and concluding that bankruptcy purposes are not only several and varied, but also are in a state of continuous evolution).

II. IN DEFENSE OF *DEWSNUP*

In the context of lien stripping other than pursuant to section 522(f)(1)(A), the most recent, and perhaps the most cogent, defense of *Dewsnup* along policy lines comes from Professor Barry Adler.<sup>57</sup> While Adler submits that the majority's decision yielded a good result, even he concedes that it did so based on a flawed interpretation of the language in section 506.<sup>58</sup> In Adler's estimation, strip down, and for that matter cram down,<sup>59</sup> unfairly exposes the creditor to the risk of error in court valuation of the collateral, a risk that he views as a very serious one.<sup>60</sup> The better solution, according to Adler, would be openly to require surrender to the secured creditor of any collateral that the court values as worth less than the sum of the liens that encumber it, rather than abandonment followed by either strip down or cram down.<sup>61</sup> In the meantime, however, Adler seems inclined to accept *Dewsnup*, interpretational shortcomings notwithstanding, as a means of forcing a debtor either to repay her debt in full or to allow the secured

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57. See Barry E. Adler, *Creditor Rights After Johnson and Dewsnup*, 10 BANKR. DEV. J. 1 (1993-1994).

58. *Id.* at 12 ("The Court decided *Dewsnup* incorrectly, yet the decision yielded a good result."). In direct contrast, we are far less troubled with the majority's liberal approach to statutory construction, and far more troubled with the outcome insofar as consistency with core bankruptcy policy is concerned.

59. Adler contrasts strip down in chapter 7 with "cram down" in chapter 13, which essentially permits a debtor to retain property so long as the plan proposes to pay an undersecured creditor in present dollars the judicially determined value of the property, even where the debtor has previously discharged the unsecured portion of the creditor's claim in chapter 7. *Id.* at 5-6 (discussing *Johnson v. Home State Bank*, 501 U.S. 78 (1991)). The apparent incongruity between *Dewsnup* and *Johnson*, which Adler avoids dwelling upon by arguing instead against a debtor's entitlement to both abandonment and judicial determination of collateral value, is discussed further *infra* text accompanying notes 246-56.

60. Adler acknowledges that if courts could determine value accurately and quickly, creditors *should* be indifferent between cram down or strip down on the one hand and foreclosure sale on the other. See Adler, *supra* note 57, at 5. Of course, implicit in Adler's assumption that courts consistently misvalue assets is the further assumption that the misvaluation consistently inures to the debtor's benefit, that is, that courts' valuations are always too low. The response to this is threefold. First, there is no empirical evidence to support this assumption. Second, even if courts do undervalue assets, this makes the case only for improving the judicial valuation process, not for prohibiting strip down. See Howard, *supra* note 24, at 418-19 (making this point as well as observing that secured creditors do, after all, have the opportunity to fully litigate the issue). Finally, it is hardly clear that the alternative to strip down — release from the stay and foreclosure — produces more accurate valuation. In fact, commentators writing from both sides of the issue reject as naïve the suggestion that permitting debtors to strip-down liens under chapter 7 merely replicates the foreclosure process. See Adler, *supra* note 57, at 5 (referring to the assessment as "incredible"); Howard, *supra* note 24, at 406 (calling the proposition an "oversimplification"). The disagreement centers on whether foreclosure is the most likely alternative to strip down and who, as between debtor and creditor, has the superior claim to postbankruptcy appreciation in the absence of foreclosure. See generally *id.* at 408-18.

61. See Adler, *supra* note 57, at 15.

lender to retain all of the proceeds from foreclosure up to the outstanding balance of the loan.

Implicit in Adler's argument may be a concession. Specifically, Adler seems willing to concede that "true" postbankruptcy appreciation belongs to the debtor.<sup>62</sup> However, given the apparent difficulty in separating true appreciation from the phantom appreciation attributable to judicial misvaluation, Adler concludes that the only fair solution is to effectively give the property to the creditor to dispose of as it wishes. While this notion may not be too far from Justice Blackmun's admonition that lien stripping deprives the creditor of its bargain, the two approaches are not in fact identical. The majority in *Dewsnup* indulges, without much scrutiny or analysis, in two questionable assumptions: first, that such a bargain exists in fact, and, second, that this bargain (even if one concedes its existence) is inviolate in bankruptcy. As will be discussed further,<sup>63</sup> we think both assumptions are suspect, and Adler does not necessarily endorse either one.<sup>64</sup>

Indeed, Adler's defense of *Dewsnup* is curious. It is curious in the sense that while he is extremely concerned (perhaps not without good reason) for the accuracy of judicial valuations, he seems to accept without blanching the notion that state-law foreclosure sales produce better estimates of value.<sup>65</sup> In fact, neither approach con-

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62. See *supra* note 60. "True" appreciation would be appreciation attributable to actual changes in market conditions, rather than the appreciation "created" by undervaluation.

63. See *infra* text accompanying notes 144-58.

64. Adler's concern is, at bottom, much more prosaic. It is a concern over the risk of court error in valuation. Although not essential to the elimination of that risk, not to be lost in the wash is the fact that Adler's solution to the valuation error problem — prohibiting abandonment of encumbered property unless each creditor holding an interest in such property consents — serendipitously reallocates the benefit of true postbankruptcy appreciation to the secured creditor. Perhaps a more neatly tailored solution would be to reform the valuation process to eliminate from the system the risk of persistent bias against secured creditors in that process. See *infra* note 65.

65. See Adler, *supra* note 57, at 5 (suggesting that strip down would be acceptable if, in fact, it provided to creditors the same economic result as foreclosure). The evidence, however, is overwhelmingly at odds with the notion that foreclosure sales establish fair market value. See *BFP v. Resolution Trust Corp.*, 511 U.S. 531, 537 (1993) ("[M]arket value, as it is commonly understood, has no applicability in the forced-sale context; indeed, it is the very *antithesis* of forced-sale value."); *OB/Gyn Solutions v. Six (In re Six)*, 80 F.3d 452 (11th Cir. 1996) (noting that foreclosure sale price does not conclusively establish the value of the property at issue even if no objection is made); Howard, *supra* note 24, at 407. Therefore, to the extent that the secured portion of the creditor's claim for § 506(a) purposes is determined with reference to market as opposed to forced-sale value, the creditor should end up with a greater return from the property as a result of strip down and retention than could be expected from the logical alternative of abandonment and foreclosure. In fact, the trend in the courts has been away from a foreclosure approach to valuation in favor of a replacement or fair market value theory, focusing on retail rather than wholesale value. Most recently, the U.S. Supreme Court has ruled the "replacement value," rather than the lower "foreclosure value," should be used in valuing the allowed secured-credit claim of a creditor when a

sistently produces the same price that would be established at a true auction conducted under optimal conditions with open and competitive bidding.<sup>66</sup> Quite simply, the issue boils down to who should bear the risk of valuation error, and as to that question Adler offers no more than an opinion that it should be the debtor rather than the secured creditor, even though in reorganization proceedings the governing rules of law produce the opposite result.<sup>67</sup> In fact, one

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chapter 13 debtor proposes to retain the collateral over the secured party's objection. *See* Associates Commercial Corp. v. Rash (*In re* Rash), 65 U.S.L.W. 4451 (U.S. June 16, 1997).

Initially, the retreat from a foreclosure sale approach began when several courts concluded that the deduction of hypothetical repossession, foreclosure, and sale costs was inappropriate in circumstances in which the debtor intended to retain the secured asset. *See* Huntington Natl. Bank v. Pees (*In re* McClurkin), 31 F.3d 401 (6th Cir. 1994); Lomas Mortgage USA v. Wiese, 980 F.2d 1279 (9th Cir. 1992), *vacated*, 508 U.S. 958, *modified*, 998 F.2d 764 (9th Cir. 1993); Brown & Co. Sec. v. Balbus (*In re* Balbus), 933 F.2d 246 (4th Cir. 1991); United States v. Case (*In re* Case), 115 B.R. 666 (Bankr. 9th Cir. 1990). From these decisions, it was a rational leap to the view that fair market value, rather than forced-sale value, is the proper valuation of secured assets that the debtor intends to retain. *See, e.g.*, Taffi v. United States (*In re* Taffi), 96 F.3d 1190 (9th Cir. 1996) (involving property retained by chapter 11 debtors), *petition for cert. filed*, 65 U.S.L.W. 3433 (U.S. Oct. 31, 1996) (No. 96-881); Metrobank v. Trimble (*In re* Trimble), 50 F.3d 530 (8th Cir. 1995); Winthrop Old Farm Nurseries v. New Bedford Inst. for Sav. (*In re* Winthrop Old Farm Nurseries), 50 F.3d 72 (1st Cir. 1995). The Court's decision in *Rash* not only overruled the foreclosure value standard that had been adopted below, 90 F.3d 1036 (5th Cir. 1996), but also replaced the hybrid approach adopted in the Seventh Circuit, which used a midpoint between foreclosure and replacement value as the proper method for valuing a secured creditor's interest in property retained by a chapter 13 debtor. *See In re* Hoskins, 102 F.3d 311 (7th Cir. 1996). Although use of any greater-than-wholesale-value approach arguably overcompensates creditors, *see Hoskins*, 102 F.3d at 320 (Easterbrook, J., concurring in the judgment); the point is that, since replacement cost is now the prevailing standard, the contention that creditors are somehow prejudiced by permitting a debtor to strip an undersecured lien down to the amount of the secured claim as determined under § 506(a) seems particularly unfounded, if not incredulous.

66. Producing those conditions, however, is no sure thing. For example, some markets are just too "thin" to ensure that a well publicized auction will always bring the best price. *See generally* Douglas G. Baird, *Revisiting Auctions in Chapter 11*, 36 J.L. & ECON. 633, 647-52 (1993) (suggesting that auctions may not be the most effective way of achieving maximum value in all cases); David A. Skeel, Jr., *Markets, Courts, and the Brave New World of Bankruptcy Theory*, 1993 Wis. L. REV. 465, 477-79 (pointing out some of the limitations of an auction approach as applied to whole firms). The Code recognizes that the standard of valuation will vary with the circumstances, because value is to be determined in light of the purpose for the valuation. *See* H.R. REP. NO. 95-595, at 356 (1977), *reprinted in* 1978 U.S.C.A.A.N. 5963, 6311-12; *see also In re* Vitreous Steel Prods. Co., 911 F.2d 1223, 1332 (7th Cir. 1990). Moreover, contrary to Adler's assumption, there is no such thing as an objective, determinable value out there waiting to be revealed under the right circumstances. Just as value depends on context, so too is it the case that "value" is inherently subjective. That judicial valuation is simply an estimate or prediction does not automatically make it less reliable than a value established by actual sale. Only under perfect market conditions does an arms-length sale emulate "real value," but such conditions exist only in hypothesis, not reality. *See* Elizabeth Warren, *Bankruptcy Policymaking in an Imperfect World*, 92 MICH. L. REV. 336, 380 (1993) (pointing out that in testing economic principles, researchers ignore transaction costs, informational asymmetries, and ambiguous property rights that are always present in real markets).

67. *See supra* note 54. It also strikes us as odd that debtors whose financial condition or financial prospects are sufficiently strong to permit reorganization should be given a fresher start than debtors whose only alternative is liquidation. The protection of human capital, which lies at the heart of the fresh-start policy in consumer cases, would seem to militate

suspects that Adler's concerns in this area have been assuaged to at least some degree now that, at least for purposes of cram down, the courts have moved away from a foreclosure-sale standard of valuation to standards more closely approximating a true "fair market value" measurement.<sup>68</sup> Ultimately, then, lack of faith in the ability of the bankruptcy process specifically and the judicial process generally to render rational and accurate valuation judgments cannot form the basis for a principled defense of *Dewsnup*.

### III. THE PUZZLE OF SECURED CREDIT

#### A. A Brief History

In order to decide what to do about lien stripping in chapter 7, we thus must return to the fundamental question of how we should understand security in bankruptcy. As bankruptcy law seems to have adopted to a substantial degree state-law conceptualizations of the security interest, inquiry must begin with a review of the positions that have been staked out in relation to the same question outside of bankruptcy. In the late 1970s, legal scholars associated with the law and economics movement began to question the conventional explanation that secured financing expands debtors' access to credit markets and, in the process, increases the overall availability of credit.<sup>69</sup> Using the analytical tools of modern finance theory, these writers attempted to show that, viewed from a macro perspective, the benefits flowing from secured credit in the form of lower borrowing costs are more than offset by the combination of

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against any approach that gives prepetition creditors a stake in the debtor's postpetition life. See generally *infra* notes 223-34. The term *human capital*, used to refer to value derived by the debtor after filing, comes from Professor Jackson. See Thomas H. Jackson, *The Fresh-Start Policy in Bankruptcy Law*, 98 HARV. L. REV. 1393, 1440 n.147 (1985). While Jackson tends to limit use of the term to a debtor's earned income, there seems no logical reason for drawing a line between wealth derived from postpetition labor and wealth attributable to postpetition appreciation in exempt or abandoned assets.

68. See *supra* note 65.

69. The first salvo was fired by Thomas Jackson and Anthony Kronman in 1979. See Jackson & Kronman, *supra* note 9 (offering a justification for security interests in the form of reduced monitoring costs). The formal challenge to solve the "puzzle" of secured credit was issued a couple of years later by Professor Alan Schwartz, who observed that, in a perfect market, the benefits derived from secured financing would be offset exactly by higher rates of interest charged for unsecured credit because of the increased risk undertaken. See Alan Schwartz, *Security Interests and Bankruptcy Priorities: A Review of Current Theories*, 10 J. LEGAL STUD. 1 (1981). Subsequently, several legal academics employing the tools of economic analysis have labored unsuccessfully to provide a general account of secured credit that demonstrates its efficiency. See *infra* note 72.

the increased cost of unsecured credit and the transaction costs entailed in establishing enforceable security arrangements.<sup>70</sup>

Having thus exposed and debunked the conventional "myth" that there is a net gain in the aggregate amount of credit available because of the high-risk loans that would not be made but for the existence of secured credit,<sup>71</sup> these theorists turned to the task of constructing an explanation for secured financing that would demonstrate why the social gains from secured lending exceed the social costs.<sup>72</sup> That is to say, they launched a quest to justify the existence of secured financing on grounds of systemic efficiency, the same normative imperative that had served as the benchmark for declaring the failure of the traditional analysis.<sup>73</sup> The conventional

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70. Applying the basic insight of the Modigliani-Miller Irrelevance Theorem, which holds that in a perfectly functioning capital market the value of a firm is independent from the particular mix of debt and equity securities that comprise its capital structure, Professor Schwartz has hypothesized that secured credit is a zero-sum game. See Schwartz, *supra* note 69, at 10. That is to say, the benefits to one creditor garnered by taking security are offset exactly by the increased cost imposed on unsecured creditors who will extract a higher charge to compensate for the diminishment in the amount of assets available to satisfy their claims. For a further discussion and analysis of the Irrelevance Theorem as applied in this context, see Alan Schwartz, *The Continuing Puzzle of Secured Debt*, 37 VAND. L. REV. 1051, 1053-65 (1984).

71. See, e.g., JAMES C. VAN HORNE, FINANCIAL MANAGEMENT AND POLICY 464 (10th ed. 1995) (arguing that without security, high-risk debtors would be denied access to credit altogether).

72. Several good articles survey this literature at various points in its evolution. See sources listed *infra* notes 73, 75. For example, Professor Scott suggested that the premium earned by secured creditors could be seen as a return for the valuable counseling functions they provided to the debtor. See Robert E. Scott, *A Relational Theory of Secured Financing*, 86 COLUM. L. REV. 901, 930-33 (1986). In 1989, Professor Shupack argued that the general efficiency of security interests could be demonstrated by casting away the erroneous assumption that the cost of secured credit always exceeds that of unsecured credit, although he also pointed out that explaining security interests in economic terms left unanswered several important policy questions. See Paul M. Shupack, *Solving the Puzzle of Secured Transactions*, 41 RUTGERS L. REV. 1067, 1121-24 (1989). In 1992, Professor Triantis attempted to explain how two different and seemingly inconsistent explanations for secured debt — signaling and agency cost theories — could be reconciled by differentiating between the different types of market informational asymmetries to which they are a response. He concluded that secured debt is the most cost-effective way for addressing a variety of informational imperfections in the market. See George G. Triantis, *Secured Debt Under Conditions of Imperfect Information*, 21 J. LEGAL STUD. 225, 255-58 (1992). More recently, Professors Kanda and Levmore have attempted to explain the existence of security, as well as bankruptcy priorities, as representing a compromise between the benefits and dangers of late-in-time borrowing by financially troubled debtors. See Hideki Kanda & Saul Levmore, *Explaining Creditor Priorities*, 80 VA. L. REV. 2103, 2121-27 (1994).

73. Most of the law and economics literature assumes that security is efficient and then labors to explain or prove that it is so. One more recent work from the genre, however, not only rejects the presumption of efficiency, but also concludes that, in fact, full recognition of the rights of secured creditors in bankruptcy is inefficient. See Lucian Arye Bebchuk & Jesse M. Fried, *The Uneasy Case for the Priority of Secured Claims in Bankruptcy*, 105 YALE L.J. 857, 904-26 (1995) (arguing that adoption of one of two alternative partial-priority rules would eliminate the efficiency costs associated with the current norm, full priority). Professor Ronald Mann has gone even a step beyond Bebchuk and Fried in his assertion that wealth-maximization considerations demand nothing less than the complete abandonment of

wisdom that secured lending expands access to capital markets on a transactional basis was apparently no longer worthy of note or comment once it was shown that the gains to those firms and secured creditors were achieved at the expense of correspondingly greater losses to other creditors and, presumably, firms at large.

The several alternative explanations advanced by economic theorists since 1979 have already been neatly catalogued and described in the periodic literature.<sup>74</sup> By and large, they have failed altogether or offer astonishingly anemic justifications for secured credit.<sup>75</sup> While steeped in the impressive language of finance economics and mathematics, these frequently elaborate models end up doing little more than identifying a few dollars saved here or there in the form of monitoring, credit investigation, or other costs associated with the extension of credit. Proceeding from the premise that any rationale for secured financing ultimately must be judged on the basis of its efficiency in reducing costs or risks to the secured party relative to the increase in costs and risks to unsecured creditors, the benefits of secured credit as identified by the legal economists are disappointingly small and fundamentally uninteresting.<sup>76</sup>

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temporal (first-in-time) priority rules in favor of a system of contextualized rules designed to create party incentives that minimize the prospect for business failure. See Ronald J. Mann, *The First Shall Be Last: A Contextual Argument for Abandoning Temporal Rules of Lien Priority*, 75 TEXAS L. REV. 11 (1996).

74. See generally Harris & Mooney, *supra* note 13, at 2025-27; Scott, *supra* note 72, at 904-11; Shupack, *supra* note 72, at 1073-93.

75. As recently as 1994, Professor Schwartz declared the puzzle still unsolved. See Alan Schwartz, *Taking the Analysis of Security Seriously*, 80 VA. L. REV. 2073, 2080 n.13 (1994). Earlier Schwartz concluded that a significant reduction in transaction costs, and a concomitant increase in firm value, could be achieved by abandoning the priority scheme in article 9 in favor of a regime in which the debtor's initial long-term financier would rank first, whether secured or not. See Alan Schwartz, *A Theory of Loan Priorities*, 18 J. LEGAL STUD. 209, 211, 243-47 (1989). Several commentators also have attacked the law and economics literature on methodological grounds. See, e.g., David Gray Carlson, *On the Efficiency of Secured Lending*, 80 VA. L. REV. 2179, 2192-95 (1994) (questioning the assumption that risk cannot be reduced in absolute terms, only reassigned); Homer Kripke, *Law and Economics: Measuring the Economic Efficiency of Commercial Law in a Vacuum of Fact*, 133 U. PA. L. REV. 929 (1985) (arguing that the social value and utility of security interests should be approached as an empirical question, rather than as a matter of "cloistered" economic theorizing relying on assumed facts and bereft of conventional legal analysis); James J. White, *Efficiency Justifications for Personal Property Security*, 37 VAND. L. REV. 473, 491-502 (1984) (explaining security interests in traditional terms of making credit available to high-risk borrowers).

76. Early on, Professor Kripke observed that the law and economics analysis of secured credit proceeds from a perspective unburdened by a practical appreciation for the factual world of commerce and the role of financing in our systems of manufacturing and distribution. See Kripke, *supra* note 75, at 931-33. Not to be insulting, along the same lines it might also be said that, to the average lawyer or banker engaged in the real world of secured financing, the legal economists' analysis of what they do and why is of little relevance. Perhaps the fatal error was committed at the onset, with the assumption that all secured transactions were reducible to a single explanation or "unified theory." See Jackson & Kronman, *supra* note 9, at 1146 (stating as their objective the development of a unified theory as to why the law permits secured financing in the first place). This flaw has been pointed out by a



The game seems hardly worth the candle when one considers the transaction costs inevitably associated with secured lending.<sup>77</sup> In short, economics-based analysis has provided less than satisfying answers, even to scholars employing that mode of analysis. This is evidenced by the persistent efforts at theoretical justification among commentators sympathetic to the genre<sup>78</sup> and, more recently, the admission and proof by two of their number that security indeed is not efficient.<sup>79</sup>

In the wake of unfulfilled promises of the law and economics approach, we were left, until recently, with what might be termed the "folk theory" justification for secured credit. This is the conventional theory that holds that secured credit is worth having because it makes credit easier to obtain or, in some cases, possible where it would not be otherwise.<sup>80</sup> Even if the economics-based analysis is correct that making credit available to those who would otherwise be excluded does not invariably yield a system-wide return of the ilk that the economics model insists upon as an *a priori* normative proposition, the folk theory's observation about one of the effects of secured lending is no less valid. Transactional efficiency might not alone justify the existence of a social institution, but when it is clearly an intended consequence,<sup>81</sup> its accomplishment should not be regarded as superfluous merely because the institution fails to abide by an after-invented standard.<sup>82</sup>

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number of later commentators. See Picker, *supra* note 52, at 650 (expressing skepticism that secured credit plays the same role in all transactions).

