University of Missouri School of Law Scholarship Repository

Faculty Publications | Faculty Scholarship

Summer 2015

Bankruptcy Weapons to Terminate a Zombie Mortgage

Andrea Boyack

Robert Berger

Follow this and additional works at: https://scholarship.law.missouri.edu/facpubs

Part of the Bankruptcy Law Commons, Housing Law Commons, and the Property Law and Real Estate Commons

Bankruptcy Weapons to Terminate a Zombie Mortgage

Professor Andrea Boyack* and Judge Robert Berger**

I. INTRODUCTION

After receiving notice from JP Morgan Chase in 2008 that foreclosure was imminent, homeowner Joseph Keller vacated his home, moved to a new residence, and tried to pick up the pieces and start again.[1] Two years after he had relocated, however, the county sued Keller because his house, "already picked clean by scavengers," was in violation of the housing code. Upon returning to investigate, Keller found his former home "in [] shambles," with "hanging gutters and collapsed garage."[2] Keller also discovered that he owed back taxes, sewer fees, as well as bills for municipal weed and waste removal. Furthermore, he remained personally liable on the Chase mortgage loan, the debt having grown from $62,000 to $84,000 because of two years of unpaid interest, penalties, and fees. Adding insult to injury, the Social Security Administration rejected his disability application because the vacant, crumbling home he still unwittingly owned was a valuable "asset." Chase had dismissed the foreclosure judgment two months after Kelley had moved out, but somehow Kelley was never informed.[3]

In 2012, Marlon Sheafe was sentenced to probation and faced jail time based on failure to maintain a home that he had abandoned and had presumed was foreclosed upon back in 2008.[4] Sheafe, struggling with the symptoms of advanced cancer, started visiting the abandoned home weekly to mow the lawn and attempt to rehabilitate the property that was plagued by "cracked steps, shredded siding, weeds as tall as the door."[5] The Cleveland Housing Court had cited Sheafe for building code infractions on the property even though he did not know that he still owned it. During the four years after Sheafe's

* Associate Professor of Law, Washburn University School of Law, J.D. (University of Virginia School of Law), M.A.L.D. (Tufts University Fletcher School of Law and Diplomacy), B.A. (Brigham Young University). I would like to thank the participants of the Junior Faculty Regional Workshop at Washington University School of Law for their helpful comments on this article.

** U.S. Bankruptcy Court Judge, District of Kansas.

1. Conlin, *supra* note 35 (illustrating the following case studies).
2. *Id.*
3. *Id.*
4. *Id.*
5. *Id.*

abandonment, "[l]ooters had stripped the place bare, and 'dope boys' had left their sneakers on the porch and their empty cans of sausages strewn about inside."[6] Sheafe eventually convinced the bank to release its lien and tried to donate the home to a land bank, but by that time, the county had sold its tax lien to a debt collector who brought suit for foreclosure. This second foreclosure still pending, Sheafe faced thousands of dollars in code violations and court costs and risked owing $10,000 in fees to the county if it ordered the home to be demolished because of blight.[7]

David Volker assumed that his home had been sold in foreclosure when, in 2009, he found the house padlocked and bank foreclosure stickers on the door.[8] But the home was left unattended, and ultimately the property was "trashed" and "stripped"—looters took everything, even the toilets.[9] Eventually, his neighbors complained to the Buffalo Housing Court, and when Volker was summoned to appear, he discovered that he was still the title owner of the home. HSBC rejected Volker's offers to conduct a short sale to a third party buyer and refused to accept Volker's proffered deed in lieu of foreclosure. This left Volker owing thousands of dollars in unpaid water and trash bills and possibly facing a $30,000 demolition charge from the city.[10]