77. See F.H. Buckley, *The Bankruptcy Priority Puzzle*, 72 VA. L. REV. 1393, 1403 (1986) (arguing that the external costs of secured lending exceed any efficiencies gained from security).

78. See authorities cited *supra* note 72; see also Carlson, *supra* note 75, at 2195 ("On this explanation of secured lending, security interests lower risk and make credit available that otherwise could not be obtained."); Shupack, *supra* note 72, at 1083 (noting that practicing lawyers accept as true what they know from their own experience; that some debtors will have to offer security or they will not receive loans).

79. See Bebchuk & Fried, *supra* note 73, at 895-903. Bebchuk and Fried's article is discussed in more detail *infra* note 90.

80. See, e.g., Kripke, *supra* note 75, at 941-49 (making the case in traditional terms for secured credit on personal property); White, *supra* note 75, at 491-502 (pointing out that noneconomic considerations may lead lending officials to withhold credit from risky borrowers unless the officials are able to take security).

81. See Shupack, *supra* note 72, at 1072 n.15 (distinguishing between general efficiency and transactional efficiency, and pointing out that transactional efficiency was clearly one of the intended purposes in the minds of the drafters of the U.C.C.).

82. The institution of secured debt has been around since the beginning of recorded history. See White, *supra* note 75, at 479-80. Even if that is a little bit of an exaggeration, nobody can argue seriously against the prevalence of secured lending practices well before Professor Schwartz insisted that its global efficiency be demonstrated using the jargon and tools of modern microeconomic theory. See generally Carlson, *supra* note 75 (arguing that

Unlike the economics-based analysis, which itself has failed to offer a solution to the puzzle of secured transactions,<sup>83</sup> the folk theory at least offers an explanation without contradiction. However, to declare that secured credit is “justified” because it makes more credit available, or more credit more easily available, is not to offer a justification in the first place, a fact that appears to have been missed in the literature thus far, and particularly overlooked in the legal economists’ summary rejection of folk wisdom. That is, folk theory does not offer a normative justification at all. Rather, it leaves open the fundamental question of whether we should have secured credit in any form, or, at the very least, whether we might be better off without it in some cases.<sup>84</sup> At most, then, folk theory states the ontological *effects* of having secured credit while blandly assuming that those effects are normatively desirable without telling us why.

## B. *The Contemporary Debate*

### 1. *Functional Analysis*

Into the disarray left in the wake of the failure of earlier theories has stepped another group of scholars,<sup>85</sup> led initially by Professor Lynn LoPucki.<sup>86</sup> The thrust of the argument launched from this quarter is that the institution of secured credit allows debtors and their chosen creditors to enjoy a subsidy at the expense

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the efficiency literature on secured lending proceeds from the false premise that risk can never be created or destroyed but only shifted around).

83. See authorities cited *supra* note 78.

84. The significance of the conventional explanation for secured lending, postulated as an effect rather than as a rationale, has yet to be meaningfully analyzed. Indeed, as Professor Carlson has recently reminded us, the question is, at bottom, an empirical one, although Carlson goes on to offer a theoretical justification for secured credit in traditional terms. That justification posits that the reduction in risk to creditors in an imperfect market resulting from the use of security interests outweighs the external costs, resulting in a net increase in available credit. See Carlson, *supra* note 75, at 2192-97.

85. These scholars are uncharitably referred to in certain quarters as “Symps” (shorthand for the tongue-in-cheek school of thought dubbed “Sympathetic Legal Studies”) because of their concern for the negative effects of secured financing on certain categories of unsecured creditors. See Harris & Mooney, *supra* note 13, at 2045. In fact, the label is unfair since other commentators, for reasons unrelated to fairness to unsecured creditors *per se*, have endorsed their own version of this theory. See Bebchuk & Fried, *supra* note 73, at 913-21 (explaining that their proposal for a rule of only partial priority for secured creditors in bankruptcy is predicated on concerns about the use of inefficient (non-welfare-maximizing) security interests, not the welfare of “victimized” unsecured creditors); Mann, *supra* note 73, at 42-49 (using the construction context as a working example of the purely economic superiority of a rule that gives contractors priority over construction lenders without regard to who was first-in-time.).

86. See Lynn M. LoPucki, *The Unsecured Creditor’s Bargain*, 80 VA. L. REV. 1887 (1994).

of nonconsensual and unwitting unsecured creditors.<sup>87</sup> By transferring a priority position in the debtor's assets to the favored creditor, the debtor and that creditor are able both to externalize the risk of subsequent tort liability and to "victimize" certain other unsecured creditors — particularly those in the middle credit markets<sup>88</sup> — who simply lack the sophistication to appreciate that their extension of credit to the debtor is little more than a trip to the roulette wheel.<sup>89</sup> LoPucki contends that the combination of these subsidies causes a misallocation of resources by encouraging more secured lending to occur than is optimal.<sup>90</sup>

To rectify this situation, LoPucki proposes two simple yet controversial reforms of article 9 of the Uniform Commercial Code. The first is to subordinate secured creditors' priority in the debtor's assets to the claims of tort victims.<sup>91</sup> The second, and somewhat more ambiguous proposal, is to award secured creditors priority only over those unsecured creditors who can be shown to have consented in fact, rather than hypothetically, to a subordinate posi-

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87. *See id.* at 1891 (suggesting that the institution of secured credit "tends to misallocate resources by imposing on unsecured creditors a bargain to which many, if not most, of them have given no meaningful consent"). LoPucki divides the vast bulk of unsecured creditors into two categories — involuntary creditors and uninformed creditors — and describes unsecured creditors' prospects for recovery as wholly contingent on cash flow; that is to say, without any expectation of recovery against the assets of the debtor in the event of liquidation. *See id.* at 1931-41. LoPucki distinguishes both of these categories of creditors from the sophisticated, unsecured creditors who rely on negative covenants to stake out a claim to the net worth of their borrowers, who are ordinarily large, public companies. *See id.* at 1924-31.

88. Large companies, LoPucki observes, are the only ones that approach bankruptcy with significant amounts of unsecured credit. *See id.* at 1924-25.

89. These are LoPucki's "cash-flow surfers." *See id.* at 1907-16.

90. *See id.* at 1897-98 (noting that by simply entering into the security agreement the debtor and a favored creditor are able to appropriate for themselves value that, in the absence of such an agreement, would go to unsecured creditors); *see also* Bebchuk & Fried, *supra* note 73, at 882-91 (explaining the phenomenon in terms of imposing a negative externality on involuntary and uninformed creditors who are unable to adjust the terms of their credit to reflect the expected loss arising from the existence of the secured credit). In order to eliminate the incentive — consisting of this ability to transfer value from nonadjusting unsecured creditors — on the part of the debtor and certain creditors, to adopt a secured financing relationship even if value is lost as a result of that arrangement, Bebchuk and Fried propose a rule of partial priority in bankruptcy for secured creditors based either on the actual extent of nonadjustment or, patterned on the 1985 proposal by the German Commission on Bankruptcy Law, a fixed percentage of every secured claim. *See id.* at 905-13. Moreover, contrary to the approach customarily taken by commentators concerned with theoretical efficiency, Professors Bebchuk and Fried explain that a rule of partial priority should be imposed by legislative fiat, and not left to private ordering by the parties. *See id.* at 930-31.

91. Of course, the universe of involuntary creditors is broader than merely tort victims, but LoPucki limits the scope of his subordination of secured creditors to tort creditors. *See* LoPucki, *supra* note 86, at 1896-97; *see also* Lynn M. LoPucki, *Chapter 11: An Agenda for Basic Reform*, 69 AM. BANKR. L.J. 573, 579-80 (1995).

tion.<sup>92</sup> LoPucki maintains that the cumulative effect of these two reforms would eliminate the unjustified advantages secured creditors presently enjoy under article 9 as a result of its tacit endorsement of the wholly fictitious bargain invented by law and economics scholars in their futile attempt to prove secured credit efficient.<sup>93</sup>

## 2. A Property-Based Account of Secured Credit

Against the backdrop of this two-front assault on the article 9 security interest, Professors Harris and Mooney have developed a normative justification for secured financing grounded in deeply rooted and hallowed concepts of private property.<sup>94</sup> Harris and Mooney's property-based analysis is straightforward and direct, but no less elegant or compelling for its simplicity than some of the more intellectually pretentious challenges to which it is in large measure a response.<sup>95</sup> Moreover, it raises a formidable challenge

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92. See LoPucki, *supra* note 86, at 1947-48. To round out his package of reforms, LoPucki also calls for modernization of the article 9 filing system to provide greater disclosure of the terms and conditions of the security arrangement between the debtor and the secured party. See *id.* at 1950-51. For a more detailed account of these proposals, see Lynn M. LoPucki, *Computerization of the Article 9 Filing System: Thoughts on Building the Electronic Highway*, LAW & CONTEMP. PROBS., Summer 1992, at 5; see also Lynn M. LoPucki, *Why the Debtor's State of Incorporation Should Be the Proper Place for Article 9 Filing: A Systems Analysis*, 79 MINN. L. REV. 577 (1995) (advocating an incorporation-based choice-of-law rule in order to assist searchers in assuring and reducing system costs).

93. See LoPucki, *supra* note 86, at 1892-96, 1935; see also James J. White, *Work and Play in Revising Article 9*, 80 VA. L. REV. 2089, 2090-91 (1994) (agreeing that the economic efficiency debate is irrelevant, "pure intellectual masturbation," to quote his colorful phrase). At the same time, however, White described LoPucki's proposal to elevate unsecured creditor priority as the "real threat" to the goal of maintaining systemic efficiency. See *id.* at 2093-102. Using the results of perhaps the most comprehensive empirical investigation undertaken to date, Professor Ronald Mann also has cast into doubt the conclusions reached by both the efficiency justifications for secured credit and the scholarship that criticizes the current regime as intended to exploit the inability of certain unsecured creditors to adjust the cost of credit to reflect the higher risk that secured lending imposed on them by reducing the pool of assets available to apply to their claims. See Ronald J. Mann, *Explaining the Pattern of Secured Credit*, 110 HARV. L. REV. 625, 683 (1997) (speculating that secured credit may lower the cost of lending transactions "by enhancing the borrower's ability to give a credible commitment to refrain from excessive future borrowing and by limiting the borrower's ability to engage in conduct that lessens the likelihood of repayment").

94. See Harris & Mooney, *supra* note 13, at 2047-53. Professors Harris and Mooney are the reporters for the Drafting Committee for the proposed revision of article 9, conducted under the joint supervision of the American Law Institute and the National Conference of Commissioners on Uniform State Laws. In large measure, the proposed revisions proceed from a property-based conception of security. See UNIFORM COMMERCIAL CODE REVISED ARTICLE 9 (Discussion Draft No. 2, Apr. 1997). The adverse distributional impact of this approach on unsecured creditors has raised serious questions about its appropriateness. See LoPucki, *supra* note 86, at 1891, 1924-41.

95. *But see* Schwartz, *supra* note 75, at 2086 (asserting that Harris and Mooney fail in their effort to explain security because they "do not seriously consider inefficiencies, arising from market externalities and asymmetric information, that may be associated with security").

for anyone who advocates, as we do, that lien stripping ought to be permitted in chapter 7 bankruptcy cases.

Concisely, Harris and Mooney advance an apologia for secured credit grounded upon the normative theories that justify the institution of private property.<sup>96</sup> Although cognizant that all property interests are not identical and that to recognize an interest as a property interest does not end further inquiry,<sup>97</sup> they accept as essentially sound the baseline principles that underlie the policies of freedom of contract and free alienability of property rights.<sup>98</sup> They then explore the implications of those baseline principles for the law of secured transactions, concluding that there is nothing sufficiently different or unique about conveyances for security purposes or their distributive effects to warrant a deviation from the ordinary deference to party autonomy that controls when dealing with other forms of property transfers.<sup>99</sup> While Harris and Mooney construct their account of security in the context of the debate over the future of the law of personal property financing, what they have to say in support of a “hands off” approach to article 9 security interests applies equally to secured credit as an institution, including real property liens and encumbrances.

Harris and Mooney’s defense of security transfers from the attacks that have been leveled from the right, on grounds of wasteful inefficiencies, and from the left, on grounds of unfairness, serves as a healthy reminder that the burden of persuasion rests with those who would favor eliminating or limiting the effectiveness of consensual security interests.<sup>100</sup> Although we can conceive of that case

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96. See Harris & Mooney, *supra* note 13, at 2048-53. Encapsulated within this conceptualization are the related precepts of freedom of contract and the right to alienate property freely, as well the right of an owner of private property to enjoy his property, within certain widely circumscribed parameters, to the exclusion of others.

97. The issue is not so much whether property rights are absolute, but the extent to which the state may limit or interfere with private property ownership. While opinions on this question differ, nobody in our political-economic system seriously questions the importance and deference to be accorded to such rights as a threshold proposition. See generally Ponoroff & Knippenberg, *supra* note 23, at 321 n.347, and authorities cited therein.

98. See Harris & Mooney, *supra* note 13, at 2050.

99. See *id.* at 2052-53. The two important principles the authors derive from analogizing a security transfer to any other transfer of an interest in property are: (1) Article 9 should be drafted to facilitate rather than impede the creation of security interests; and (2) the scope of article 9 should be expanded to include several types of transactions that are now excluded. See U.C.C. § 9-104 (1994).

100. See also White, *supra* note 93, at 2092, 2099 (suggesting, in connection with a commentary on Harris and Mooney’s work, that if article 9 were repealed, the response inevitably would be the development of what, in all likelihood, would be even less efficient and less advantageous security substitutes). Professor White has broadly called for retention and even expansion of the first-to-file priority principle that now forms one of the central underpinnings of article 9. See James J. White, *Reforming Article 9 Priorities in Light of Old Igno-*

being made, perhaps most easily in relation to the priority of non-consensual unsecured claims,<sup>101</sup> Harris and Mooney have refocused and centered the debate by pointing out, quite accurately, that anyone who has a proposal to make in this area writes against the backdrop of a deeply rooted legal tradition, and not *tabula rasa*.

Harris and Mooney conclude that the extent to which secured transactions promote efficiency considerations and general social welfare are empirical questions probably not conducive to reaching a definitive answer.<sup>102</sup> While that assertion certainly is true, it is equally certain, regardless of whether the precise effects can be measured or not, that a debtor that fully encumbers its assets has externalized the cost of its tort and other general business risks to its unsecured creditors and, in the process, effectively eliminated any hope for successful reorganization if the debtor later encounters financially turbulent waters.<sup>103</sup> Harris and Mooney would respond to this point presumably by pointing out that by focusing only on the distributional consequences of secured credit, we potentially overlook the fact that an extension of credit to a troubled debtor, even if secured, may still be better for unsecured creditors than if their debtor is unable to borrow at all.<sup>104</sup> Although

*rance and New Filing Rules*, 79 MINN. L. REV. 529, 535 (1995). For another contemporary apologia for the current system, as well as the current direction of the reform process, see Peter A. Alces & David Frisch, *On the UCC Revision Process: A Reply to Dean Scott*, 37 WM. & MARY L. REV. 1217 (1995).

101. The authors of this article differ on whether uninformed creditors, so-called "Bubbas," should be accorded the same treatment as tort creditors, but then one of us is biased by his lifelong affiliation with that group, while the other is perhaps insensitive because of his inability to relate. See Steve Knippenberg, *The Unsecured Creditor's Bargain: An Essay in Reply, Reprisal, or Support?*, 80 VA. L. REV. 1967, 1969 n.13 (1994).

102. See Harris & Mooney, *supra* note 13, at 2047.

103. This is essentially a problem of scope; that is, whether secured creditors should be permitted, to the detriment of general creditors, to take a lien on virtually everything the debtor owns, thereby ensuring participation in the debtor's successes if things go well, without risking serious loss if the debtor fails. We are sympathetic to the view that the reach of secured credit should not extend to this extent. In fact, one of us has been active in advancing a proposal that would permit a lien creditor of a business debtor to execute on a fully encumbered debtor's assets and receive a specified percentage of the proceeds of sale ahead of the secured creditor. However, the issue insofar as this proposal is concerned is an inter-creditor issue and, as such, it is outside the scope of this article. However, the existence of the debate does serve to underscore the point that, in both a bankruptcy and a nonbankruptcy setting, we have some control over the concept of security, and that, in defining a security interest, we have the freedom to proceed from a sound balancing of normative objectives, not an immutable set of *a priori* principles.

104. See Harris & Mooney, *supra* note 13, at 2035. The authors refer to this phenomenon as the "second best" result for unsecured creditors. See also Steven L. Schwartz, *The Limits of Theory: A Lesson from the Secured Credit Controversy* (May 27, 1997) (unpublished manuscript, on file with authors) (arguing that Bebchuk and Fried, as well as other commentators critical of article 9's basic priority scheme, tend to ignore the fact that the increased liquidity afforded by secured credit in times of financial difficulty actually creates value for unsecured creditors as well as for the debtor).

this observation fails to address satisfactorily all of the problems associated with a system that permits a debtor to pledge all of its assets to a single creditor, Harris and Mooney's conveyance model remains a highly workable heuristic apparatus for understanding how security operates under state law. Moreover, it reveals why the quest to solve the "puzzle" of secured credit may simply have been a wild goose chase from the beginning.<sup>105</sup>

But what of the conveyance model as it relates to secured creditors and secured claims in bankruptcy? More specifically, what are the implications of this conceptualization of a security interest as a form of private property not just for the general creditors of a firm,<sup>106</sup> but specifically for a consumer debtor? Even more to the point, what are the implications of the conveyance model for the *Dewsnup* issue, and are they tenable? It is at this juncture that we encounter the limits of the conveyance model precisely because, ironically enough, of its distributional effects in the case of those debtors who do become insolvent.

#### IV. SECURED CLAIMS AND BANKRUPTCY POLICY

##### A. *The Limits of the Conveyance Model*

Insolvency, of course, is the risk against which a secured creditor has hedged. Harris and Mooney's defense of secured credit is premised, in significant part, on the belief that the distributive effects of secured credit upon insolvency are neither contrary to the wealth maximization norm nor any more prejudicial to unsecured creditors than are other forms of wealth transfers.<sup>107</sup> Some, but far fewer than all, insolvent debtors seek bankruptcy relief. Those who do and who are individual debtors are presumptively entitled to a fresh

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105. See Harris & Mooney, *supra* note 13, at 2036 ("Whether the benefits of secured credit outweigh its costs in a few, many, or most of the circumstances in which security interests are granted is an empirical question that cannot be answered with any certainty using existing information."). The first serious effort to develop these empirical data reveals that the reasons why commercial debtors resort to secured and unsecured credit are more complex, as well as industry- and context-dependent, than they have been given credit for in the literature to date. See Mann, *supra* note 93, at 630 (pointing out that prior attempts at grand theoretical justifications have ignored important party motivations and incentives that significantly affect borrowers' decision to use or not to use collateral).

106. See *supra* note 99.

107. See Harris & Mooney, *supra* note 13, at 2067-71 (arguing that the purposes and benefits of giving and taking security would be undermined considerably if security interests were not generally honored in bankruptcy). *But see* Bebchuk & Fried, *supra* note 73, at 891-903 (maintaining that according full priority to secured creditors in bankruptcy undermines the goal of economic efficiency by promoting excessive use of security interests).

start.<sup>108</sup> In addition, it is certainly not unheard of for a balance-sheet-solvent debtor to take refuge from cash flow pressures or other business problems in a chapter 11 proceeding. Thus, when Harris and Mooney test their conveyance model of security interests against bankruptcy policy, and find the two not fundamentally incompatible,<sup>109</sup> they overlook a central tenet of their own normative view of security interests. Specifically, they fail to see that the logical concomitant of a property-based theory would be that a secured creditor's protectible interest is not limited to the value of the property at any given point in time. Rather, it should extend to future as well as to existing equity and to control over the decision of when to realize that value through foreclosure or otherwise.<sup>110</sup> In bankruptcy, however, while there may be general agreement that bankruptcy proceeds from state-law entitlements and priorities,<sup>111</sup> we also begin with the notion that a claim is "secured" only to the extent of the value of the underlying collateral as of the date of

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108. Section 707(b) of the Code, which essentially permits dismissal of a chapter 7 case where the debtor is able to pay off a substantial portion of her debts in a chapter 13 plan, nevertheless provides: "There shall be a presumption in favor of granting the relief requested by the debtor." 11 U.S.C. § 707(b) (1994).