Harms to mortgagors and communities result from vacant, un-foreclosed property. If a lender declines to foreclose, the defaulted mortgage is not completely killed off, even when a borrower has abandoned the home or even declared bankruptcy. Borrowers who remain nominal title holders to vacant property remain legally liable for all costs associated with its upkeep. Markets and communities suffer from un-foreclosed, vacant properties as well. The undead—or "zombie"—mortgage prevents the property from entering the flow of commerce and poses a barrier to acquisition by a new owner willing to shoulder its upkeep.[11] Neighborhoods and municipalities also pay the cost of zombie mortgages, as years can drag by with no resident owner paying homeowner association dues or property taxes.[12] Furthermore, vacant, unmaintained properties pose a safety hazard and drive down community property values.[13] Policymakers have tried—with varying success—to address this zombie mortgage apocalypse, and the law generally offers little aid.[14] Bankruptcy law, however, provides tools with which a debtor and a court can combat the zombie mortgage problem.

Bankruptcy promises borrowers a fresh start—a way for a debtor to free

6. *Id.*
7. *Id.*
8. *Id.*
9. *Id.*
10. *Id.*
11. *See infra* Part I.
12. *See infra* notes 38–39 and accompanying text.
13. *See infra* notes 37–44 and accompanying text.
14. *See infra* Part III.

himself from the burdens of pre-petition obligations and re-commence his financial life.[15] Under the Bankruptcy Code (the "Code"), if a bankruptcy debtor surrenders property burdened by a lien to the lien-holder, and if this lienholder accepts title to the surrendered property, then the debtor will be released from ongoing obligations under the loan.[16] This is true even in cases where the collateral's value is less than the secured loan—because in bankruptcy, a lender's secured claim is limited to the value of its lien.[17] In Chapter 13, a debtor who elects to keep secured property must pay the secured claim through an acceptable plan, and if the debtor opts to liquidate the secured property, then the debtor may sell it free and clear of liens if he is authorized to do so under § 363 of the Bankruptcy Code.[18] Recently, home mortgage lenders' reluctance to foreclose has threatened the efficacy of this straightforward method of achieving a debtor fresh start in bankruptcy. By refusing to accept a debtor's surrender and foreclose on its lien, the lender blocks the debtor's efforts to free himself from property carrying costs and associated liabilities, and even after a bankruptcy discharge, the debtor will remain on the hook.

The ineffectiveness of surrender in bankruptcy as a solution to the zombie mortgage problem has prompted a search for alternate Code applications that will effectively achieve a debtor fresh start. One useful but underutilized way to kill off a zombie mortgage is to order that the home be sold, free and clear of liens, under § 363(f) of the Code.[19] This section permits a trustee, or debtor-in-possession, to sell property free of outstanding liens in certain enumerated cases, including cases of lender assent, cases where the sale price will cover the aggregate value of liens encumbering the property, and cases where a free-and-

---

15. *See, e.g.*, 9 AM. JUR. 2D BANKRUPTCY § 7 ("The Bankruptcy Code is designed to afford debtors with a fresh start."); Thomas H. Jackson, *The Fresh-Start Policy in Bankruptcy Law*, 98 HARV. L. REV. 1393, 1405 (1985) (exploring normative underpinnings of bankruptcy's fresh-start policy); Richard Lieb, *Eleventh Amendment Immunity of a State in Bankruptcy Cases: A New Jurisdictional Approach*, 7 AM. BANKR. INST. L. REV. 269, 276 (1999) (noting "[t]here are two basic goals of the bankruptcy law: equality of distribution for creditors, and a 'fresh start' for the debtor"); Tamara Ogier & Jack F. Williams, *Bankruptcy Crimes and Bankruptcy Practice*, 6 AM. BANKR. INST. L. REV. 317, 329 (1998) (observing debtor relief and equitable distribution as two goals of bankruptcy law); *see generally* Robert C. Yan, *Note: The Sign Says "Help Wanted, Inquire Within" - but It May Not Matter If You Have Ever Filed (or Plan to File) for Bankruptcy*, 10 AM. BANKR. INST. L. REV. 429 (2002) (discussing applications of the fresh-start policy). The fresh-start policy has its roots in early English common law. William Blackstone justified bankruptcy discharge by explaining that this allowed "the bankrupt [to] becomes a clear man again; and, by the assistance of his allowance and his own industry, may become a u[s]eful member of the commonwealth." Michael D. Sousa, *The Principle of Consumer Utility: A Contemporary Theory of the Bankruptcy Discharge*, 58 U. KAN. L. REV. 553, 566 n.67 (2010) (citing 2 WILLIAM BLACKSTONE, COMMENTARIES at 484).