109. See Harris & Mooney, *supra* note 13, at 2067. The authors conclude both that bankruptcy policy does not conflict with the principle of honoring a debtor's prebankruptcy transfers of property generally, and that there is nothing "special" about security interests that give rise to a conflict with bankruptcy policy. Of course, the Code regards at least some transfers as beyond the pale. See 11 U.S.C. §§ 547-548 (1994). Although we have no problem with respecting and enforcing the transfer, or with its conceptualization as a property interest for state-law purposes, we believe that in a bankruptcy context, fresh-start policy dictates the interest should not be deemed to continue beyond the filing of the case. See *infra* notes 222-29 and accompanying text.

110. This follows naturally from Harris and Mooney's insistence that the transfer of a security interest must be understood in the same manner as the physical transfer of possession. As we demonstrate below, however, once we abandon the unstated assumption that the conveyance- or property-based model is the only appropriate metaphoric concept for defining security, the secured creditor's claim to future appreciation through control over the disposition of the property immediately becomes more attenuated. See *infra* text accompanying notes 204-10.

111. See Harris & Mooney, *supra* note 13, at 2067 n.135. The basic disagreement that exists in the literature is not over the recognition of state-law rights and priorities as a starting place for analysis, but over whether, and the extent to which, bankruptcy should have a distributional policy separate and apart from the distributional scheme imposed by state debt collection law. See Frost, *supra* note 56, at 82-91, 122-35 (describing the nature of the disagreement, but concluding, wrongly in our judgment, that bankruptcy is not suited to redistributing the social and economic costs of business failure). But see Elizabeth Warren, *Bankruptcy Policy*, 54 U. CHI. L. REV. 775, 789-90 (1987) (pointing out that the bankruptcy process is our system for distributing the costs of simultaneous default to multiple creditors — an issue that is not addressed directly by state law).



filing or confirmation.<sup>112</sup> Moreover, with one curious exception,<sup>113</sup> a secured creditor's protectible interest in a debtor-rehabilitation proceeding is limited to the current value of its collateral.<sup>114</sup>

Harris and Mooney perhaps even overstate the threshold point that most scholars agree that, at least as a baseline, bankruptcy law should honor nonbankruptcy entitlements.<sup>115</sup> Even the law and economics scholars who adhere most strictly to that baseline — due mainly to its compatibility with their view on the scope of bankruptcy policy<sup>116</sup> — acknowledge that a bankruptcy system cannot honor state-law entitlements in every respect. Rather, they contend that what matters is preserving the “relative value” of state-law rights and entitlements.<sup>117</sup> But this is very different from preserving every aspect of the interest including, potentially, its future entail-

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112. See 11 U.S.C. §§ 506(a), 1129(b)(2), 1225(a)(5), 1325(a)(5) (1994); Carlson, *Undersecured Claims*, *supra* note 6, at 304-06 (discussing whether bankruptcy values should be regarded as fixed or subject to change as circumstances during the course of the case dictate). The time for valuation, particularly in reorganization cases, is a subject of vigorous and continuing disagreement; see also *supra* note 54. See Peter V. Pantaleo & Barry W. Ridings, *Reorganization Value*, 51 BUS. LAW. 419 (1996); *infra* note 223; see also *In re Maddox*, 194 B.R. 762 (Bankr. D.N.J.) (addressing the issue in the context of a chapter 13 plan), *affd.*, 200 B.R. 546 (D.N.J. 1996).

113. The exception, of course, is for debts secured only by the debtor's principal residence pursuant to § 1322(b)(2), which cannot be modified in a chapter 13 plan. See *Nobelman v. American Sav. Bank*, 508 U.S. 324 (1993). The exception is curious, in our judgment, precisely because it attaches to what is usually the single most important asset in a consumer bankruptcy case: the debtor's home. Its inclusion in the Code may be explicable much more easily with reference to special-interest pressure than in terms of its consonance with Code policy. Cf. Veryl Victoria Myles, *The Bifurcation of Undersecured Residential Mortgages Under § 1322(b)(2) of the Bankruptcy Code: The Final Resolution*, 67 AM. BANKR. L.J. 207, 218 (1993) (describing the provisions as a compromise reflecting Congress's desire to protect the home mortgage industry). Because, however, most home mortgage loans will have a remaining term considerably longer than the term of the chapter 13 plan, this restriction is of less practical significance than might be apparent at first blush. See *In re Foster*, 61 B.R. 492 (Bankr. N.D. Ind. 1986) (suggesting that § 1322(d) (formerly (c)) should be read as prohibiting modification of any debt, the last payment under which is due after the last payment date under the proposed plan); see also 11 U.S.C. § 1322(c)(2) (1994) (added by the 1994 Amendments to permit modification of a home-mortgage loan, the final payment for which is due prior to the date on which the final payment under the plan is due). Moreover, as a practical matter, if the mortgage has ten or more years remaining, even if modification were not prohibited, it would be difficult in most cases to come up with a plan that satisfied the confirmation standard for the secured portion of the debt as set forth in § 1325(a)(5).

114. See *supra* note 12. In a chapter 11 case, a qualification must be made for a creditor that makes the § 1111(b) election, but even then the creditor is only entitled to payments with an aggregate value of the amount owed, and not the present value of the face amount of the claim. For an alternative reading of § 1111(b), see Carlson, *Unsecured Claims*, *supra* note 6, at 300-04. We adopt the reading that Professor Carlson acknowledges to be the “orthodox interpretation.” *Id.* at 291.

115. See Harris & Mooney, *supra* note 13, at 2067 n.135.

116. See *supra* note 52.

117. See *supra* note 53. But see *Bebchuk & Fried*, *supra* note 73, at 862-63 (challenging the traditional view that it is desirable to recognize the state-law priority rights of secured creditors to the greatest extent possible in bankruptcy).

ments. Moreover, there are numerous instances in which the Code substantively alters prebankruptcy entitlements and priorities in order to advance a specific bankruptcy policy, whether it be equality,<sup>118</sup> equity,<sup>119</sup> maximization of value,<sup>120</sup> or fresh start.<sup>121</sup> Finally, even among scholars whose normative judgment about the efficacy of legal rules is inversely correlated with their assessment of the extent to which such rules produce negative distributional consequences, there is no longer unanimous assent to the view, derived from the "creditors' bargain theory,"<sup>122</sup> that economic efficiency demands that the secured creditor's bargain must be emulated in bankruptcy.<sup>123</sup>

B. "*Liens Survive Bankruptcy*": *Eternal Verity or Silly Semantics?*

A 1995 decision from the Seventh Circuit,<sup>124</sup> authored by Chief Judge Posner, illustrates this point, albeit perhaps inadvertently. John and Alyce Penrod were hog farmers. They executed a promissory note for \$150,000 to the predecessor in interest of Mutual Guaranty Corporation. The note was secured by the Penrods' hogs. A year later, the Penrods filed for relief under chapter 11 and eventually proposed and confirmed a reorganization plan in which Mutual Guaranty's claim would be paid in full, with interest, over seven years.<sup>125</sup> The plan made no mention of Mutual Guaranty's lien on the hogs. After the plan went into effect, the Penrods sold what Mutual Guaranty apparently believed were still its hogs. When the Penrods refused to turn the proceeds from the sale over to Mutual Guaranty as required under the terms of the original

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118. See 11 U.S.C. § 547(b) (1994) (permitting the trustee to avoid prebankruptcy transfer of the debtor's property, including transfers for security purposes, that undermine the bankruptcy policy of equality among creditors).

119. See 11 U.S.C. § 510(c) (1994) (conferring discretion on the bankruptcy court to alter the legal priority of claims based upon equitable considerations).

120. See 11 U.S.C. §§ 361, 362(a), (d) (1994) (allowing the debtor to prevent enforcement of a security interest by providing adequate protection to the secured creditor).

121. See 11 U.S.C. § 522(f)(1)(13) (1994) (permitting the debtor to avoid nonpossessory, nonpurchase money security interests in certain collateral, including consumer goods and tools of the trade, to the extent such security interest impairs an exemption).

122. See *supra* note 52.

123. See *Bebchuk & Fried, supra* note 73, at 895-902 (arguing that according full priority to secured claims in bankruptcy tends to reduce the efficiency of the loan agreement consummated between the borrower and the secured creditor); *Picker, supra* note 52, at 661-62 (maintaining that secured credit can be employed to solve the common-pool problem, thereby eliminating the need for the mandatory Eden that the creditors' bargain theory imposes to justify the existence of the bankruptcy system).

124. See *In re Penrod*, 50 F.3d 459 (7th Cir. 1995).

125. See 50 F.3d at 461.

security agreement, Mutual Guaranty sued in state court to enforce its lien against the proceeds. The Penrods responded by seeking a contempt order from the bankruptcy court on the ground that Mutual Guaranty had violated the confirmation order. The bankruptcy court ruled that Mutual Guaranty's lien had been extinguished and enjoined Mutual Guaranty from attempting to enforce it, and the district court affirmed.<sup>126</sup>

On further appeal, the Seventh Circuit observed that the default rule under the Code for secured creditors who file claims for which provision is made in the plan is extinction of the lien unless the plan expressly provides otherwise.<sup>127</sup> Because this particular plan *did* make provision for the claim, and because that provision *did not* include continuance of the lien, the court concluded that of necessity the lien was extinguished upon confirmation. In response to Mutual Guaranty's property-based rejoinder, Judge Posner's opinion expressed surprise that it was still necessary to debunk the myth that "liens pass through bankruptcy unaffected," observing that, "[t]hey do — unless they are brought into the bankruptcy proceeding and dealt with there."<sup>128</sup> Finally, the court dismissed as

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126. See 50 F.3d at 461.

127. See 50 F.3d at 462-63. The court based its interpretation on the express language of § 1141(c), which provides that "except as otherwise provided in the plan or in the order confirming the plan, after confirmation of a plan, the property dealt with by the plan is free and clear of all claims and interests of creditors." 11 U.S.C. § 1141(c) (1994); see also *Simon v. Tip Top Credit Union (In re Simon)*, Nos. 94-3304, 94-3312, 1996 U.S. App. LEXIS 8733, at \*7 (10th Cir. Apr. 22, 1996) (applying *Penrod*); *Tor Husjord Shipping v. Isabel/San Benito Navigation Dist. (In re Burton Secs. S.A.)*, No. C-96-68, 1996 U.S. Dist. LEXIS 16951, at \*23 (S.D. Tex. July 2, 1996) (citing *Penrod* in support of the proposition that liens, once brought into a bankruptcy proceeding, can be altered there). In *FDIC v. Union Entities (In re Be-Mac Transp. Co.)*, 83 F.3d 1020 (8th Cir. 1996), the court observed that a creditor could only lose its lien under § 1141(c) "if the lien holder participated in the reorganization; otherwise, its lien would not be 'property dealt with by the plan.'" 83 F.3d at 1026 (citing *Penrod*, 50 F.3d at 463). However, even if the creditor elects to ignore the proceeding, the debtor can always force the issue by filing a claim for the creditor under § 501(c). See *supra* note 43 (quoting *Penrod*, 50 F.3d at 459, 462). Moreover, in *Winchell v. Town of Wilmington (In re Winchell)*, 200 B.R. 734 (Bankr. D. Mass. 1996), the court relied on the broad definition of property of the estate in § 541 as the basis for finding that the creditor's lien was extinguished upon confirmation of the debtor's plan, even though neither the creditor nor the debtor had filed a proof of claim. See 200 B.R. at 737-38.

128. *Penrod*, 50 F.3d at 463. The court rejected as well the argument that the plan dealt only with the secured creditor's claim, but not with its lien. See *Penrod*, 50 F.3d at 463. But see *Cen-Pen Corp. v. Hanson*, 58 F.3d 89 (4th Cir. 1995) (refusing to interpret § 1327(c), despite its linguistic similarity to § 1141(c), as releasing the debtors' property from a mortgage that, under the terms of the plan, had been treated as an unsecured claim); *Manistee County v. Reef Petroleum Corp. (In re Reef Petroleum Corp.)*, 92 B.R. 741 (Bankr. W.D. Mich. 1988). While Chief Judge Posner in *Penrod* recognized that the axiom that "liens pass through bankruptcy unaffected" was little more than a mesmerizing rhetorical aphorism, the court in *Cen-Pen* fell prey to that rhetoric even though, in that case, the mortgagee had raised no objection to its treatment under the plan. See *Cen-Pen*, 58 F.3d at 92 ("[L]iens pass through bankruptcy unaffected . . . [u]nless the debtor takes affirmative action to avoid a security interest in the property of the estate . . ."); see also *In re Beta Intl., Inc.*, No. 96-

essentially frivolous Mutual Guaranty's suggestion that this interpretation of the Code might be problematic under the Due Process Clause or Takings Clause of the Fifth Amendment.<sup>129</sup>

Unquestionably, the decision in *Penrod*, authored by one of the early luminaries of the law and economics movement, establishes that what comes out of a bankruptcy proceeding may bear little resemblance to that which entered. The reason for this potential transmogrification, contemplated in Code provisions like section 506(d) no less than in section 1141(c), is that bankruptcy does have certain normative policy objectives distinct from those of state collection law.<sup>130</sup> Not the least of these, in a consumer bankruptcy case, is the fresh start for a financially beleaguered debtor.<sup>131</sup>

In spite of the majority's deliberate attempt to limit the precedential value of the holding,<sup>132</sup> *Dewsnup* might have triggered a

71561, 1996 U.S. Dist. LEXIS 18869 (E.D. Mich. Nov. 7, 1996) (distinguishing *Cen-Pen* and *Penrod* based on the specific provisions of § 1141(c)); *Coffin v. Malvern Fed. Sav. Bank*, 189 B.R. 323 (E.D. Pa. 1995) (distinguishing *Penrod* on the grounds that the mortgagee in this case had not attempted to collect, and the plan did not provide for, the entire debt owing to the creditor, but only the past due arrearages). *But see* *Green Tree Fin. Servicing Corp. v. Smithwick*, 202 B.R. 420 (S.D. Tex. 1996) (applying *Penrod* in the context of a confirmed chapter 13 plan).

129. *See Penrod*, 50 F.3d at 464 (noting that the creditor's reliance on *United States v. Security Industrial Bank*, 459 U.S. 70 (1982), was misplaced since the creditor could have protected its property interest from an uncompensated taking by appealing from the order confirming confirmation). With respect to lien stripping per se, *Security Industrial Bank* is equally not a bar since, by virtue of having a full and fair opportunity to litigate the issue of the value of the secured claim, and by having an unsecured claim for the unsecured portion of the claim, nothing has been taken from the creditor. *See* Howard, *supra* note 24, at 416 (noting that the lien avoided under § 506(d) is without current value — an “empty legal right”); *see also In re Butcher*, 189 B.R. 357, 372-73 (Bankr. D. Md. 1995) (rejecting a similar challenge to § 522(b) premised on a rational basis standard); *infra* note 144.

130. As observed *supra* note 53, this is a pivotal point of disagreement in contemporary scholarship over bankruptcy purposes and policymaking. *See* Ponoroff & Knippenberg, *supra* note 56, at 948-62; *see also infra* text accompanying notes 230-34.

131. *See supra* note 23. The fresh start represents neither a cognizable legal right nor a formal legal status. Rather it is the condition intended to result from the application of specific bankruptcy rules in particular cases. While the centrality of the fresh start as a core feature of the consumer bankruptcy system is no longer an open question, serious disagreement over the normative underpinnings of the fresh-start doctrine still exists and has enormous implications for questions relating to application of the doctrine in particular contexts. *See* Ponoroff & Knippenberg, *supra* note 23, at 250-52; *see also* Beth A. Buchanan Staudenmaier, Note, *Survival of Liens: “Liens Pass Through Bankruptcy Unaffected” — Or Do They?* In re *Penrod — Challenging an Adage*, 21 U. DAYTON L. REV. 445 (1996) (arguing that the approach taken by Judge Posner in *Penrod* adequately balances the competing fresh-start and creditor-protection goals of bankruptcy).

132. The Court stated: “We . . . focus upon the case [only] before us and allow other facts to await their legal resolution on another day.” *Dewsnup v. Timm*, 502 U.S. 410, 416-17 (1992). The court went on to admonish that “we express no opinion as to whether the words ‘allowed secured claim’ have different meaning in other provisions of the Bankruptcy Code.” *Dewsnup*, 502 U.S. at 417 n.3. For discussion of how courts have interpreted that language in other debtor-relief contexts, *see supra* note 12.

return to an *in rem* notion of security interests in bankruptcy.<sup>133</sup> As *Penrod* robustly illustrates, however, it did not.<sup>134</sup> Instead, it seems that the Supreme Court's decision in *United Savings Association v. Timbers of Inwood Forest Associates, Inc. (In re Timbers of Inwood Forest Associates)*<sup>135</sup> rendered four years prior to *Dewsnup*, was indeed the watershed event it appeared to be at the time, in terms of laying to rest the notion that a secured creditor's "interest in property" could be determined in isolation from other provisions of the Bankruptcy Code.<sup>136</sup> In virtually every context in which the *Dewsnup* issue has been presented to the courts, the outcome has been to reject expansion of the doctrine beyond the narrow factual parameters of the case.<sup>137</sup> For a time, the only significant exception was in the case of lien avoidance under section 522(f) of the Code.<sup>138</sup> However, as discussed earlier, Congress has now amended that provision in a manner that implicitly abnegates a property-based conception of security in this context as well in favor of one that recognizes only the secured creditor's priority in collateral to the extent of its immediate prebankruptcy value.<sup>139</sup>

As useful and as normatively appealing as Harris and Mooney's property metaphor may be for understanding the institution of secured credit within the broader framework of the commercial law, the explanatory prowess of the model breaks down when extended to the bankruptcy milieu. It does so not because this conceptualization of security is flawed necessarily, although the

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133. See Newborn, *supra* note 4, at 573-81 (suggesting that prior bankruptcy law, including the former Bankruptcy Act, was more inclined to accept an *in rem* notion of security and, thus, was more reticent about altering the lien enforcement rights of secured creditors).

134. See *supra* notes 12, 54 and accompanying text.

135. 484 U.S. 365 (1988).

136. In *Timbers*, the Court rejected the argument that an undersecured creditor, as a condition to the continuation of the stay, was entitled to compensation for the "lost opportunity costs" attributable to the delay in repossessing and realizing the value of the collateral. Instead, the Court concluded that the creditor's "interest in property" entitled to adequate protection under § 361 was limited to the value of the collateral as of the time of filing. See *Timbers*, 484 U.S. at 370-82. How to measure that value, and at what point in time, has been a continuing source of controversy and uncertainty. See *supra* note 65; *infra* note 223. But see Carlson, *supra* note 10, at 20-23 (contending that, after *Dewsnup*, secured creditors are entitled to claim post-filing appreciation value in reorganization proceedings until confirmation, and again upon conversion or dismissal). While his main focus is on reorganization cases, Professor Carlson points out that a logical reading of *Dewsnup* is that § 506(a) valuation might never constitute a ceiling on undersecured entitlements to collateral, short of actual sale. See *id.* at 4.

137. See *supra* note 12. For example, in *Harmon v. United States*, 101 F.3d 574, 581-83 (8th Cir. 1996), the court noted that the weight of authority now establishes that lien-stripping is permitted in all reorganization chapters.

138. See *supra* notes 27-29 and accompanying text.

139. See *supra* notes 15-17.

attempt to define a security interest as a property interest has been vigorously resisted in some quarters.<sup>140</sup> Rather, even giving this conceptualization of security its due, the model fails because bankruptcy policy establishes the limits of private property no less than it does the limits of sanctity of contract.<sup>141</sup> *Dewsnup*'s interdiction against lien stripping has been rejected in chapter 11 and 13 cases because it would effectively eviscerate the rehabilitative policy that underlies those chapters.<sup>142</sup> Similarly, *Dewsnup* should be discarded in chapter 7 because it interferes fundamentally with fresh-start policy and is not necessary to protect the secured creditor's interest in the estate's property in a bankruptcy proceeding. To the extent that the property-based characterization of security interests is at odds with this formulation, it too should be rejected once a bankruptcy proceeding has been initiated.<sup>143</sup>

Once we get beyond the false rhetoric in *Dewsnup* that lien stripping implicates constitutional concerns,<sup>144</sup> we can appreciate

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140. See Harris & Mooney, *supra* note 13, at 2051 n.82 (referring to a functional approach to security devised by Professors LoPucki and Warren); see also John D. Ayer, *Rethinking Absolute Priority After Ahlers*, 87 MICH. L. REV. 963, 989-90 (1989) (describing the "demise of property as possession" in the Supreme Court's (pre-*Dewsnup*) approach to property interests in bankruptcy cases).

141. See Robert A. Hillman, *Contract Excuse and Bankruptcy Discharge*, 43 STAN. L. REV. 99 (1990) (discussing bankruptcy's liberal policy of discharging individuals from contractual obligations in comparison to traditional contract law's "miserly approach" to excusing parties who fail to perform as agreed from liability for breach).

142. See *supra* notes 12, 129.

143. Of course, it is not a foregone conclusion that a property-based conception of security is inconsistent with this view of bankruptcy policy and purposes. To the extent the undersecured creditor receives a priority claim in its collateral, its property interest arguably has been fully vindicated. It is the undersecured portion of the claim — which has no value — that is stripped down. In this sense there is no taking. This is why, for example, strip down poses no serious constitutional question. See *infra* note 144. On the other hand, if one includes within the definition of the property right conveyed to the secured creditor the right to foreclose on the collateral and choose the time of foreclosure, then, to that extent, bankruptcy conflicts with the property-based understanding of security.