16. 11 U.S.C. § 1325(a)(5)(C) (2012) (allowing confirmation if the plan provides for "surrender" of the collateral to the secured creditor). Although the Bankruptcy Code (the "Code") does not define the term "surrender," courts have consistently held that surrender means making property available to a lender. *See e.g.*, *In re* Cornejo, 342 B.R. 834, 836 (Bankr. M.D. Fla. 2005). Surrender itself, however does not operate to transfer title to a lender. *See infra* notes 119–129 and accompanying text.

17. 11 U.S.C. § 506(a) (providing that a secured lender's claim is limited to the value of the collateral—or the estate's interest in the collateral).

18. *Id.* § 1325(a) (detailing the requirements for plan confirmation, and § 363 authorizes certain asset sales in bankruptcy).

19. 11 U.S.C. § 363(f).

clear sale would otherwise be available under a legal or equitable proceeding.[20] Each of these options provides an interesting possible route to clearing title and ending a bankruptcy debtors liability caused by foreclosure delay.

This Article explores the utility of the various subparts of § 363 as a tool to terminate zombie mortgages in bankruptcy. We believe that this bankruptcy power of sale provides a useful avenue to free debtors from the haunting shadow of a defaulted, un-foreclosed mortgage and associated involuntary homeownership. At the same time, the sale power of § 363 can provide great community and market benefits and alleviate foreclosure crisis fallout. A § 363 sale of property encumbered by a zombie mortgage will encourage home occupancy and maintenance, wipe out stale liens, and release real property back into the stream of commerce.

Part I of this Article explains the zombie mortgage phenomenon, its prevalence and the societal and economic harms it causes, and Part II discusses factors contributing to the phenomenon of zombie mortgages and explores why lenders may strategically delay foreclosure. Part III considers various approaches to transferring title and ownership responsibility to lenders, particularly in the context of bankruptcy. The opportunities afforded by § 363 of the Code to achieve title transfer are analyzed in Part IV.

II. BANKRUPTCY AND THE PROBLEM OF FORECLOSURE DELAY

When we think of debtors in trouble—unable to pay their financial obligations—we think of bankruptcy. And this makes sense because our bankruptcy system is predicated on creating an orderly way to distribute assets to creditors (allowing them to split the losses on bad investments) as well as providing debtors a way to wipe out the past and start again.[21] The stereotypical intersection of bankruptcy and mortgage foreclosure is predictable and easy to understand: A homeowner borrower, facing a foreclosure sale, files for bankruptcy protection so that the automatic stay will stop, or at least delay, the loss of his home.[22] The bankruptcy filing buys the debtor some time.[23]

But in the case of vacated homes, bankruptcy debtors may actually want foreclosure to happen, and fast. A debtor who sees no future in owning a particular mortgaged home is better off losing title to the property sooner rather than later. After all, the title owner of the real property continues to accrue debt in the form of property-carrying costs such as real estate taxes, homeowner

20. *Id.* §§ 363(f)(2)-(3), (5).

21. *See e.g.*, Lieb, *supra* note 1, at 276; Ogier & Williams, *supra* note 15, at 329.

22. Immediately upon filing for bankruptcy, "all legal or equitable interests of the debtor in property as of the commencement of the case" become part of the bankruptcy estate and is subject to bankruptcy's automatic stay. 11 U.S.C. §§ 541(a)(1), 362(d).

23. Filing a bankruptcy petition keeps a debtor's mortgaged property from being sold without leave of the Bankruptcy Court. Section 362(a)(3) prohibits a lender from committing "any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate."

association assessments, and other ownership liabilities.[24] If a debtor knows that he will be unable to pay his mortgage and has given up possession of the home, and especially when there is no equity in the property, the debtor benefits from being divested of title. Unlike ownership of personal property, ownership of real property cannot be lost through abandonment.[25] It is only through the transfer of legal title that a debtor can avoid continuing liability for a vacated home's post-bankruptcy costs.[26]

In a robust housing market, pushing foreclosures through quickly is usually in a lender's best economic interest. But in a depressed market where resale may take some time and the collateral sale proceeds will fail to cover the mortgage loan, a foreclosure sale may cause a lender to lose money.[27] Today's market realities have resulted in numerous cases of debtors who abandon possession of their homes even though their mortgage lenders have failed to foreclose. These mortgage loans exist in a sort of un-dead state, with unresolved liens haunting collateral realty long after borrowers have attempted to divest their equity, bury their debt, and move forward. The phenomenon has achieved the colorful moniker of "zombie mortgage," and there is no consensus on how to most effectively wipe out lingering mortgages and free up title to vacant properties.[28]

Foreclosure delay causes problems, particularly in cases where houses have been vacated. And the number of properties plagued by a zombie mortgage is significant. Of the ten million home mortgage foreclosures that have commenced since 2006, two million have not yet been completed.[29] In March 2013 RealtyTrac reported that there were 301,874 vacant properties not yet foreclosed.[30] In terms of raw numbers, Florida, California, New York, and

---

24. *See In re* Pigg, 453 B.R. 728, 736–37 (Bankr. M.D. Tenn. 2011). Section 523(a)(16) was amended in 2005 to explicitly provide that a debtor remains personally liable for homeowner association fees accruing post-bankruptcy on property still titled in the debtor.

25. "You can devise, bequeath, grant, deed, and give fee simple property away but you cannot abandon it." Cristofani v. Bd. of Educ. of Prince George's Cnty., 632 A.2d 447, 453 (Md. Ct. Spec. App. 1993); *see* Lior Jacob Strahilevitz, *The Right to Abandon*, 158 U. PA. L. REV. 355, 359–60, 399–402 (2010) (discussing the common law impossibility of abandonment of real property); Pocono Springs Civic Ass'n, Inc. v. MacKenzie, 667 A.2d 233, 236 (Pa. Super. Ct. 1995); Picken v. Richardson, 77 A.2d 191, 193 (Me. 1950); Turk v. Wilson's Heirs, 98 S.W.2d 4, 10 (Ky. Ct. App. 1936).

26. *See generally Pigg*, 453 B.R. 728; OCC Bulletin, *Guidance on Potential Issues with Foreclosed Residential Properties*, December 14, 2011, 2011 WL 7067447.

27. Andrea J. Boyack, *Community Collateral Damages: A Question of Priorities*, 43 LOY. U. OF CHI. L.J. 53, 56, n.2 (2011). In 2009, in some parts of the country, lenders canceled up to 50% of the pending foreclosure sales in an effort to avoid upkeep costs such as maintenance, community assessments, and local taxes. Todd Ruger, *Lenders' Latest Foreclosure Strategy: Waiting*, HERALD. TRIB., (July 12, 2009 at A1).

28. *See generally* David P. Weber, *Zombie Mortgages, Real Estate, and the Fallout for the Survivors*, 45 N.M. L. REV. 37 (2014).

29. Linda Finley, *Walking Dead? Beware the Zombie Foreclosure*, NATIONAL MORTGAGE NEWS (Aug. 6, 2014) (citing RealtyTrac statistics).