144. See Howard, *supra* note 39, at 524-25 (explaining that the constitutional issue in relationship to *Dewsnup* is a false one; that is, there can be no taking if the lien avoided under § 506(d) has no value); see also James Steven Rogers, *The Impairment of Secured Creditors' Rights in Reorganization: A Study of the Relationship Between the Fifth Amendment and the Bankruptcy Clause*, 96 HARV. L. REV. 973, 987-88 (1983) (explaining why Fifth Amendment uncompensated takings arguments with respect to the impairment of secured claims fail because of the primacy of the Bankruptcy Clause of the Constitution); *supra* note 129. It might also be argued that even if one were to conclude in this context that there was a taking for the benefit of another private person, the taking might still be permitted as a justifying public purpose — the national interest in debtor relief, with the creditor's corresponding unsecured claim as compensation. See *Hawaii Hous. Auth. v. Midkiff*, 467 U.S. 229, 240-41 (1984). This assumes that an undersecured creditor whose lien is not stripped down has no claim for the unsecured portion of its claim. See Howard, *supra* note 39, at 517-18. However, as discussed *infra* note 183, it is not clear that an unsecured claim is barred in the absence of strip down and that, therefore, it can properly be treated as recompense for strip down were it permitted to occur.

that Justice Blackmun's analysis was influenced heavily by the implicit conception of a security interest as entailing a *bargain* between the debtor and creditor,<sup>145</sup> a notion that is congruent in many respects with the theoretical underpinnings of Harris and Mooney's conveyance model.<sup>146</sup> This bargain metaphor, perfectly valid and fiercely rational under state law and procedures, conjures up entailments of vested rights and interests that, once internalized, preordain the protection of those rights and interests under virtually any circumstances. The bankruptcy regime, however, changes the rules of the game. Many bargains, fairly struck and fully enforceable in the workaday world, come undone once a bankruptcy petition is filed. Hard-core promises are broken and, in the process, losses reallocated between debtor and creditors and among creditors *inter se*.<sup>147</sup> In fact, in its most fundamental sense, bankruptcy, whether in its liquidation or reorganization mode, represents nothing less than a wholesale and compulsory readjustment of contractual obligations<sup>148</sup> and realignment of property interests.<sup>149</sup> In this mix, the time-honored axioms that "liens pass through bankruptcy"<sup>150</sup> and "bankruptcy respects state law entitlements"<sup>151</sup> are

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145. See *Dewsnup v. Timm*, 502 U.S. 410, 417 (1992) ("[T]he creditor's lien stays with the real property until the foreclosure. That is what was bargained for by the mortgagor and the mortgagee.").

146. See *supra* section III.B.2. Admittedly, this assumes that the property interest conveyed includes not only the right to foreclosure value but the right to choose the timing on foreclosure. Since bankruptcy is always a known possibility, and since, under state law, a mortgagee is not always assured of controlling the timing on foreclosure — for example, another lienholder may elect to initiate such proceedings — it is not by any means impossible to reconcile a property-based conception of security with the characterization of secured claims in bankruptcy advanced here. See Harris & Mooney, *supra* note 13, at 2068 (observing that bankruptcy requires "that property claimants recover their property *or its value* before the conclusion of the case" (emphasis added)).

147. See Warren, *supra* note 66, 352-61 (discussing the distributional functions of the business bankruptcy system).

148. See generally Donald R. Korobkin, *Rehabilitating Values: A Jurisprudence of Bankruptcy*, 91 COLUM. L. REV. 717, 774 (1991) (describing the bankruptcy system as the forum where the diverse aims and values of the participants in financial distress can be debated and ultimately synthesized into a coherent view of what it is that the rehabilitated enterprise shall exist to do in the future).

149. There are numerous Bankruptcy Code provisions that have the effect of either eliminating liens entirely or altering the post-bankruptcy rights of lienholders, including the trustee's avoiding powers, the debtor's power to avoid certain liens under § 522(f)(1), and the ability to modify the rights of secured claimholders in various reorganization proceedings. See *supra* notes 118-21; see also *In re Penrod*, 50 F.3d 459, 463 (7th Cir. 1995), discussed *supra* text accompanying notes 124-29; Howard, *supra* note 39, at 526 ("A more accurate statement is that liens pass through bankruptcy unaffected only if none of bankruptcy's powers to affect liens have been brought to bear.").

150. See *Dewsnup v. Timm*, 502 U.S. 410, 418 n.4 (1992) (identifying support for the proposition in the 1898 Bankruptcy Act).

151. See *supra* note 54.

still bandied about with great frequency. Yet they are alone only empty incantations, and even in context they at best represent incomplete and imperfect expressions of reality that take on subtle shadings of different meaning depending on the particular context in which they are raised.

There is nothing new in all of this. Put in its proper historical context, the Bankruptcy Reform Act of 1978 was an evolutionary, not a revolutionary, piece of legislation. Debtors have been able to discharge contractual obligations, wholly valid and otherwise enforceable under state law, since at least the time of the Bankruptcy Act of 1841.<sup>152</sup> Renegotiation of contractual obligations, including secured obligations, in reorganization or rehabilitation proceedings goes back at least as far as the Chandler Act of 1938.<sup>153</sup> Furthermore, notwithstanding Justice Blackmun's protestations in *Dewsnup* to the contrary, even in straight bankruptcy, the Bankruptcy Act of 1898 was not entirely neutral insofar as the treatment of the state-law rights of undersecured creditors was concerned.<sup>154</sup> Unquestionably, however, the Bankruptcy Reform Act did expand in certain critical respects the ability of the debtor or the trustee to alter prebankruptcy bargains in order to attain bankruptcy goals.<sup>155</sup> An essential component of this undertaking was the Code's adoption, in a far more overt manner than anything even hinted at under the former Act, of the principle that the secured creditor's rights were limited to the value of its collateral rather than to a possessory

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152. Bankruptcy Act of 1841, ch. 9, 5 Stat. 440 (repealed 1843); see Tabb, *supra* note 43, at 350-53.

153. Chandler Act, Pub. L. No. 75-575, 52 Stat. 840 (1938) (repealed 1978). The Chandler Act amendments to the Bankruptcy Act of 1898, Pub. L. No. 55-541, 30 Stat. 544 (repealed 1978), added to the bankruptcy law, among other things, chapter X (addressing corporate reorganizations), and chapter XII (addressing real property arrangements), both of which permitted the extension or reduction of secured as well as unsecured debt under proper circumstances. See Vern Countryman, *A History of American Bankruptcy Law*, 81 *COM. L.J.* 226, 231 (1976). The other new form of reorganization, chapter XI arrangements, was confined to unsecured debt. The general principles of composition and extension have even more ancient antecedents in Anglo-American bankruptcy law. See generally JAMES ANGELL MACLACHLAN, *HANDBOOK OF THE LAW OF BANKRUPTCY* 371-72 (1956); Charles Jordan Tabb, *The History of the Bankruptcy Law of the United States*, 3 *AM. BANKR. INST. L. REV.* 5, 27-29 (1995).

154. See generally Frank R. Kennedy, *Secured Creditors Under the Bankruptcy Reform Act*, 15 *IND. L. REV.* 477, 482-86 (1982) (noting that the former Bankruptcy Act's approach to secured claims was largely left to implication); Newborn, *supra* note 4, at 565-67 (describing the treatment of undersecured claims in straight bankruptcy cases under § 57(h) of the Act).

155. Explicit claim bifurcation under § 506(a), the liberalization of the standards governing preference recovery pursuant to § 547(b), the ability of consumer debtors to redeem items of personal property under § 722, and the right to avoid exemption-impairing liens can be pointed to as just a few examples. See generally Kennedy, *supra* note 154, at 486-97 (describing the efforts made under the Code in relation to secured creditors as particularizing and clarifying the ways in which their rights are affected).



interest in the collateral itself.<sup>156</sup> This principle found substance, for example, in the concept that, under the Code, a debtor might retain essential collateral even though there was no equity cushion to protect the secured creditor.<sup>157</sup> In short, the Code openly embraced a sufficiently new and different attitude toward undersecured claims so as to render feeble at best Justice Blackmun's contention that application of the plain language of section 506(d) would amount to an *unwarranted* break with pre-Code practices relating to the treatment of liens.<sup>158</sup>

### C. *The Multiple Lien Redux*

Whatever the answer is to the puzzle of secured credit as a matter of state commercial law,<sup>159</sup> the bargain metaphor is untenable in a bankruptcy case. Bankruptcy generally, and chapter 7 in particular, represents a day of financial reckoning. All pre-filing claims are accelerated,<sup>160</sup> adjudicated (or estimated, if necessary),<sup>161</sup> priori-

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156. See Peter F. Coogan, *Article 9 — An Agenda for the Next Decade*, 87 YALE L.J. 1012, 1028-30 (1978) (indicating that the Code had moved away from an approach that viewed the secured party's interest as "property rights" to one that recognized the interest as a prior claim against specific assets). That view, analogizing a security interest to a priority claim rather than a property right *per se*, is consistent with the approach to security advocated in this article. See *infra* text accompanying notes 216-29.

157. See 11 U.S.C. § 362(d)(2) (1994); see also Carlson, *supra* note 10, at 18-19 (noting that under the Act the absence of an equity cushion was *per se* grounds for relief from the automatic stay).

158. See *Dewsnup v. Timm*, 502 U.S. 410, 418 n.4 (1992); see also Howard, *supra* note 39, at 527-29 (describing the changes made in the Code to the rights of lienholders as involving a "rebalancing" of the rights of debtors and creditors). Professor Carlson goes even further, describing Congress's approach under the Code to undersecured claims as representing "a sweeping sea of change in the law of the undersecured creditor." Carlson, *supra* note 10, at 20. Thus, he concurs with Professor Newborn that *Dewsnup* wrongly abandoned "the priority theory of the Code in favor of an outmoded *in rem* theory of the old Bankruptcy Act." *Id.*

159. Under state law, the issue comes down to a battle of sorts between secured and unsecured creditors. LoPucki, for example, perceives as noted that security extracts a subsidy from unsecured creditors that is not reflected in the form of lower borrowing costs, but is arrogated to the secured lender. Thus, LoPucki would subordinate secured creditors' priority to at least two classes of unprotected unsecured creditors. See *supra* notes 91-93 and accompanying text. While not unsympathetic to both the fairness and efficiency concerns motivating LoPucki's proposal, our assertions in this article are not nearly so bold or radical. We would recognize the secured creditor's priority in bankruptcy in its collateral to the exclusion of other creditors *up to* the value of that collateral. We propose only that if the debtor can find a way to save the property from foreclosure, any subsequent appreciation should be used to prime the debtor's fresh start. See *infra* notes 225-29 and accompanying text.

160. In certain other instances, typically involving a prebankruptcy default in an installment obligation, claims are actually *deaccelerated*. See Chaim J. Fortgang & Thomas Moers Mayer, *Valuation in Bankruptcy*, 32 UCLA L. REV. 1061, 1102 (1985) (discussing Code §§ 1123(a)(5)(G), 1124(2), 1322(b)(3)). These situations occur, however, under the reorganization chapters of the Code.

161. See 11 U.S.C. § 502(c)(1) (1994) (authorizing the bankruptcy court to estimate any unliquidated or contingent claim when necessary to avoid undue delay in the administration of the estate).

tized *inter se*, and ultimately settled. The idea of “fresh start,” whatever else it means, demands that we cleave a wide chasm between the debtor’s pre- and postfiling lives.<sup>162</sup> To do so implies that there is no more intrinsic reason for clinging to the bargain metaphor in the case of security interests than there is in the case of garden-variety unsecured contractual obligations.<sup>163</sup> To illustrate the point we return to the example that was the organon for the original discussion.

In that example we hypothesized a chapter 7 debtor with a homestead valued at \$120,000 and subject to three liens consisting, in order of priority, of: (1) a \$100,000 mortgage; (2) a \$15,000 judicial lien; and (3) a \$20,000 second mortgage. We also assumed a \$15,000 homestead exemption in the applicable jurisdiction. If the property were to go to state-law foreclosure at the behest of the first mortgagee, one would anticipate that the first mortgagee would bid in the amount of its indebtedness — that is, bid its note — and either emerge as the successful bidder or be taken out by the second lienor seeking to protect its interest in the equity over and above the first mortgage by bidding in all or a portion of its indebtedness on top of the amount due on the first lien.<sup>164</sup> Depending on the nuances of the law of the jurisdiction, junior lienors that elected not to bid at sale would then have a statutory right to redeem in order of priority.<sup>165</sup> If the judicial lienor were inclined to redeem, it

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162. This is one of the reasons that the continued expansion of the categories of debt that are excepted from discharge under § 523(a) is troubling. On the other hand, it is instructive to recognize that the exclusive grounds for objecting to discharge enumerated in § 727(a) have remained fixed since the adoption of the Code.

163. This point is discussed in greater detail *infra* text accompanying notes 204-10.

164. It is well-recognized that, by and large, foreclosure sales do not attract the kind of lively concurrence of bidders that is likely to produce a “fair” price. In fact, in most instances the only bidder will be the foreclosing party that bids its indebtedness. This is one of the reasons why, until recently, several courts refused to treat the sale price received at a regularly conducted mortgage-foreclosure sale as a conclusive indication of “reasonably equivalent value” for purposes of the fraudulent transfer provisions of § 548(a)(2). See *BFP v. Resolution Trust Corp.*, 511 U.S. 531, 564 (1994) (Souter, J., dissenting) (“And where a property is obviously worth more than the amount of the indebtedness, the lending mortgagee’s interests are served best if the foreclosure sale is poorly attended; then, the lender is more likely to take the property by bidding the amount of indebtedness, retaining for itself any profits from resale.”).

165. See, e.g., COLO. REV. STAT. §§ 38-38-302 to -304 (Supp. 1996) (containing a fairly typical statutory redemption scheme, with the first right to redeem accorded to the owner of the property or any other person liable for the deficiency, and thereafter to junior lienors and encumbrancers). Unlike personal property financing, where the Uniform Commercial Code has imposed some semblance of uniformity, local variations from state to state make it more difficult to generalize about the procedures governing real property foreclosures. See GRANT S. NELSON & DALE A. WHITMAN, REAL ESTATE FINANCE LAW § 7.1, at 551-52 (3d ed. 1994) (distinguishing between the common law right of equitable redemption that exists after default but prior to sale and statutory redemption rights that pertain *after* the sale). Much of what is described here in the context of a statutory redemption process would apply equally

would likely be required to tender, in cash, \$115,000 to the court or trustee, consisting of the \$100,000 bid<sup>166</sup> and the amount of the homestead exemption as to which, under state law, the judicial lien is subordinate.<sup>167</sup> The holder of the second mortgage might understandably elect not to redeem on these facts, even though its interest is not subject to the exemption,<sup>168</sup> as it would be required to pay at least \$115,000, representing the sum of the two prior liens.<sup>169</sup> If it did redeem in order to appropriate any additional value over and above the sum of the prior liens, obtain future appreciation in the property, or both, the \$115,000 redemption price (plus other charges) would be distributed as reimbursement to the judicial lienor. The result would be that the debtor's homestead would be

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to the dynamics in the bidding process at foreclosure in a jurisdiction that did not confer statutory redemption rights on the holders of junior liens and encumbrances.

166. This would include accrued post-sale interest and other proper charges. *See, e.g.,* COLO. REV. STAT. § 38-38 302(1) (Supp. 1996); NELSON & WHITMAN, *supra* note 165, at 554-55.

167. Ordinarily, a redeeming lienor would tender only the amount paid by the successful bidder or the next prior redeeming lienor, and the amount of the indebtedness secured by such lien — on these facts \$100,000, plus interest and proper charge, if any. In this case, however, because the redeeming lien is subject to the debtor's homestead, it is presumed that the redemption price would have to include the homestead amount. This is not by any means a foregone conclusion. *See* *Howell v. Farrish*, 725 P.2d 9 (Colo. Ct. App. 1986) (holding that, under Colorado law, the homestead exemption only applies to execution and attachment, and not to redemption). Under the alternative rule discussed in *Howell*, the junior lienor in this example could redeem by paying only \$100,000 in cash and then submitting an affidavit attesting to the amount of its lien. *See* COLO. REV. STAT. § 38-38-303(4) (Supp. 1996). The affidavit is to protect the redeeming party in the event of a subsequent redemption. Assuming the homestead exemption did pertain and further assuming no subsequent redemption by the holder of a junior encumbrance to which the homestead was subordinated, the \$15,000 homestead amount would ordinarily be turned over to the debtor. Even under these assumptions, however, the issue is not beyond cavil. For example, a nonredeeming junior encumbrancer with a consensual lien might successfully make a claim to the homestead proceeds based either on an express contractual subrogation right or on an equitable basis in light of the legal priority of its interest in relation to the homestead. Obviously, there are no absolutes in this area and the vagaries of individual state law would control.

168. If the homestead exemption did not apply, there would be greater incentive to redeem, since there would be some value to claim. *See infra* note 170.

169. On the other hand, because there is some equity (\$5,000) over the sum of the two prior liens, the second mortgagee might well choose to redeem if it had the available cash and believed there was a potential for appreciation. Because of the circular priority situation that exists in this scenario, however, this assumes that the second mortgagee could argue successfully that the junior lien should effectively be deemed satisfied out of the homestead funds in order to recognize the priority of the second mortgage over the exemption. *See supra* note 167. Failing that argument, redemption would make no sense, since it would require payment of both the \$115,000 paid by the judgment creditor *plus* an additional \$15,000 representing the amount of the judgment lien. If the judicial lienor elected not to redeem in the first place, the second mortgagee would be well advised to redeem on these numbers, since it would take title free and clear of both the judgment lien and the debtor's homestead exemption. *See, e.g.,* COLO. REV. STAT. § 38-38-304(1) (Supp. 1996). In this context the debtor's only hope would be a claim for equitable subrogation to the priority of the judicial lien, but the argument is attenuated at best, probably not worth litigating, and without substantial case authority of any sort.

forfeited and the judicial lien would effectively have been frozen out of any excess value in the property.<sup>170</sup> Alternatively, if the judicial lienor did not redeem,<sup>171</sup> whether the second mortgagee redeemed or not, the debtor would still lose her homestead exemption and the judicial lienor would still be frozen out of any excess value or future appreciation.

If, in contrast to the scenario of a forced sale under state law just discussed, the debtor were to file bankruptcy prior to foreclosure, we arrive at a similar but not identical outcome. Under the new formulaic approach in section 522(f)(2)(A) for determining impairment, the entire judicial lien impairs and, therefore, may be avoided under section 522(f)(1)(A).<sup>172</sup> The one clear beneficiary of that action is the second mortgagee, who enjoys a \$15,000 improvement in its state-law position, provided that the court is either not prepared or unwilling to save the avoided lien for the debtor's benefit.<sup>173</sup> It is a little difficult to understand, however, why improving one creditor's position at the expense of another comports with either the core bankruptcy policy of equality among creditors or the baseline principle of respecting state law entitlements. Furthermore, elevating the priority of junior unavoidable liens hardly advances the fresh-start objectives underlying the lien-avoidance provisions in section 522(f)(1).

A better approach — “better” defined in terms of its congruence with bankruptcy policy — would be to allow the debtor also to invoke section 506(d) and void the second mortgagee's lien to the extent of the unsecured portion of its bifurcated claim as of the date of filing.<sup>174</sup> The result would coincide in most respects with the result under state law,<sup>175</sup> subject to the important difference that

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170. Assuming the homestead exemption applies at all in this proceeding, *see supra* note 169, there is at least the argument that the second mortgagee, in order to redeem, must pay not just the judicial lienor's prior redemption amount but also the amount of the judicial lien itself. This might operate to preserve the homestead for the debtor. The problem is that, by the same reasoning, the second mortgagee should be entitled to the benefit of the homestead exemption, resulting in a \$5,000 payment to the judicial lienor, the debtor being cut out of any homestead payment, and the second mortgagee with the property at a cost of \$105,000. One observation that emerges rather clearly from this otherwise cloudy picture is that emulating the state-law result is often easier said than actually done given the uncertainty and the consequent myriad of possible outcomes that exists under most states' law.

171. Because of the requirement of producing cash, this is always a possibility, particularly if the lienor is not a professional lender and foresees considerable carrying, maintenance, and resale costs.

172. *See supra* text accompanying notes 15-18.

173. *See supra* note 21 and accompanying text.

174. Under § 506(a), this would reduce the lien to \$5,000. *See supra* note 24.

175. *But see* text accompanying *infra* note 176. This assertion assumes that mortgage lenders are in the business of money lending, not real-estate speculating. While the point

the debtor's homestead exemption would be protected. Of course, so long as *Dewsnup* remains the law of the land, that alternative is mere wishful thinking. In fairness, permitting the debtor to use section 506(d) as an avoiding power may not always emulate the state-law result with precision, depending on whether relevant state law resolves the circular priority issue between the judicial lienor and the junior unavoidable mortgagee by awarding the value of the judicial lien to the second mortgagee or to the debtor.<sup>176</sup> Nevertheless, the main difference is that the outcome without *Dewsnup* — that is, an outcome following lien stripping — would preserve the fresh start instincts in section 522(f)(1)(A) and avoid a rearranging of state law priorities in a manner that served no compelling bankruptcy purpose.

The argument might be made that it is not necessary to overrule *Dewsnup* for this reason alone because application by analogy of the lien-preservation concept of section 551 eliminates the problem.<sup>177</sup> Suppose, however, as is likely to be the case, that the property is not liquidated during the course of the bankruptcy administration. Under no scenario is there any incentive for the trustee to sell the property<sup>178</sup> and, more than likely, it would simply be abandoned.<sup>179</sup> After the case is closed, two possibilities are presented: (1) immediate foreclosure by the first mortgagee, or (2) the debtor staves off foreclosure by reaching an understanding with the holders of the first and second mortgages.<sup>180</sup> In the former

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seems self-evident, even to the extent that one is inclined to see both activities as legitimate components of a secured creditor's expectation, rarely will the mere hope of future increases in value justify the present costs of carrying the property. See Howard, *supra* note 24, at 408-09 (pointing out, as well, that many lenders are restricted by regulatory rule from owning significant inventories of repossessed properties). Practical constraints, such as complying with loan-loss reserve requirements or the tax benefits of booking and writing off loan losses in the current year, also operate in this connection.

176. See *supra* note 169.

177. See *supra* notes 19-21; see also *In re Gonzalez*, 149 B.R. 9, 10 (Bankr. D. Mass. 1993) (invoking § 522(f) as the basis for subordinating the unavailed portion of a judicial lien to the portion of the lien avoided, due to its impairment of an exemption to which the debtors would otherwise have been entitled), *vacated sub nom. Gonzalez v. First Natl. Bank*, 191 B.R. 2 (D. Mass. 1996).

178. Section 363(f)(3) prohibits the trustee from selling assets of the estate free and clear of liens unless "the price at which such property is to be sold is greater than the aggregate value of all liens on such property."

179. The standard under 11 U.S.C. § 554(a) (1994) of "burdensome to the estate or that is of inconsequential value and benefit to the estate" would seem to be easily satisfied.

180. As a practical matter, this would probably have to be in the form of an enforceable reaffirmation agreement under 11 U.S.C. § 524(c) and (d), although a de facto redemption is also possible. The problem with the first option is that, while it is no longer necessary to establish that the reaffirmation is in the best interests of the debtor and his dependents, see § 524(c)(6)(B), it is still difficult to rationalize a decision to accept personal liability for what is, for all intents and purposes, an unsecured claim. The problem with the redemption alter-

case, how do we ensure that the debtor's subrogated position will be respected in the state-law foreclosure?<sup>181</sup> In the latter case, how can we reasonably expect the holder of the second mortgage to go along with any proposal the debtor is likely to be able to afford as long as the second mortgagee's lien secures a \$20,000 claim? Moreover, because the holder of the second mortgage has the power to initiate, or threaten to initiate, its own foreclosure proceeding even though there would be little direct economic reason for it to do so, it retains enormous hold-up power to secure a concession from the debtor greater in value than the true value of the lender's interest in the property.<sup>182</sup>

But for *Dewsnup* the debtor would be assured of her homestead exemption in either case. The only "loss" to the second mortgagee would be the loss of its prebankruptcy right to future appreciation. The response to the charge of unfairness in pushing that loss on the second mortgagee is twofold. First, compensation for the additional \$15,000 already was provided in the form of an unsecured claim in the prior bankruptcy case.<sup>183</sup> Second, the assertion that the secured

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native is the "hold-up" leverage that the failure to strip the lien in bankruptcy has given the junior mortgagee. See *infra* note 182.

181. In the usual situation in which 11 U.S.C. § 551 (1994) is employed to preserve an avoided lien for the benefit of the estate, the property will be liquidated in the course of the bankruptcy administration in order to realize for the estate the value represented by the avoided lien. See, e.g., *Sorenson v. Board of County Commrs. (In re Knights Athletic Goods)*, 128 B.R. 679 (D. Kan. 1991). In a situation in which an avoided lien is preserved for the debtor's benefit, the existence of the junior unavoidable encumbrance typically means that there is no reason for the trustee to sell the property, and ordinarily the debtor would not want that to occur. This raises the problem of how to enforce the debtor's subrogated position under state law, particularly in the face of a contractual subordination of the homestead in the unavailed junior lien. In effect, there is no obvious enforcement mechanism short of incurring the expense and delay of reopening the bankruptcy case in the event of either a subsequent sale or foreclosure of the property, so as to protect the interest of the debtor established in the earlier proceeding. Cf. *In re Kampen*, 190 B.R. 99 (Bankr. N.D. Iowa 1995) (involving an action to reopen a case in order to enjoin the sheriff's sale of certain previously unadministered real property in order to protect the debtors' homestead rights).

182. The ability of the undersecured second mortgagee to extract from the debtor a price which is greater than the value of the lien can be attributed to the debtor's nonfinancial attachment to the property, what Professor Howard terms the "emotional increment." See Howard, *supra* note 24, at 421 (demonstrating how, in a foreclosure context, the second mortgagee can use the "underwater" portion of its lien to increase beyond market value the amount the debtor must bid to secure the property in the event of foreclosure). In addition, even in a sale context, the lien creditor can exploit its strategic advantage by requiring payment in excess of the true value of its lien as a condition to its willingness to release its lien in order to clear title.

183. There may or may not be any actual value available for distribution in respect of unsecured claims, but the same is true for all other unsecured claimants, consistent with bankruptcy's basic equality principle. In any event, that risk also was part of the original "bargain," to the extent one is inclined to imagine the relationship in those terms. It has never been quite clear to us, frankly, what the position of the undersecured creditor properly ought to be with respect to any dividend paid to unsecured creditors. On the one hand, there is at least a suggestion in the majority opinion in *Dewsnup* that the secured creditor must

creditor has some form of indefeasible right to postbankruptcy appreciation is a rhetorical position of advocacy, not an eternal legal verity as the solemnity with which the argument is sometimes advanced would lead one to believe. The two points are obviously related. To conflate the matter, once the debtor files bankruptcy, the second mortgagee's secured claim in this case is limited to \$5,000. Not only does postfiling appreciation belong to the debtor, but the prospect of ultimately losing the property to foreclosure, a result often inimical to fresh-start objectives, also is reduced precipitously. Reaching this result, however, requires that we dispatch with the holding and the normative result in *Dewsnup*. That, in turn, requires us to accept the possibility of and to construct an alternative to the conceptualization of security in bankruptcy implicitly endorsed by Justice Blackmun in his *Dewsnup* opinion, an undertaking that occupies our attention in the final two parts of this article. Part V offers an explanation of what we mean when we speak of a new conception of security. That part explains the basis for our analysis of extant concepts of security, and, for that matter, all legal concepts, as metaphor. Part VI then offers an alternative metaphor that we submit advances the discourse about security in bankruptcy beyond the limits imposed by the bargain and conveyance metaphors that have enjoyed a conceptual monopoly in the doctrinal analysis thus far.

## V. LEGAL CONCEPTS AND METAPHORIC REASONING

### A. *Legal Concepts as Metaphors*

Throughout this article, we have regularly referred to the bargain *metaphor* and the conveyance or property *metaphor*. Our use of that term is not casual; rather, it is central to the doctrinal analysis that follows. When we speak of reconceptualizing security, we are calling for a fresh consideration of the metaphors by which

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sacrifice its unsecured claim as compensation for having its lien left intact and for having access to future appreciation. See *Dewsnup v. Timm*, 502 U.S. 410, 418 (1992); Howard, *supra* note 39, at 517. It is far from obvious, however, that this is what actually transpires. Instead, in most cases it is logical to assume that the creditor enjoys its pro rata share of distributions to unsecured creditors, crediting such amount against its total claim, and then sits back and seeks eventual recovery of the balance out of its *in rem* claim. While this result, if it occurs, prejudices other unsecured creditors by reducing their dividends *pro tanto* in violation of the basic policy interdiction against unequal distributions, it is difficult to see how the result can be avoided, since there is no statutory basis for disallowance of the unsecured claim. Indeed, § 506(a) seems to support the argument that the claim is proper and, from the debtor's perspective, it is advantageous to have as much as possible of the undersecured creditor's total claim satisfied out of the estate. Also, as earlier noted, the debtor has the authority to file the claim on the secured creditor's behalf even if the creditor elects to ignore the bankruptcy entirely and rely on its lien. See 11 U.S.C. § 501(c) (1994).

security has come to be understood. In so doing, we proceed from recent insights from the cognitive sciences that make a compelling case for the proposition that virtually all our concepts, including legal concepts, are metaphoric in nature. A brief excursus may be helpful here. Experiential Realism ("Experientialism")<sup>184</sup> provides an account of reasoning relatively new to the cognitive sciences that, among other things, reveals the singular role metaphor plays in human conceptual systems.<sup>185</sup> On the Experientialist account, only the least sophisticated concepts are garnered directly from experience. Concepts such as up-down, light-dark, and containment emerge from our interactions with physical reality and thus are directly grasped.<sup>186</sup>

These rudimentary concepts have natural dimensions and are therefore well delineated and sharply defined.<sup>187</sup> Most of our concepts, however, do not arise directly from physical experience. Reasoning to concepts without natural dimensions therefore requires the capacity for metaphor, whereby well-defined concepts from a *source domain* are deployed to structure ill-defined or under-defined concepts from another and different domain, the *target domain*.<sup>188</sup> The target concept is thus modeled on, and is understood *in terms of*, the source concept.<sup>189</sup>

Consider the following simple example. One of our rudimentary concepts is that of physical containment.<sup>190</sup> We continuously

184. The term, "Experientialism," or "Experiential Realism," is the cognitive theory advanced by George Lakoff and Mark Johnson. See GEORGE LAKOFF & MARK JOHNSON, METAPHORS WE LIVE BY (1980). The philosophical assumptions on which Experientialism is premised are outlined in detail in MARK JOHNSON, THE BODY IN THE MIND: THE BODILY BASIS OF MEANING, IMAGINATION, AND REASON (1987). Evidence from the cognitive sciences, which is in part the basis of their theory of cognition, is elaborated on in GEORGE LAKOFF, WOMEN, FIRE, AND DANGEROUS THINGS: WHAT CATEGORIES REVEAL ABOUT THE MIND (1987).

185. See LAKOFF & JOHNSON, *supra* note 184, at 3.

186. In referring to rudimentary concepts, we refer to those that are directly apprehended from experience and that are not modeled on other concepts — that is, are not understood metaphorically. See *id.* at 56-57.

187. The source of rudimentary concepts is the kinesthetic image schemata. Image schema are preconceptual and have a bodily basis. They emerge from endlessly recurring patterns we discern in experience, such as the ways in which we experience our physical orientation in the world around us. Since those patterns are repeating, they become recognizable and are embodied as image schematic concepts. See JOHNSON, *supra* note 184, at 13. For a summary explanation of image schema, see F. Stephen Knippenberg, *Future Nonadvance Obligations: Preferences Lost in Metaphor*, 72 WASH. U. L.Q. 1537, 1563-65 (1994). For an extended discussion, see JOHNSON, *supra* note 184, at 19-28.

188. See LAKOFF & JOHNSON, *supra* note 184, at 115-17.

189. See *id.*

190. See JOHNSON, *supra* note 184, at 21. Johnson has identified and catalogued several image schema, including up-down, front-back, linear order, and part-whole, to name a few. See *id.* at 19-37. The concept of containment, born of the container schema from physical



experience ourselves and other objects in the physical world as contained within buildings, rooms, and so on. With its physical basis, the concept of containment is crisply defined by its natural dimensions.<sup>191</sup> The concept of *trouble*, on the other hand, lacks natural dimensions and cannot therefore be directly grasped.<sup>192</sup> Recognizing analogies between the way we experience troublesome situations and physical containment enables the metaphor, *trouble-is-a-container*, such that we can speak of "getting into" or "getting out of trouble." The ill-defined target concept of trouble is understood in terms of the well-defined source concept of containment from the physical domain. The concept, that is to say, is understood metaphorically.<sup>193</sup>

The Experientialist insight that most concepts are metaphoric is premised on an important epistemological conviction that our concepts are not abstractions of some set of conditions that exists in the world independent of the reasoner. Experientialism rejects the fundamental assumptions of what has been called an epistemology of objectivism.<sup>194</sup>

Objectivism posits a mind-independent reality wherein objects, events, and states of affairs are inherently possessed of various properties and naturally stand in a fixed relation to one another.<sup>195</sup> Concepts are abstract likenesses of that reality, true when they capture and faithfully represent it, but false otherwise. Cognition, from the perspective of objectivism, is algorithmic, such that the measure

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experience, is regularly deployed in structuring legal concepts. For an extended discussion of the containment metaphor at work in article 9 of the U.C.C., see Knippenberg, *supra* note 187, at 1571-75.

191. Because of its bodily basis, containment is meaningful in the most primary sense. See LAKOFF & JOHNSON, *supra* note 184, at 57-58.

192. Experientialism teaches us that in considerable part we must come to understand experience through metaphor. Abstractions, like trouble, are directly experienced, but only indirectly understood. See *id.* at 115. For further basic examples and summary explication, see Knippenberg, *supra* note 187, at 1561-71.

193. On the Experientialist account, human conceptual systems are mainly metaphoric. See LAKOFF & JOHNSON, *supra* note 184, at 3.

194. See, e.g., JOHNSON, *supra* note 184, at 196.

195. On the Objectivist view, "there is or must be some permanent, ahistorical matrix or framework to which we can ultimately appeal in determining the nature of rationality, knowledge, truth, reality, goodness, or rightness." RICHARD J. BERNSTEIN, *BEYOND OBJECTIVISM AND RELATIVISM: SCIENCE, HERMENEUTICS, AND PRAXIS* 8 (1983). Objectivism might usefully be defined as the antithesis of subjectivism. If, for the Objectivist, the world consists of naturally occurring, mind-independent properties, categories, and structures, for the Subjectivist they are altogether relative to the prevailing aims of the reasoner. Reality is very much up to the individual. See LAKOFF & JOHNSON, *supra* note 184, at 224. For an extended discussion of Objectivism, its evolution, and principle themes, see RICHARD RORTY, *PHILOSOPHY AND THE MIRROR OF NATURE* (1979). Objectivist influences and themes in semantic theory are described in JOHNSON, *supra* note 184, at xxix-xxxv.

of the correctness (and utility) of our concepts is the degree to which there is a verifiable correspondence of the symbols they employ to the reality they are meant to represent.<sup>196</sup>

In contrast, the Experientialist view holds that conceptual categories do not capture slices of a reality or of categories *as they are out there*. Rather, conceptual categories are entirely the product of human cognitive processes, which are dependent on imaginative devices such as metaphor.<sup>197</sup> Whereas under the objectivist regime categories transcend cognition, under Experientialist rule categories have no ontological status independent of it.<sup>198</sup>

That concepts are metaphoric has important ramifications for legal analysis and law transformation. Traditional legal analysis is deeply grounded in objectivist assumptions that postulate a tran-

196. The epistemology of Objectivism, unsurprisingly, supposes the task of human cognition to be one of capturing and describing objective reality. Knowledge transcends cognitive processes, since it is "out there" whether or not there is a reasoner to "discover" it. Objectivist epistemological assumptions have been referred to as "metaphysical realism." See Michael S. Moore, *The Interpretive Turn in Modern Theory: A Turn for the Worse?*, 41 STAN. L. REV. 871, 881-90 (1989).

197. On the Experientialist account, there are no categories that are not conceptual categories. The naturally occurring properties of objects, states of affairs, conditions, and so forth that we experience do not define a category, simply because those things have no inherent properties a priori. Instead, conceptual categories are defined by perceived prototypes, which are distinctly human conceptual constructs. See LAKOFF & JOHNSON, *supra* note 184, at 122-25.

198. Two features of metaphoric reasoning must be noted and explained. First, knowledge and meaning arrived at by understanding one concept, the target concept, in terms of another, the source concept, are by hypothesis partial and incomplete. See LAKOFF & JOHNSON, *supra* note 184, at 12-13. If a source and target concept were identical in every particular, they would be the same concept. The latter feature gives rise to a corollary proposition, that in highlighting similarities between source and target concepts, asymmetries (a term we use to refer to dimensional differences between source and target concepts) are lost to view. Second, when one concept is structured and defined by another, in the process of metaphoric mapping, the inferential consequences, or "entailments," belonging to the source concept are carried to, or mapped on, the target concept. For an extended discussion of entailments, see JOHNSON, *supra* note 184, at 130-38.

As to the first of these features, consider the following example from contract law. A contract is partially defined by the metaphor, *a contract is a container for contracting parties*. The metaphor is manifested in expressions like, "they entered into a contract," and "she could not get out of her contract." The metaphoric concept is useful because it highlights certain dimensions of our experience of *contracts* shared with our experience of the concept of physical *containment*. But the concept of containment from the physical domain only partially structures the concept, contract. To provide more complete meaning, other metaphors must be pressed into service, which in conjunction afford a fuller understanding of the target concept. To continue the above example, "contracts" or "agreements" are also partially defined by the metaphor, *an agreement is a place*, or, more particularly, *an agreement is a destination*. The metaphor finds expression in statements like, "they arrived at an agreement." The containment and destination metaphors together tell us more about how we experience contracts than either alone. The more metaphors by which a target concept is understood, the richer the definition, and the fuller our understanding of that concept. Important, sophisticated concepts are the most likely to be highly defined by multiple metaphors. Lakoff and Johnson have, for instance, catalogued some ten ontological metaphors that define the concept *idea*. See LAKOFF & JOHNSON, *supra* note 184, at 46-48.

scendental, objective reality that exists independent of human concepts.<sup>199</sup> The method of traditional legal analysis is to abstract principles from cases, statutes, and other authority to arrive at transcendent propositions.<sup>200</sup> Inasmuch as the propositions transcend their instantiations in the concrete cases from which they derive, they are assumed to be capable of objective application when brought to bear in subsequent cases. There is a “right answer,” and the analyst has only to find it — the decisionmaker need only avoid contaminating the proposition to be applied with subjective impulses.

For example, as discussed in considerable detail above,<sup>201</sup> much of the discourse about the treatment of secured claims in bankruptcy turns on the *nature* of security,<sup>202</sup> whether the rights of secured claimants with security interests or mortgages are property or contract rights. Under an analytic program guided by objectivist assumptions, there is an immutable, correct conception of security — the rights of secured claimants *are* property or they *are* contract rights. The business of legal analysis, rightly understood, is to identify the correct conception.

On acknowledging that our concepts, legal and otherwise, are no more and no less than metaphoric constructs that enable meaning in accordance with our goals and purposes, rather than abstractions of things the way they *really* are, analysis of legal doctrine takes a different turn.<sup>203</sup> For example, it is one thing to say that a contract *is* a container, but something very different to say that the concept of *contract* shares recognizable dimensions with the concept of physical containment and so can be usefully, if only partially, understood in that way. As we make clear in the next part, exploring alternative metaphors by which the concept of security is structured forces attention upon aspects of security and the fresh

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199. Objectivism finds its expression in the law as Externalist principles, or legal formalism. This is not to say, of course, that legal formalism has gone unchallenged. See Moore, *supra* note 196, at 890 (discussing “interpretivism,” which discounts metaphysical debate as impossible of resolution, and so not worth scholarly attention). Moore characterizes as illustrative the work of Stanley Fish, Robert Cover, and Ronald Dworkin. See *id.* at 891-92.

200. See *id.* at 888; cf. Steven L. Winter, *The Metaphor of Standing and the Problem of Self-Governance*, 40 STAN. L. REV. 1371, 1387 (1988) (positing that the law of standing has proceeded from the metaphor of standing regarded as a literal truth).

201. See *supra* Part III.

202. See generally Knippenberg, *supra* note 187 (offering an extended discussion of the Coogan-Gilmore debate over the “true nature” of the security interest in the context of future advance priority under article 9).

203. See, e.g., Ponoroff & Knippenberg, *supra* note 23, at 312-24 (demonstrating how conversion of nonexempt assets to exempt assets on the eve of bankruptcy can be understood either as an act of bad faith or as a legitimate exercise of a property right).

start that are otherwise lost to consideration. Moreover, recognizing that our concepts are imaginative devices of cognition, and not symbolic representations of some transcendental state of affairs in experience, frees us to augment, modify, or, where it serves our ends to do so, suspend one concept in favor of others.

### B. *Beyond the Bargain, Conveyance, and Property Metaphors*

We have so far described the bargain and conveyance/property metaphors and identified the failure of both to offer either a viable explanation, in the case of the bargain metaphor, or justification, in the case of the conveyance and property metaphors, for secured credit in bankruptcy. Here, we seek to explain the reasons those models are driven to inextricable impasse. As it is central to our analysis and explication, we would at this juncture reiterate the fundamental principle upon which Experientialism rests: All concepts are the product of imaginative instruments of cognition, most notably the capacity to understand a target concept by reference to a source concept, the capacity to reason metaphorically.

The conveyance/property metaphor advocated by Harris and Mooney serves both to illustrate Experientialist principles and to advance our remaining discussion of the troublesome holding in *Dewsnup*. By insisting that a security transfer must be understood as a conveyance of property from debtor to creditor, Harris and Mooney corroborate the conceptualization of security at the basis of article 9. On entering into the security agreement with its creditor, the debtor transfers something to the creditor, some interest that thereafter belongs to the creditor and that is as a matter of course understood to be property. The security agreement, then, is as much an instrument of conveyance as it is a contract between the parties that gives rise to contractual rights and duties. In short, the undisputed traditional metaphor regards the creation of a security interest as representing the movement of property from the debtor to the creditor. Security is thus understood in terms of property concepts ordinarily associated with absolute transfers, the prototype for which is the transfer of physical possession of real or personal property from one party to another.<sup>204</sup>

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204. As we noted earlier, important concepts tend to be well defined by multiple metaphors. See *supra* note 198. Article 9, a case in point, is a complex cognitive model consisting of a variety of coherent ontological metaphors and an overarching structural metaphor (*the secured transaction is a journey*).

For an in-depth discussion of the metaphors that structure the concepts in article 9, see Knippenberg, *supra* note 187. It is worth noting here that the property and bargain metaphors are consistent with the cognitive model by which article 9 is structured.

That a security interest *can* usefully be thought of in terms of a conveyance of possession is irrefutable.<sup>205</sup> That security *must necessarily* be thought of in those terms is not. The creation of a security interest is, in many respects, like a physical transfer of property. Accepted rules of conveyancing are modeled on the *source-path-goal* image schema,<sup>206</sup> whereby physical possession passes from one party to another. The security transfer can be, and routinely is, conceived of in the same way. The debtor, in conferring upon the secured creditor the right to seize an asset identified in the security agreement, can be taken to have passed something to the secured creditor, thereby forfeiting an aspect of ownership of that asset;<sup>207</sup> the right to hold it as against all others under all circumstances. The debtor thereby alters the relationship to property that she would otherwise enjoy under settled notions about property ownership.<sup>208</sup>

The conveyance/property metaphors are useful in defining security, an abstraction without natural dimensions of its own. The concept of a physical conveyance of property has natural dimensions in that it can be directly observed, directly experienced, and so directly understood without recourse to other defining concepts. Security, in contrast, represents a conceptual extension beyond the rudimentary notion of a physical transfer. Nothing observable passes from debtor to creditor as the result of the security "transfer." Nevertheless, to think of security *in terms* of a conveyance, and so to think of the security interest *in terms* of property, is to make the concept of security meaningful. The source concept of the conveyance is well understood, and the clearly defined attributes associated with it serve to define the target concept of security when conveyance is mapped onto that concept.

Understanding security in terms of a conveyance of property enables us to reason about security by highlighting those features that we perceive the two concepts to share. As indicated earlier, however, metaphoric reasoning is by hypothesis partial. While similarities between concepts are highlighted, asymmetries are lost to view. It is one thing to say that the creation of a security interest can usefully be understood in terms of a conveyance of property,

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205. See *supra* notes 100-01 and accompanying text.

206. This is one of the several image schema identified by Lakoff and Johnson. See *supra* note 184.

207. See Ponoroff & Knippenberg, *supra* note 23, at 313-14 (describing the metaphor of encumbered property as a physical resource depleted by the security transfer).

208. See ROGER A. CUNNINGHAM ET AL., *THE LAW OF PROPERTY* 2-5 (1984).

but quite another to say it *is* a conveyance of property. The former assertion acknowledges that security is in many respects like a conveyance of property, but admits of differences between them. The latter assertion denies those distinctions. The loss of asymmetries is, of course, the natural product of metaphoric reasoning: In highlighting similarities between concepts, differences are eclipsed or hidden.

The hiding power of metaphor is hardly remarkable. Metaphoric reasoning is so pervasive in cognitive processing, so ubiquitous in our concepts, that we are mainly unaware of it.<sup>209</sup> It is a natural inclination to presume that our concepts are not imaginative constructs, but slices of reality, or symbolic representations of external conditions or phenomena.

For example, in constructing an entire statute, article 9, around security understood as property, the implicit assumption is that the security transfer *is* a conveyance of property, and that to assert as much is to proclaim the discovery of the true nature of the security interest about which there can be no doubt. The property model has therefore become the starting point, and frequently the ending point, for analysis of doctrine and the rules governing security, both in and out of bankruptcy.

To insist that the creation of security is a conveyance of property rather than a target concept *modeled* on the source concept of the conveyance leads to doctrinal impasse and dysfunctionality, some instances of which have been and will be identified in this article. Worse, if discourse about security in bankruptcy is limited by the conviction that there is a single, correct conception of security, meaningful analysis of bankruptcy policy, insofar as it is related to secured claims in consumer cases at least, is foreclosed. To illustrate, we return to one of the features of metaphoric mapping discussed above: the imposition of entailments associated with source concepts onto target concepts.

Entailments, it will be recalled, are the ontological consequences that attend a concept. Consider again the conveyance metaphor on which security is modeled. Where one transfers possession of tangible property, the relationship of the transferor to the property conveyed terminates. The transferor may neither physically occupy the thing transferred nor subsequently transfer it to others. Such are the consequences, the entailments, of the transfer of possession and of ownership.

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209. See LAKOFF & JOHNSON, *supra* note 184, at 28.

When the concept of security comes to be understood in accordance with the metaphor, *the-creation-of-a-security-interest-is-a-physical-conveyance-of-property*, the entailments associated with the source concept are mapped onto the target concept; that is, the ontological consequences associated with the concept, conveyance, are imposed upon the concept of security. Once it is decided that a lien is the product of a conveyance of property, the secured creditor's claim suddenly enjoys special status because security interest or mortgage is *property*. The entailments-of-the-source concept, the property/conveyance metaphor, are axiomatic in the law. Whatever rights in the collateral that remain with the debtor are limited by that which she has "transferred" away — all value of the asset — unless there is value in excess of the claim. If the debtor "transported away" the value in the property, none remains to be given to, or taken by, others in the absence of equity.

For present purposes, the most important entailment mapped from the source concept of property to the target concept of security arises from the metaphor that defines the nature of the lien from the perspective of secured creditors. The security interest or mortgage is understood initially according to the simple ontological metaphor, *a-lien-is-a-physical-object*. That metaphor is, of course, entirely consistent with the conveyance metaphor, which envisions a physical transfer of lien rights from the debtor to the creditor.

While this simple ontological metaphor does not go far in defining security, it does enable various extensions. For example, a security interest as a physical object can *attach* to the collateral, or, in the case of real estate, can be understood as a mortgage *on* encumbered property. That view of security coheres with the metaphor, *the-collateral-is-a-container-for-property-interests*, enabling various metaphoric extensions expressed in remarks like, "she has a security interest in the debtor's inventory."

An entailment of singular importance follows from these ontological metaphors. Where objects or substances are attached to or are contained within another — for example, where a security interest becomes attached to the collateral, where the secured claimant has an interest in the collateral — they remain with it unless they are somehow extricated. That is a fundamental consequence of physical attachment and containment. The entailment is mapped onto the concept of security, meaning that it remains with the collateral should it pass out of the debtor's possession and control or, importantly, into the bankruptcy estate.

The above-described entailments emanate from the property and conveyance models. Those metaphors enable meaning in that, in conjunction, they define security such that we may manipulate the latter concept in useful ways. When we come to understand security in terms of the property and bargain metaphors, well-defined concepts with natural dimensions like physical attachment and containment, it becomes possible to reason about security.

But when we grant a conceptual monopoly to the conveyance and property models, the entailments of the conveyance model — of security as property — tyrannize analysis and suppress penetrating considerations of policy. As stated earlier, entailments offer ready solutions to issues under consideration with no apparent need for meaningful justification beyond that suggested by the entailments themselves. If we presume security to be property, then of course liens must “pass through” bankruptcy, since they are something within or attached to the collateral.

But the entailments of the ontological metaphors that define property and security understood as property have consequences beyond the obvious. Both in and out of bankruptcy, property receives protection under the law that contract rights do not; for example, constitutional protection. For that and other reasons, it is axiomatic that property rights of creditors are left undisturbed in bankruptcy. Where it might not be deemed offensive to alter contract rights, tampering with property invokes claims of taking and unfairness. As we explain in the next part, that is the very sort of limiting analysis we believe is responsible for *Dewsnup*.

The *Dewsnup* opinion is completely dominated by the property and conveyance models of security that pervade state law. It evaluates lien stripping exclusively by reference to the metaphor, *security-is-property*. In the majority opinion, the property metaphor is the beginning and ending point for analysis, and the dissent offers no contradiction on that point.<sup>210</sup> Given the entailments mapped from that concept to the concept of security, the outcome in the case was inescapable: the secured claimant’s “property” cannot be divested through lien stripping. Justice Blackmun’s hopelessly convoluted interpretation of the Code is powerful evidence of the influence of the entailments-of-the-property metaphor.

*Dewsnup* is therefore dysfunctional. To say that security can only be understood as property leads inexorably to the conclusion reached in that case, but it is not a justification for it. Entailments

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210. See *supra* text accompanying notes 43-47.



compel results, but they do not implicitly justify them. Where analysis is limited by entailments, there is no room to consider countervailing policy objectives at work in the bankruptcy case, including most importantly the fresh start in consumer cases.

It is upon recognizing that legal concepts are metaphorically defined that analysis is enabled. In ending the search for the *right* way to conceive of security in favor of the quest for multiple metaphoric concepts to yield a more robust definition, we are freed to consider and reconsider concepts like security.

More important, letting go of the commitment to a single metaphoric system advances discourse by diverting attention from results enjoined by metaphoric entailments to a wide-ranging exploration of bankruptcy policy. Letting go of the property metaphor in bankruptcy focuses attention on the fresh start in a way that, we believe, leads to a very different view of lien stripping. Appraisal of rules and doctrine, unfettered by entailments that are necessarily mapped from source to target concepts, becomes an exercise in meaningful normative evaluation. In the next part, we offer an alternative model for security to enable precisely that sort of analysis.

## VI. A RECONCEPTUALIZATION OF UNDERSECURED CLAIMS IN BANKRUPTCY

### A. *In Concept*

As described earlier,<sup>211</sup> one alternative to a property-based conception of security interests in bankruptcy is a value-based account that recognizes the existence and priority of the secured creditor's interest in the debtor's property up to the value of the collateral as of the moment of filing.<sup>212</sup> Several commentators have put forth cogent arguments based on the history of the Code in support of a priority approach to security and, in particular, undersecured claims.<sup>213</sup> Rehashing those arguments at this time would serve no point. Instead, we would press the logic of those arguments one step further by proposing that, in a bankruptcy context, it is appro-

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211. See *supra* notes 145-51 and accompanying text.

212. Actually, the precise timing of the valuation, whether at the time of filing or some other point in the case, is a subject of some controversy. See *infra* note 223.

213. See, e.g., Eisenberg, *supra* note 6, at 952 (suggesting that under the Code the argument can be made that secured status consists of no more than a priority claim equal to the value of the creditor's collateral); Newborn, *supra* note 4, at 577-81 (arguing that the Bankruptcy Code evinces a congressional intent to bring undersecured creditors within the jurisdiction of the bankruptcy court, contrary to the Bankruptcy Act jurisprudence on which the majority in *Dewsnup* relied).

priate to reassess the character of secured claims with reference to the fundamental underlying nature of a bankruptcy case. We appreciate that this process has ramifications that resonate throughout the fabric of the commercial law.<sup>214</sup> For present purposes, however, we urge such a reconceptualization of secured claims simply as a means for more fairly balancing the rights of secured creditors with the Code's fresh-start policy, a policy that is without analogue in state debt/collection law.<sup>215</sup>

In substance, as earlier noted,<sup>216</sup> a bankruptcy case involves nothing less than the complete acceleration and adjudication of all claims<sup>217</sup> against the debtor — liquidated and unliquidated, contingent and noncontingent, disputed and undisputed, matured and unmatured, secured and unsecured — in a single, expedited proceeding.<sup>218</sup> A pivotal, although frequently unarticulated, premise

214. See, e.g., Nickles, *supra* note 8 (discussing the inherent tension between bankruptcy and the commercial law). This is also part of the broader debate over whether a security interest represents a property interest or just another species of contract right. See *infra* text accompanying notes 224-34; see also Kenneth N. Klee, *A Brief Rejoinder to Professor LoPucki*, 69 AM. BANKR. L.J. 583, 587 (1995) (indicating support for a proposal to reform article 9 to carve a fixed percentage out of collateral for the benefit of a levying judicial lien creditor).

215. See generally Warren, *supra* note 111, at 782-89 (explaining the policy difference between state collection and federal bankruptcy law).

216. See *supra* notes 147, 151 and accompanying text.

217. The term "claim" is broadly defined in 11 U.S.C. § 101(5) (1994). However, the determination of when a claim arises, for purposes both of discharge and entitlement of administrative expense status, has proved an exceedingly nettlesome one, particularly in the area of environmental and product liability claims. See, e.g., *In re Chicago, Milwaukee, St. Paul & Pac. R.R.*, 974 F.2d 775, 786 (7th Cir. 1992) (decided under § 77 of the 1898 Act); *United States v. LTV Corp. (In re Chateaugay Corp.)*, 944 F.2d 997, 1004-06 (2d Cir. 1991) (involving environmental clean-up claims); *Grady v. A.H. Robins Co.*, 839 F.2d 198, 201 (4th Cir. 1988) (involving products liability claims); *Kane v. Johns-Manville Corp. (In re Johns-Manville Corp.)*, 843 F.2d 636 (2d Cir. 1988) (involving products liability claims). Recently, the Eleventh Circuit adopted a new test for determining whether persons asserting claims based on postconfirmation events, but arising out of products manufactured and sold before confirmation, would be treated as holding "claims" within the meaning of § 101(5). See *Epstein v. Official Comm. of Unsecured Creditors of the Estate of Piper Aircraft Corp. (In re Piper Aircraft Corp.)*, 58 F.3d 1573 (11th Cir. 1995). This test focuses on the existence of a preconfirmation relationship between the debtor's product and the claimant. See 58 F.3d at 1577. The Fifth Circuit, relying heavily on the lower courts' opinions in *Piper*, has adopted a similar version of the "relationship" test. See *Lemelle v. Universal Mfg. Corp.*, 18 F.3d 1268 (5th Cir. 1994). Whatever standard ultimately predominates, the expansive definition of "claim" and the near-universal criticism evoked in response to the Third Circuit's decision in *Avellino & Bienes v. M. Frenville Co. (In re M. Frenville Co.)*, 744 F.2d 332 (3d Cir. 1984), which used a state-law claim accrual theory for measuring when a claim arises, serve as compelling testimony to the emphasis in bankruptcy cases placed on separating what happened in the debtor's prefiling life from the debtor's postfiling existence, regardless of whether the proceeding is in the nature of liquidation or rehabilitation.

218. The procedures allowing for estimation of claims that cannot be determined without unduly delaying the administration of the case, moreover, reinforce the primacy of "closing the books" on all outstanding prebankruptcy transactions. See *supra* text accompanying note 148.

of bankruptcy policy is that, with a few notable exceptions, pre-filing claims lose their individual identity once a case is commenced. That is to say, except in circumstances in which strong competing public policy considerations predominate,<sup>219</sup> the origin of any particular claim — whether incurred in good faith or bad, in contract or tort — is no longer relevant. Rather, inquiry is focused solely on questions of allowability and relative priority, essentially inter-creditor issues.

By and large, courts seem to recognize this principle in reorganization and debt-adjustment cases,<sup>220</sup> but *Dewsnup* stands in the way of a comparable recognition in individual chapter 7 cases. The irony could not be more striking. In the one type of proceeding in which the bankruptcy fresh start is most sharply in focus, the debtor's ability to accomplish a clean break with her past is foreclosed by a determination that the postfiling accrual of value will be burdened by a claim originating in the debtor's pre-filing life.<sup>221</sup>

How does this observation inform the question of the proper conceptualization of secured claims in bankruptcy? The *in rem* notion simply superimposes the state-law template onto the bankruptcy landscape while remaining oblivious to the differences in the legal terrain. Under state law, a secured creditor can be said to possess two different sets of rights: rights against the debtor upon default of repossession and foreclosure triggered by default — so-called “default rights” — and rights of exclusivity or priority against other claimants with an interest in the collateral — so-called “priority rights.”<sup>222</sup> What is often overlooked in the *Dewsnup* type of analysis is that only one set of rights survives a bankruptcy filing,

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219. These policies generally are reflected in the statutorily enumerated discharge exceptions. See 11 U.S.C. § 523(a) (1994).

220. Initially, commentators expressed serious concern over the pernicious effects of *Dewsnup* in chapter 11, 12, and 13 proceedings. See, e.g., Howard, *supra* note 4, at 319-36. Despite some early indications of reason for concern, particularly in chapter 11, courts have seemed to recognize the importance of confining the holding in *Dewsnup* to the facts presented in the case and, in particular, of not extending the holding beyond chapter 7 proceedings. See *supra* note 12.

221. The disruptive effect of extending *Dewsnup*'s interdiction against lien stripping into rehabilitation proceedings has been widely recognized. As one court accurately described it, importation of *Dewsnup* into chapter 11 could not be accomplished without eviscerating the core principles of reorganization law. See *Wade v. Bradford*, 39 F.3d 1126, 1129 (10th Cir. 1994). By the same token, *Dewsnup*'s interference with the core policy in consumer cases, namely fresh start, is arguably no less ominous.

222. For example, in the case of personal-property financing under article 9, attachment of the security interest vests in the secured party what might be termed its “vertical” rights against the debtor, which are triggered on default. See U.C.C. §§ 9-201, 9-203, 9-501 to -507 (1994). Beyond this, consummation of the additional steps necessary to perfect the interest establish the creditors' “horizontal” rights in the collateral vis-à-vis other claimants, including creditors, buyers, statutory lienors, etc. See U.C.C. §§ 9-201, 9-301, 9-303(1), 9-307, 9-312

namely the creditor's priority rights in the collateral. Like other *in personam* claims, the secured creditor's default rights against the debtor are eliminated, save for a successful challenge to discharge or dischargeability. Furthermore, even the creditor's priority rights do not represent a continuing interest *in* property, irrespective of the appropriate characterization of those rights prior to bankruptcy. Instead, they represent a claim *against* the property that may continue after bankruptcy if the property is exempt or has been abandoned, but only to the extent of the value extant at the moment of filing.<sup>223</sup> It is this closure of the debtor's prepetition life, expressly built into the confirmation standards in nonliquidation cases and implicit in the structure of chapter 7, that resides at the core of the fresh start.<sup>224</sup>

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(1994). The same basic dynamic occurs when a creditor secures a claim with an interest in realty.

223. The particular time for valuation is itself a more complicated question, particularly in chapter 11. See generally David Gray Carlson, *Time, Value, and the Rights of Secured Creditors in Bankruptcy, or, When Does Adequate Protection Begin?*, 1 BANKR. L. & PRAC. 113, 121-22 (1992) (noting that a moment-of-filing approach enhances the debtor's fresh start if strip down under § 506(d) is permitted). For an exhaustive review of the case law addressing the question of the applicable date of valuation of property of the estate, see *Wood v. LA Bank (In re Wood)*, 190 B.R. 788 (Bankr. M.D. Pa. 1996). See also *supra* notes 54, 112. However, a priority-only construction of secured claims in bankruptcy can be reconciled with either a "later than petition filing date" valuation or even, as Professor Carlson has argued, with the date of "disposal" of the collateral, either by sale or confirmation of a plan. See Carlson, *supra* note 10, at 20-52 (exploring the finality of bankruptcy valuations in light of *Dewsnup*).

224. Section 727(b) provides for the discharge of all debts arising prior to entry of the order for relief, and § 524(b) operates as an injunction against any attempt to collect a discharged debt. Obviously, along with the exemptions in § 522 and the right to be free from discrimination based on the fact of bankruptcy, the discharge and discharge injunction are key ingredients of the fresh start. Attempting to define the fresh start or to justify it in normative terms is a more difficult exercise. See generally Ponoroff & Knippenberg, *supra* note 23, at 248-52; Charles Jordan Tabb, *The Scope of the Fresh Start in Bankruptcy: Collateral Conversions and the Dischargeability Debate*, 59 GEO. WASH. L. REV. 56, 89-103 (1990) (reviewing the various policy justifications that have been proffered for the discharge). Moreover, determining the proper scope of the fresh start in relatively precise functional terms, and not simply invoking the shopworn incantation that the discharge is intended for the "honest but unfortunate" debtor, is essential to the resolution of a variety of questions that arise during the course of a bankruptcy proceeding. See Margaret Howard, *A Theory of Discharge in Consumer Bankruptcy*, 48 OHIO ST. L.J. 1047, 1047-48 (1987) (proposing a "functional economic theory" as a means for resolving specific issues relating to, and proposals for, modification of the discharge); Lawrence Ponoroff, *Vicarious Thrills: The Case for Application of Agency Rules in Bankruptcy Dischargeability Litigation*, 70 TUL. L. REV. 2515 (1996) (describing the fresh start as a condition intended to result from application of specific bankruptcy rules in particular cases, rather than as a formal legal status or cognizable legal right). While it is not (thankfully) our goal to put forth a full-blown normative theory of fresh start in this work, it is clear nevertheless that to the extent a debtor otherwise deserving of discharge carries any of the financial burdens of the past into the postbankruptcy future, the fresh start has been encumbered. Thus, however one individually resolves the fundamental issues of essential nature and appropriate scope, the damage has been done, and done in deference to an ideal — protection of private property — that the very existence of a system for discharging debts belies in the first instance.

If the central issue in *Dewsnup* relating to the right to future appreciation in property is framed in these terms instead of using the rhetoric of property law, the picture develops quite differently than the outcome reached by the *Dewsnup* majority. Specifically, in the bankruptcy context, a secured claim must be regarded first and foremost as a "claim," indistinguishable from other claims insofar as the debtor/creditor analysis is concerned.<sup>225</sup> The significance of the secured nature of the claim relates only to the question of priority in particular assets in the ultimate distribution of the estate among the body of creditors as whole — the creditor/creditor analysis. Contrary to Justice Blackmun's suggestion in *Dewsnup*, it is not *property* entitled to protection any more than an unsecured claimant can assert a protectible property interest in its state-law-based contractual rights against the debtor. What was conveyed at the onset was the right to foreclose under state law upon default, not some form of joint- or common-ownership rights. Therefore, when a collective procedure is initiated, barring the creditor from unilaterally taking action to foreclose, this right translates into a prior claim to the asset — nothing more and nothing less. This was after all the real *bargain*, just as the unsecured claimant has the right to sue and levy upon specific assets under state law *or* to receive a pro rata distribution from unencumbered assets upon insolvency. While the bargain in many cases may not be explicit, or even voluntary in the sense of there being meaningful alternatives, there is no defensible basis for recasting the secured claim in a manner that confers an unintended and unwarranted advantage on the secured creditor. This is particularly true when doing so potentially erects an insurmountable obstacle in the way of the debtor's fresh start.

The preceding discussion points to a conceptualization of secured credit in bankruptcy that abandons the inherent subjectivity and ambiguity imbedded in the bargain metaphor and the state-law property entailments that attend that metaphor. In their place, we urge a view that coheres with the bankruptcy notion of a "claim." In effect, a security interest can more accurately be seen as representing a kind of priority claim; it is a priority claim of a different ilk than the statutory priority unsecured claims,<sup>226</sup> but only in that the priority is measured against certain assets of the estate rather than against the unencumbered residue. Thus, just as in the

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225. See *supra* note 156.

226. See 11 U.S.C. § 507(a) (1994).

case of any other priority claimant, the secured creditor's future rights against the debtor are severed by the filing of the petition, including its rights against the debtor's future property interests no less than against the debtor *in personam*. Properly understood, the secured claim is a claim against specific assets that, like any other claim, must be fixed as of the time of filing. This is, of course, a very different conception of security than one that envisions the secured claim as representing a continuing property right that "survives" bankruptcy. It will be recalled, however, that the claim survives, as Judge Posner put it so well, only to the extent *we say it survives*.<sup>227</sup>

Although imagining secured claims in this fashion may be conceptually at odds with the orthodox state-law ideation of security, it is perfectly consistent with the jurisprudential principles that animate the consumer bankruptcy system. It squares with the fresh-start principle embedded in chapter 7 in the same manner as, for example, the 1994 Amendments' statutory formulation of "impairment" for section 522(f) purposes.<sup>228</sup> Furthermore, once we accept this reconceptualization of the meaning of secured claims in bankruptcy, it becomes very easy to let go of the antiquated notions of security in bankruptcy, and the "fairness" kinds of impulses that derive from those notions, that bolstered and may have even accounted for the result in *Dewsnup*.<sup>229</sup>

While basically explicated from a positivist stance — how the Bankruptcy Code operates in fact — the justification we have advanced for conceptualizing secured claims in bankruptcy also derives from a particular normative view of bankruptcy policy and purposes, a view that transcends the traditional consumer/commercial bankruptcy dichotomy. By and large, in recent years the controversy over the proper scope of chapter 11 has formed the backdrop against which the larger battle over bankruptcy policy has been waged.<sup>230</sup> Yet that discussion has significant implications for all types of bankruptcy proceedings. Ignoring for simplicity's sake the subtle, albeit important, shadings of difference in the various

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227. See *supra* note 128 and accompanying text.

228. See *supra* notes 15-18 and accompanying text.

229. See *supra* text accompanying notes 42-44. In effect, this result strikes a fair and sensible balance between the fresh-start doctrine and the policy considerations, properly understood, that seem to have animated the Supreme Court's decision in *Long v. Bullard*, 117 U.S. 617 (1886). See *supra* note 51.

230. For citation to the voluminous literature devoted to this topic, see Linda J. Rusch, *Bankruptcy as a Revolutionary Concept: Good Faith Filing and a Theory of Obligation*, 57 MONT. L. REV. 49, 96-97 n.236 (1996).

positions that have been staked out in the literature, the primary bone of contention among the commentators has been over the question of whether the bankruptcy process exists solely to maximize returns for creditors with cognizable state-law claims, or whether the process properly takes into account a broader range of social and economic concerns that includes protection of non-creditor constituencies with an interest in the debtor firm.<sup>231</sup> We subscribe to the latter view. That is to say, we recognize creditor wealth maximization as a legitimate, but not the only legitimate, purpose of the bankruptcy process. As we have argued elsewhere, bankruptcy purposes are several and varied, and these purposes "form the ever-shifting basis upon which bankruptcy courts must act to sort out and order a broad spectrum of interests clamoring for protection in the bankruptcy proceeding."<sup>232</sup>

This eclectic understanding of bankruptcy purposes coheres with the conceptualization of secured claims that we have advanced in this article in relation to the question of lien-stripping in chapter 7. Specifically, it provides the normative fulcrum that we use in striking the appropriate balance between the legitimate expectations of secured creditors and the fresh-start policy in consumer bankruptcy cases. Contrary to the view held by most commentators who subscribe to the economic account's first principle that bankruptcy provides nothing more than a collective mechanism for collecting debt, we believe that distributional issues are preeminent in bankruptcy proceedings.<sup>233</sup> Successful reorganization cannot be accomplished without taking into account and accommodating the conflicting, often antithetical, interests of all groups affected by firm failure. Likewise, fresh start, whether conceived in purely humanitarian terms or as a mechanism for returning the debtor to active participation in an open-credit economy,<sup>234</sup> cannot be attained unless prebankruptcy rights are subject to adjustment and the norms of prebankruptcy collection law are subject to deviation. Therefore, reconceptualizing the rights of an undersecured creditor in bankruptcy as a "claim," no different in its essential character

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231. See generally Frost, *supra* note 56, at 81-91; Ponoroff, *supra* note 56, at 468-71 (discussing just whom the bankruptcy law serves). For an attempt to justify circumscribing the concern of the bankruptcy law to traditional creditor groups in constitutional terms, see Thomas E. Plank, *The Constitutional Limits of Bankruptcy*, 63 TENN. L. REV. 487, 559-84 (1996).

232. Ponoroff & Knippenberg, *supra* note 56, at 966.

233. See generally Warren, *supra* note 66, at 356 (offering a normative justification for distributive goals in bankruptcy).

234. Alternative normative justifications for the discharge are discussed *supra* note 224.

than any other claim, secured or unsecured, is defensible on both positive and normative grounds.

### B. *In Application*

Having a defining model or working theory for justifying a value-based approach to security, with all of the consequential policy implications that this approach holds for lien stripping, is an essential point of departure in any reform effort. Ultimately, however, the wisdom of the rule and the prospects for its adoption, will be judged in terms of its practical effects on the lending community and the market for consumer credit. Oddly, perhaps, given the furor the issue has generated, we surmise that reversal of *Dewsnup* would cause, at most, a proverbial blip on the screen, although that prediction is subject to one qualification that would have to be addressed as part of the overall fix.

Most home- or other real-property-owning chapter 7 debtors will see their property sold either during the case<sup>235</sup> or very soon after the stay is lifted. In either event, restricting the secured lender to the market value of the property at filing is not prejudicial to the lender because, as a practical matter, there is no, and never will be any, appreciation to be forfeited. A debtor with sufficient postpetition cash flow or resources to carry the property will have chosen, or have been forced into, a chapter 13 debt-adjustment proceeding,<sup>236</sup> or, in rare circumstances, a chapter 11 case.<sup>237</sup> Thus, the fear of cram down in a chapter 7 case — where the debtor can retain the

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235. If that occurs, the valuation quandary is eliminated. It is the predictive character of valuation that accounts for its inherently speculative and subjective nature. See Carlson, *Eely Character*, *supra* note 6, at 70-75 (pointing out that all valuations, as distinct from actual sales, are exercises in “subjunctive” reasoning and, as such, are never reducible to a verifiable certainty). See also Fortgang & Mayer, *supra* note 160, at 1062 (observing that value is a function of time, but that bankruptcy ignores time in valuing claims).

236. While there is no involuntary chapter 13, this is often the practical effect of a finding under 11 U.S.C. § 707(b) (1994) that the granting of relief to the debtor under chapter 7 would be a “substantial abuse.” Both the Eighth and the Ninth Circuits have adopted the view that the ability to fund a chapter 13 plan is *per se* a substantial abuse. See *Fonder v. United States*, 974 F.2d 996, 999 (8th Cir. 1992); *In re Walton*, 866 F.2d 981 (8th Cir. 1989); *Zolg v. Kelly (In re Kelly)*, 841 F.2d 908, 913 (9th Cir. 1988). The Fourth and the Sixth Circuits take the approach that the ability to fund a chapter 13 plan is simply one factor in what amounts to a case-by-case facts and circumstances analysis. See *Green v. Staples (In re Green)*, 934 F.2d 568 (4th Cir. 1991); *In re Krohn*, 886 F.2d 123, 126 (6th Cir. 1989); see also *In re Higuera*, 199 B.R. 196 (Bankr. W.D. Okla. 1996) (holding that ability to pay, standing alone, is insufficient to warrant dismissal under § 707(b)); *In re Ontiveros*, 198 B.R. 284 (C.D. Ill. 1996) (adopting a limited form of the “totality of the circumstances” test); *Heller v. Foulston (In re Heller)*, 160 B.R. 655, 658 (D. Kan. 1993) (observing that whatever approach is taken, it is clear that the debtor’s capacity for repayment is the primary factor in the analysis).

237. Although statistically quite rare, a chapter 11 proceeding may be brought involuntarily. See 11 U.S.C. § 303(a) (1994).



property and modify the underlying obligation — is grossly exaggerated and cannot, as has been argued,<sup>238</sup> alone form a sufficient policy justification for the outcome in *Dewsnup*.<sup>239</sup>

Even were *Dewsnup* to be repealed tomorrow, there are realistically perhaps only three scenarios in which the debtor would be able both to proceed under chapter 7 and to retain the property, thereby exposing the mortgagee to the risk of being deprived of the benefit of its state-law bargain or, more properly, its claim in and to the property forming the collateral for the loan.<sup>240</sup> Each of these situations is taken up in turn. They reveal that (with one exception) even in these circumstances the “risk” to secured lenders is minimal.

The first scenario occurs when the debtor is able to “redeem” the property immediately after the case is closed by coming up with the cash necessary to pay off the reduced value of the lien. This is obviously the clearest example of the lender being deprived of post-filing appreciation since the lender is divested completely of any interest in the property.<sup>241</sup> But, as a practical matter, how much of a threat does this scenario really pose for professional lenders on a day-to-day basis? We submit that the risk is *de minimis*. First, short of an extraordinarily lucky day at the racetrack, relatively few debtors who have just gone through a chapter 7 bankruptcy case will personally have the resources to fund the payoff. Second, it is unrealistic to presume that such a debtor will have the cash flow to re-qualify for new financing, particularly at or near the 100% of value level that would probably be required.<sup>242</sup> Third, while family resources or similar private sources of credit are always a possibility, chances are that those options, if available, would have been exploited earlier in an effort to head off bankruptcy in the first

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238. See Adler, *supra* note 57, at 5, discussed *supra* notes 57-61 and accompanying text.

239. See Joann Henderson, *The Galia-Lowry Brief: A Quantum Leap from Strip Down to Chapter 7 Cram Down*, 8 BANKR. DEV. J. 131, 167 (1991).

240. This was, of course, a key ingredient underlying the majority's decision in *Dewsnup*. See *supra* text accompanying note 4. Because, however, the mortgage instrument is the consummate contract of adhesion, particularly in consumer transactions, the accuracy of the analogy is open to serious debate.

241. Presumably, however, the affected creditor still has an unsecured claim for the undersecured portion of the debt under § 506(a), for whatever value it is worth, which there would be no reason not to file regardless of the creditor's desire under other circumstances to remain aloof from the proceeding entirely. See *supra* note 144.

242. Alternatively, in a jurisdiction with generous exemptions, made applicable in bankruptcy under § 522(b), the debtor might look to such assets as a source of cash or credit. Ordinarily, however, the high-exemption property is likely to be the very property that the debtor is seeking to save from foreclosure and that, therefore, by definition, is already encumbered.

place. Certainly there may be some calculating (or well-advised) debtors who are willing to suffer the stigma of bankruptcy and pocket their hole card to be played at a more strategically advantageous moment, but we strongly suspect that those instances would be so numerically insignificant as to have virtually no effect on the cost or the availability of consumer credit at large.<sup>243</sup>

In addition to the foregoing circumstances making it highly unlikely that most debtors would ever be in a position to redeem, it is also the case that the mere fact that a debtor has the capacity to redeem does not mean that she has the legal right to do so. That determination is governed by applicable state law and, more particularly, by private contract. The terms and conditions of loan agreements and security instruments typically are negotiated, if at all, off of the lender's standard documents. Therefore the lender should have ample opportunity, within the perimeters established by applicable regulatory legislation, to protect itself against an undesired redemption — for example, when the note carries a favorable rate of return — with a modicum of advance planning.<sup>244</sup> Finally, even in those relatively few cases in which the debtor has both the ability and the right to redeem, the lender has not only received the full value of its collateral, but has been spared the costs and risks associated with foreclosure. Thus, subject only to the unsubstantiated charge that judicial valuations are consistently low, an assumption particularly suspect when the relevant comparison is with foreclo-

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243. The opportunity for exploiting a strategic advantage is far more likely in the case in which the lien, although without any actual economic value, remains as an encumbrance against the property. See *supra* note 182.

244. See Howard, *supra* note 24, at 391 (explaining this point in the context of a broader explanation of why an interpretation of § 506(d) that permits strip down of liens against realty does not violate either the spirit or purpose of § 722). Professor Howard cites *O'Leary v. Oregon (In re O'Leary)*, 75 B.R. 881 (Bankr. D. Or. 1987), in support of this proposition. See Howard, *supra* note 24, at 391. In fact, the court in *O'Leary* observed that redemption, as distinct from strip down, depended on the terms of the note and mortgage, which might include "pre-payment penalties and other contractual obligations that would remain unaltered by fixing defendant's allowed secured claim under § 506." 75 B.R. at 884. In fairness, however, it should be noted that in many circumstances, such as primary home mortgage loans, requirements and restrictions imposed by the secondary market may effectively tie the hands of both parties when it comes to items such as prepayment penalties. Also, since its loan is now nonrecourse, in many cases the secured creditor would have no interest in obstructing early repayment even at the reduced amount of the lien remaining after strip down. Thus, in many instances where the debtor had the financial capacity to do so, the effect of the strip down would be to facilitate a de facto redemption of real property collateral. Since the creditor would still be receiving the full value of its state-law security interest, however, we do not see any particular inequity in this result. Further, because the redemption would occur pursuant to the debtor's rights under state law, we do not regard it as inconsistent with the Code's provision for redemption of personal property collateral.

sure rather than market values,<sup>245</sup> the potential prejudice to the secured lender under this scenario is nominal at most.

The second scenario in which the debtor may be able to strip down and retain the property is one that actually does not involve or require the repeal of *Dewsnup*. It involves accomplishing in two steps what *Dewsnup* now forbids doing in one by resorting to the device that has come to be known as "chapter 20."<sup>246</sup> In its simplest form, a chapter 20 entails an initial filing of a chapter 7 case to discharge personal liability on dischargeable debts, followed by the rapid-fire filing of a chapter 13 designed to reimpose the automatic stay and, *inter alia*, permit retention of desired property or modify a nondischargeable debt.<sup>247</sup> In *Johnson v. Home State Bank*,<sup>248</sup> the Supreme Court rejected a mortgage lender's argument that once the debtor's personal liability had been discharged in the earlier chapter 7 case, the mortgage lien was no longer a "claim" subject to rescheduling in chapter 13.<sup>249</sup> By implicitly placing its imprimatur on chapter 20s,<sup>250</sup> the Court created the opportunity for debtors in *Dewsnup* situations to obtain all of the benefits of a prohibited strip down by simply using the chapter 20 technique to accomplish an installment redemption of the property at a price equal to the value of the property rather than the amount secured by the lien.<sup>251</sup>

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245. See *supra* note 66.

246. "Chapter 20" is the informal name that has been attached to a particular pattern of serial filings used by individual debtors. See generally Lex A. Coleman, *Individual Consumer "Chapter 20" Cases After Johnson: An Introduction to Nonbusiness Serial Filings Under Chapter 7 and Chapter 13 of the Bankruptcy Code*, 9 BANKR. DEV. J. 357, 363-65 (1992).

247. See, e.g., *Jim Walter Homes, Inc. v. Saylor* (*In re Saylor*), 869 F.2d 1434 (11th Cir. 1989); *Downey Sav. & Loan Assn. v. Metz* (*In re Metz*), 820 F.2d 1495 (9th Cir. 1987); *Johnson v. Vanguard Holding Corp.* (*In re Johnson*), 708 F.2d 865 (2d Cir. 1983) (*per curiam*).

248. 501 U.S. 78 (1991).

249. See 501 U.S. at 84-86 (holding that a surviving nonrecourse mortgagee lien is a "claim" within the meaning of § 101(5) of the Bankruptcy Code).

250. Prior to *Johnson* some bankruptcy courts had taken the position that chapter 20s were inconsistent with the purpose and spirit of chapter 13 and, accordingly, should be barred as a matter of law. See, e.g., *In re McKissie*, 103 B.R. 189, 191 (Bankr. N.D. Ill. 1989). In *Johnson*, the Supreme Court failed to outlaw chapter 20 cases either as an abusive manipulation of the system or as presumptively involving bad faith for purposes of the confirmation standard in § 1325(a)(3). Technically, however, the issue of good faith was not before the Court. See *Johnson*, 501 U.S. at 88 (declining to address the good faith issue (or the issue of "feasibility" under § 1325(a)(6)) because both the district court and the court of appeals had decided the case on the ground that the creditor's mortgage lien did not constitute a "claim").

251. The process would work as follows: Assume a debtor who owns real property with a current value of \$100,000 subject to a lien securing an indebtedness of \$150,000 that is currently in default. Before foreclosure can be initiated, the debtor files chapter 7, discharging all personal responsibility for the debt. Assuming no dividend to unsecured creditors (or that the creditor elects not to file in that capacity), the creditor emerges with an *in rem* claim for \$150,000 (plus accrued interest). Because of *Dewsnup*, the debtor would have been pre-

Again, the risk here to lenders is minimal. To begin with, the fact that a sophisticated or well-advised debtor can accomplish strip down today in spite of *Dewsnup* means that, at best, what we have now is unprincipled, selective regulation of mortgage strip down. It might be argued that this makes the case for reversal of *Johnson*, not *Dewsnup*.<sup>252</sup> However, chapter 20 debtors are still subject to case-by-case scrutiny of their motives under the good faith standard in section 1325(a)(3),<sup>253</sup> and, in point of fact, the highly individualized nature of the fact mosaic in these cases suggests that potential abuses are best regulated in just this fashion rather than by attempting to draw sharp, inflexible lines.<sup>254</sup> In addition, at least by dint of the number of reported decisions, there is no indication that this crack in the dam has created or threatens to create a flood of filings aimed at end-running *Dewsnup*. This may be due, in large measure, to the fact that *Nobleman*, as a matter of chapter 13 policy and interpretation, precludes use of chapter 20 to strip down a mortgage against the debtor's personal residence.<sup>255</sup> In any event, this empirical reality reinforces the notion that the repeal of *Dewsnup* poses no practical threat of consequence to the mortgage-lending community. As nifty as it sounds, most debtors flirting with bankruptcy lack the financial capacity to pull off an effective strip down, whether in one step or two. For those few who do have the ability to pay off the amount of the secured claim under a confirmed chapter 13 plan and are not legally precluded from doing so, there are sound reasons for permitting them to do so and no apparent justification for discriminating among them based solely on guile. Alternatively, if those reasons are not regarded as sufficiently

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cluded from avoiding the underwater portion of the lien in the chapter 7 case. At this juncture, the creditor would be expected to commence foreclosure proceedings. However, before that can occur, the debtor now files a chapter 13 petition and in his plan proposes, in conformity with § 1325(a)(5), to pay to the mortgagee over the life of the plan the present value of \$100,000. Obviously, because of § 1322(b)(2) and the *Nobleman* decision, the strategy will not work where the lien is on the debtor's principal residence. See *supra* note 12. Barring that circumstance, the debtor has managed to pull off in two steps what *Dewsnup* prohibits accomplishing in one. In fact, because of the payout feature of the plan, the debtor is in even a better position than would result from strip down alone, and this factor is doubtless the most troubling aspect of the practice. For further discussion of whether installment redemptions, distinct from the question of lien avoidance, should be permitted, see *infra* notes 275-78 and accompanying text.

252. This is certainly, for example, the tack that Professor Adler would advocate. See *supra* text accompanying notes 59-61.

253. Unlike some bankruptcy courts, all of the appellate courts to speak to the good faith issue in the context of a chapter 20 case have refused to find bad faith *per se*, instead leaving the determination to a fact-specific analysis in each case. See authorities cited *supra* note 247.

254. See Ponoroff & Knippenberg, *supra* note 56, at 966-70 (advocating the advantages of developing the contours of good faith, as it relates to filing, using the case method).

255. See *supra* note 12.

compelling, then logically we cannot continue to indulge without closer scrutiny the rationale that has driven Congress's preference in recent years for chapter 13 over chapter 7.<sup>256</sup>

The third scenario in which the repeal of *Dewsnup* might pose a serious practical threat to lenders is in those jurisdictions that interpret section 521(2) of the Code<sup>257</sup> in permissive rather than mandatory terms. It is this circumstance, as opposed to the chapter 20 phenomenon where good faith still operates as a control,<sup>258</sup> that poses the greatest risk of the debtor accomplishing an installment redemption of the stripped-down value of the lien. Accordingly, it is also the circumstance in which lender complaints are most legitimate and would have to be addressed as part and parcel of any reform effort aimed at repealing *Dewsnup*.

Section 521(2) requires an individual debtor in chapter 7 to file a statement with the clerk indicating the debtor's intention (to retain or surrender) with respect to property of the estate securing a consumer obligation and then to perform in accordance with that stated intention within forty-five days.<sup>259</sup> This provision has created a split in the circuits over the question of whether a debtor who is current on the debtor's obligations to the creditor may propose simply to retain the property without either redeeming it<sup>260</sup> or reaffirming the debt secured by the property.<sup>261</sup> Relying on authority from the Sixth Circuit to the effect that the Code neither pro-

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256. See generally TERESA A. SULLIVAN ET AL., AS WE FORGIVE OUR DEBTORS 340 (1989) (contending, based on empirical data, that the drive to push debtors into chapter 13 has distorted the law in certain critical respects).

257. Congress added § 521(2) to the Bankruptcy Code as part of the Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 98 Stat. 333. It provides, in substance, that if an individual debtor's debts include consumer debts secured by estate property, then the debtor, before the earlier of the first meeting of creditors or 30 days following filing of the petition, within a specific time frame, must state his intention with respect to retention or surrender of such property and, if the property is claimed as exempt, whether the debtor intends to redeem the property to reaffirm the debt secured by the property.

258. See *supra* note 253 and accompanying text.

259. See 11 U.S.C. § 521(2)(A), (B) (1994). However, subparagraph (C) states that "nothing in subparagraphs (A) and (B) . . . shall alter the debtor's or the trustee's rights with regard to such property under this title." 11 U.S.C. § 521(2)(C) (1994).

260. See 11 U.S.C. § 722 (1994) (providing individual debtors with the right to redeem personal property intended primarily for the debtor's personal, family, or household use from a lien encumbering such property by paying to the secured creditor the value of its secured claim (under § 506(a)), provided that there is no value in the property for the estate). In effect, the debtor is given a right, not available under state law, to cash out the lien by paying the value of the collateral rather than the amount of the debt. Section 722, of course, does not apply to real property.

261. Reaffirmation entails a voluntary agreement between the debtor and a creditor under which the debtor's personal liability on an otherwise dischargeable debt is renegotiated and reaffirmed or simply reaffirmed. See 11 U.S.C. § 524 (1994).

vides for nor permits installment redemptions,<sup>262</sup> the Seventh Circuit,<sup>263</sup> later joined by the Eleventh,<sup>264</sup> held that section 521(2) is mandatory in the sense that a debtor who neither redeems nor reaffirms must surrender the property to the secured creditor.<sup>265</sup> Most recently, the Fifth Circuit has joined in the view that a debtor may not retain collateral securing a consumer obligation without either redeeming the property or reaffirming the debt.<sup>266</sup> The Fourth Circuit,<sup>267</sup> by contrast, relying on authority from the Tenth Circuit,<sup>268</sup> has ruled that a debtor who is not in default, and who gives proper notice of the debtor's intention to retain the property and continue paying the debt, without formally reaffirming or redeeming, has fully complied with section 521(2).<sup>269</sup>

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262. See *General Motors Acceptance Corp. v. Bell* (*In re Bell*), 700 F.2d 1053, 1056-58 (6th Cir. 1983). Note that *Bell* was decided before the enactment of § 521(2).

263. See *In re Edwards*, 901 F.2d 1383 (7th Cir. 1990).

264. See *Taylor v. AGE Fed. Credit Union* (*In re Taylor*), 3 F.3d 1512 (11th Cir. 1993).

265. See *Taylor*, 3 F.3d at 1514-16 (noting that the plain language of the section permits only three options: retain and reaffirm, retain and redeem, or surrender); see also *First Natl. Bank v. Parlato*, Civil No. 3:95cv2056 (AVC), 1996 U.S. Dist. LEXIS 16066 (D. Conn. Sept. 24, 1996) (refusing to permit a chapter 7 debtor, even though current on his automobile installment loan payments and in compliance with other loan terms, from retaining the automobile after discharge without either redeeming or reaffirming); *In re Gregg*, 199 B.R. 404, 407-09 (Bankr. W.D. Mo. 1996) (providing that the secured creditor has standing to enforce the debtor's obligation to perform in accordance with their stated intention under § 521(2) when the debtors fail to perform).

266. See *Johnson v. Sun Fin. Co.* (*In re Johnson*), 89 F.3d 249, 252 (5th Cir. 1996) (per curiam). But see *In re Castillo*, 209 B.R. 59, 75 (Bankr. W.D. Tex. 1997) (questioning the scope of the holding in *Sun Fin.*).

267. See *Home Owners Funding Corp. of Am. v. Belanger* (*In re Belanger*), 962 F.2d 345 (4th Cir. 1992).

268. See *Lowry Fed. Credit Union v. West*, 882 F.2d 1543 (10th Cir. 1989).

269. See *Belanger*, 962 F.2d at 346. *Belanger* suggests that courts that have adopted the mandatory view have failed to give proper weight to § 521(2)(C), which provides that subsections (A) and (B) are not meant to alter the rights of debtors in regard to the property, and to the legislative history, which reveals that Congress rejected a proposal that would have provided for lifting of the automatic stay if the debtor retained the property and failed to timely redeem or reaffirm. See also *Mayton v. Sears, Roebuck & Co.* (*In re Mayton*), 208 B.R. 61 (Bankr. 9th Cir. 1997); *Capital Communications Fed. Credit Union v. Boodrow*, 197 B.R. 409, 411-12 (N.D.N.Y. 1996) (affirming the bankruptcy court's determination that the plain language of the statute supports the position taken in *Belanger*); *Sears Roebuck & Co. v. Lamirande*, 199 B.R. 221, 224 (D. Mass. 1996) (holding that the options stated under § 521(2) are not exclusive); cf. *In re Irvine*, 192 B.R. 920, 922 (Bankr. N.D. Ill. 1996) (holding that the creditor is entitled to have stay lifted if the debtor fails to comply with § 521(2)). If the debtor is not in default on the underlying obligation with respect to which he has failed to state his intention, vacation of the stay would not create any immediate remedies for the creditor. See *In re Weir*, 173 B.R. 682, 692 (Bankr. E.D. Cal. 1994). The court in *Weir* declined to comment on the enforceability of an *ipso facto* in the underlying note and security instrument under these circumstances since the issue was not presented on the facts of the case. See 173 B.R. at 692 n.24. However, the court did affirmatively reject the creditor's suggestion that other remedies might include denial of discharge or contempt. See 173 B.R. at 690-91; see also *Beneficial N.Y., Inc. v. Bushey* (*In re Bushey*), 204 B.R. 661 (Bankr. N.D.N.Y. 1997) (holding only that a debtor not current on a secured obligation has a mandatory obligation to do something in respect of the debt). For a good discussion of the

The rule in the Fourth and the Tenth Circuits, in addition to its consistency with the language of the statute and generally accepted principles of statutory construction,<sup>270</sup> seems truer to the general goal of the Code and the spirit of fresh start that animates the Code's consumer bankruptcy provisions.<sup>271</sup> For example, a mandatory interpretation of section 521(2) leads inevitably to the conclusion that a debtor cannot reaffirm just one of several debts secured by the same property even though the junior liens are wholly or partially under water.<sup>272</sup> On the other hand, were *Dewsnup* to be overruled, a permissive interpretation of section 521(2) arguably threatens to affect the terms of the secured loan in a manner that is not only inconsistent with the theory of the rights of secured creditors in bankruptcy that we have advanced in this work, but that may pose constitutional infirmities as well.<sup>273</sup>

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split in the interpretation of § 521(2) and the implications that follow from the various positions that have been staked out, see David Gray Carlson, *Redemption and Reinstatement in Chapter 7 Cases*, 4 ABI Insr. L. Rev. 289, 319-22 (1996).

270. See *Mayton*, 208 B.R. at 66 ("Amazingly, courts restricting the debtor to redemption or reaffirmation refer not at all to subparagraph (C) [of § 521(2)]." (internal quotation marks omitted) (quoting *In re Ogando*, 203 B.R. 14, 16 (Bankr. D. Mass. 1996)); *Belanger*, 962 F.2d at 347-48 (pointing out that to give full effect to the words of the statute, "if applicable" as used in § 521(2)(A) must apply to redemption or reaffirmation).

271. See, e.g., *Capital Communications*, 197 B.R. at 412 (contending that allowing debtors this "fourth option" fairly balances the "rights of secured creditors vis-à-vis debtors"); *First N. Am. Natl. Bank v. Doss (In re Doss)*, 203 B.R. 57 (Bankr. W.D. Va. 1996) (finding that § 521(2) essentially serves a notice requirement, and that the election to redeem or reaffirm is therefore not mandatory); cf. *Ogando*, 203 B.R. at 15-16 (finding that § 521(2) imposes a mandatory requirement that the debtor file a statement of his intention either to retain or surrender the collateral, but does not otherwise infringe on the debtor's rights with respect to the debt or the collateral). For a particularly well-reasoned analysis of the issue based on the applicable legislative history, see *Castillo*, 209 B.R. 59.

272. See *In re Greer*, 189 B.R. 219 (Bankr. S.D. Fla. 1995). In this case, the creditor was owed three debts, all secured, pursuant to a cross-collateralization clause, by the debtor's car. The value of the car was less than the amount of the senior claim (the original automobile loan). Thus, the debtor proposed to reaffirm that debt only, and the creditor objected. Citing *Taylor*, the court held that all three debts had to be reaffirmed if the debtor wanted to keep the car. See 189 B.R. at 221. Because, as even the court noted, the creditor's objection made no economic sense given that the creditor was better off with a partial reaffirmation than either a redemption or surrender of the car (which had a value less than the first lien), it is obvious that the objection was intended to extract an even greater repayment from the debtor by exploiting the advantage resulting from the debtor's simultaneous desire to keep her car and inability to fund a cash-out redemption. This is precisely the reason why the permissive approach to § 521(2) facilitates fresh start, and not "head start," the latter representing a catchphrase frequently employed by the courts inclined toward constraining the debtor's options in an effort to justify their position. See, e.g., *Taylor v. AGE Fed. Credit Union (In re Taylor)*, 3 F.3d 1512, 1516 (11th Cir. 1993).

273. It will be recalled that the real problem the Supreme Court had with the legislation before it in *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555 (1935), was that the original provisions of the Frazier-Lemke Act of 1934 permitted not only reduction of the indebtedness to the value of the property, but payment of such value in the form of deferred payments. See 295 U.S. at 591-93. The Act also had retroactivity problems, much like the problem with § 522(f)(2) when applied to pre-Code security interests. See *United States v. Security Indus. Bank*, 459 U.S. 70 (1982). Because of the fact that the payout in these cir-

In some instances, it is fair to assume that a debtor who proposes to continue payments as originally scheduled in order to retain the property subject to the lien does so to protect an exempt equity position that the debtor has built up in the property. That is to say, purely from a financial standpoint, the creditor will be oversecured, and the excess value is exempt from administration. There is little reason for a debtor to employ this strategy when the amount of the debt is greater than the value of the collateral, particularly when redemption under section 722 is an option. If, however, the debtor is first able to use section 506(d) to reduce the undersecured loan to the value of the collateral, there is much more incentive to retain the property because of either its sentimental value or the cost and inconvenience of replacing it.<sup>274</sup> In essence, the stripped-down creditor is forced into the position of having made a nonrecourse loan without an equity cushion, so that the debtor enjoys the benefit of any appreciation in the property while the creditor bears the entire risk of a decline in value.

While defining a secured creditor's interest with reference to the value of the collateral at filing does no violence to the prebankruptcy bargain of the parties,<sup>275</sup> it is another kettle of fish entirely to defer payment of that value *and* to put at risk the creditor's ability to recover its claim from the property.<sup>276</sup> Therefore, in the inter-

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cumstances would presumably include compensation for the deferral based on the contract rate of interest, it is not clear that the issues entailed in the combination of strip down, discharge, and extension would rise to the level of constitutional infirmity. See *Lindsey v. Federal Land Bank (In re Lindsey)*, 823 F.2d 189 (7th Cir. 1987) (a pre-*Dewsnup* case involving a debtor's effort to amortize payments on a stripped-down lien over time). There are, however, other reasons short of constitutional requirements not to put the stripped-down mortgage in this position with respect to its secured claim, including the fact that it is inconsistent with the conceptualization of a security interest in bankruptcy advanced in this work. See also *infra* note 276.

274. Given the rationale that a debtor who is not in default might simply *continue* making regular payments, the total amount of each payment would presumably have to stay at the same amount designated in the original note — that is, the amount necessary to amortize the original principal balance and accrued interest over the life of the note. Obviously, however, because of the reduction in principal, the allocation of each payment to principal and interest would change and the obligation would pay out sooner than the maturity date contemplated in the note. Conceivably, if no value were assigned to the increased risk imposed on the mortgagee, the lender might be better off with a fair valuation and imposition of this arrangement than it would be with its ordinary state-law remedy of seizure and immediate foreclosure.

275. See *supra* notes 225-27 and accompanying text.

276. Because the indebtedness would be equal to exactly the value of the property and essentially be nonrecourse on account of the discharge, in the event of a subsequent decrease in value an economically rationale debtor simply would cease paying the note and leave the creditor with its rights against the property. Moreover, the same circumstances might create a disincentive for the debtor adequately to maintain or insure the property until market appreciation operated to give the debtor something to protect. Some of these concerns easily could be ameliorated with proper covenants in the loan documentation and broad definition



ests of consistency and evenhandedness,<sup>277</sup> it seems that any proposal calling for the repeal of *Dewsnup* must also address this issue. Logically, the issue can be resolved by explicitly making reaffirmation of the stripped portion of the debt mandatory where the debtor proposes to retain *and* to continue to make regular payments.<sup>278</sup> This approach would protect the secured creditor from effectively having its lien stripped down twice, in contravention of the spirit of section 727(a)(8), in circumstances in which the debtor late-decides to cease making payments following a decline in the value of the property. In addition, it would have the further incidental advantage of clarifying that, in any other situations, the debtor is not required by section 521(2) to choose redemption, reaffirmation, or surrender of the property to the exclusion of other non-Code alternatives.

### CONCLUSION

The Supreme Court's holding in *Dewsnup* transgresses most of the traditional principles of statutory construction. Indeed, given the approach the Court has taken to other bankruptcy issues,<sup>279</sup> its existence may be explicable only as a kind of involuntary judicial reaction to the perceived opportunity that section 506(a) creates to "arbitrage between the bankruptcy court's low valuation and the higher price a buyer pays at a later sale."<sup>280</sup> In any event, justifications for Justice Blackmun's tortured reading of section 506(d)

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of the events of default to include the breach of such covenants. Further, in many instances, the debtor might have a noneconomic-based attachment to and interest in the property. See *supra* note 182. This fact, coupled with the unlikelihood that the debtor could obtain the financing to secure replacement property, provides some assurance to the lender of the debtor's incentive to stay current on payments and maintain the property so that the lender eventually will receive the full value of its secured claim. Nevertheless, in a liquidation proceeding in which the creditors are to be denied any participation in the debtor's future, they should not be required to endure both the avoidance of their undersecured claim *and* deferral in the payment of their secured claim.

277. Ironically, the bargain metaphor could lead to just the opposite conclusion. If, however, as we have advanced, it is appropriate to imagine the security interest as simply a priority "claim," rather than as a continuing property interest, it is appropriate to pay that claim at the same time it is adjusted to value and not to subject the creditor to an even less favorable result in the future.

278. We have far less sympathy for the proposal in circumstances in which the creditor effectively requires the continuance of regular payments by exercising its state-law contract rights to block any attempt to cash out the property. See *supra* note 82 and accompanying text.

279. See *supra* note 11.

280. Carlson, *Undersecured Claims*, *supra* note 6, at 254 (referring to the practice whereby the trustee is able to obtain a low judicial valuation and then sell the property at a high price, effectively extracting a subsidy for general creditors at the expense of the secured creditor). Exactly how serious a threat to secured creditors this practice represents is an open question. See *supra* notes 65-67 and accompanying text.

couched in terms of bargain metaphors and nondefeasible property rights are noble sounding, but ultimately empty, rhetorical ruses. In fact, as we have seen, the most articulate defense of *Dewsnup* has forthrightly acknowledged that the real issue is distrust over judicial valuations that are too conservative.<sup>281</sup> There are no sovereign or inalienable principles at stake. Instead, the issue boils down to a political exercise of balancing fresh-start policy against the competing commercial policies served by maintaining a stable environment for asset-based financing.

Collateral valuations are mere predictions and, as such, are inherently uncertain.<sup>282</sup> Moreover, while it is unclear to us that this uncertainty necessarily produces low valuations — particularly since judicial valuations typically do not factor selling and delay costs into the analysis<sup>283</sup> — even conceding the point does not diminish the case for overruling *Dewsnup*. We make this assertion based on our observation that the fresh-start objectives of the consumer bankruptcy system are attained by recognizing that the filing of the petition changes fundamentally the nature of the debtor's relationships with his creditors, both secured and unsecured. An essential aspect of this closure of the debtor's prepetition life is achieved by liquidating secured creditors' claims in relation to the then-extant value of their collateral. The filing of the petition serves to construct a nearly impenetrable barrier separating the debtor's pre- and postpetition lives. A property-based heuristic for understanding security provides a convenient method for structuring the discussion about the rights and entitlements of secured parties in a nonbankruptcy context. It loses its viability, however, as soon as the bankruptcy curtain is drawn. The very act of filing extinguishes the secured creditor's default rights against the debtor and repossessory rights in and to the property. This is no less true for secured claims than it is for any other kinds of claims against the debtor or assets of the estate. This judgment is not only intuitive; it also finds support in a number of other Code provisions, ranging from the new statutory definition of "impairment"<sup>284</sup> to the negative implications drawn from the explicit provision in chapter 11 of a mechanism for secured creditors to hedge against low valuations

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281. See *supra* text accompanying notes 58-61.

282. See *supra* note 66.

283. See *supra* note 65.

284. See *supra* note 15.

or a temporarily depressed market.<sup>285</sup> It also coheres with the rehabilitative goals of the consumer bankruptcy system no less than it does with the rehabilitative objectives of the various chapter proceedings.

Despite its interference with the Code's fresh-start policy, *Dewsnup* has proved tenacious. In large measure, we believe that it has been difficult to eradicate because it hangs on a false conception of bankruptcy and, in particular, an appealing but ultimately inaccurate conception of the nature of security in bankruptcy. However, once the misconception is understood, we can finally snip the slender vine from which the rule in *Dewsnup* hangs. At bottom, unlike the leaf that sustained Johnsy in her time of need, we really could have done quite nicely without it all along.

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285. Section 1111(b) permits a secured creditor to elect to have its entire debt treated as secured rather than bifurcated under § 506(a). This provision was, in large measure, a congressional reaction to a case under chapter XII of the Act in which the court held that a secured creditor that had disapproved of the debtor's plan of arrangement could be cashed out on a nonrecourse debt for the appraised value of its collateral in lieu of return of the property. See *In re Pine Gate Assocs.*, 2 Bankr. Ct. Dec. (CRR) 1478 (Bankr. N.D. Ga. 1976); see also Carlson, *Unsecured Claims*, *supra* note 6, at 255 (discussing the origins of § 1111(b)). However, as earlier noted, in terms of the economic value of the payment received by the electing creditor under chapter 11, the debtor-in-possession usually can achieve the same result as if the creditor had not elected by extending the payout period. This is a function of the fact that § 1111(b) only requires that the sum of the payments aggregate to the amount of the secured claim, not that they have a present value of such amount as of the date of confirmation. Despite this, § 1111(b) still affords some protection in the event the debtor fails to make the payments called for by the plan or if the value of the property is temporarily depressed. See *supra* note 24. Nevertheless, the absence of any sort of similar provision in chapter 7 is some indication that the drafters did not intend to preclude strip down under § 506(d) in individual liquidation cases.