30. Barbara Liston, *More than 300,000 homes are foreclosed "zombies," study says*, REUTERS (Mar. 28, 2013). Florida has the most zombie properties (90,556), followed by Illinois (31,668) and California (28,821). *Id.* RealtyTrac's methodology was very conservative and did not count properties that have been in foreclosure longer than the state average. For instance, RealtyTrac did not count any property in foreclosure longer than 853 days as a "zombie." *Id.*

Illinois have the most zombie mortgages, but this problem reaches even less populated and volatile housing markets.[31] Kansas, for example, has the third highest rate of vacant un-foreclosed homes, at thirty-one percent.[32] These vacant or constructively abandoned homes still titled in the name of a bankrupt borrower essentially lack a caretaker, and this creates problems not only for a borrower whose debts continue to accrue, but for the neighborhood and community as well.[33]

Much of the discussion regarding zombie mortgages has focused on unfairness to the borrowers, but abandoned properties actually create a wider impact zone throughout a community and even a housing market. When a home lacks a caretaker, it falls into disrepair and its value depreciates. The depreciation effect is not quarantined to the subject property. Rather, an entire neighborhood feels the depreciation effects of an abandoned and poorly maintained home.[34] Such financial harms are accompanied by health and safety concerns, including unchecked pest infestations and illegal activities that uninhabited dwellings seem to invite.[35] Vacant homes impose municipal costs in terms of casualty and crime, and insolvent homeowners represent a loss of property tax revenues to a municipality.[36] In the context of a common interest community ("CIC"), such as a homeowners association or condominium, lack

---

31. *Id.* In Florida, 35,913 abandoned homes await foreclosure as zombies. Megan Hart, *Kansas has the Third Highest Rate of Vacant Foreclosed Houses*, TOPEKA CAPITAL J. (Nov 5, 2014), http://cjonline.com/news/business/2014-11-05/Kansas-has-third-highest-rate-vacant-foreclosed-houses.

32. *Id.* RealtyTrac reports 31% of Kansas homes in default but un-foreclosed are abandoned. *Id.*

33. U.S. Gov't Accountability Office, GAO-11-93, (2010), *Mortgage Foreclosures: Additional Mortgage Servicer Actions Could Help Reduce the Frequency and Impact of Abandoned Foreclosures*, at prefatory materials, *available at* http://www.gao.gov/new.items/d11193.pdf.; Linda E. Fisher, *Shadowed by the Shadow Inventory: A Newark, New Jersey, Case Study of Stalled Foreclosures and Their Consequences*, 4 UC IRVINE L. REV. 1265, 1294 (2014); Dory Rand, *Zombie Properties are on the Rise-but here's how to kill the trend*, CRAIN'S CHI. BUS. (Feb. 12, 2014), www.chicagobusiness.com/article/20140212/OPINION/140219928/zombie-properties-are-on-the-rise-but-heres-how-to-kill-the-trend; Boyack, *supra* note 27, at 72.

34. Hart, *supra* note 31 (quoting Daren Blomquist, Vice President of RealtyTrac, saying that vacant homes drive down property values of surrounding houses and "are almost contagious"); *see also* TEMPLE UNIV. CENT. FOR PUB. POLICY & E. PA. ORG. PROJECT, BLIGHT FREE PHILADELPHIA: A PUBLIC-PRIVATE STRATEGY TO CREATE AND ENHANCE NEIGHBORHOOD VALUE, iv (Oct. 2001) (showing a significant decline in values due to proximity to vacant homes). Zombie Properties are "havens for criminal activity." Barbara Liston, *More than 300,000 homes are foreclosed "zombies,"* REUTERS (Mar. 28, 2013), www.reuters.com/article/2013/03/28/us-usa-housing-zombies-idUSBRE92R0YQ20130328.

35. At least three states have had exploding gas lines from abandoned homes where gas hadn't been shut off. Michelle Conlin, *Special Report: the latest foreclosure horror: the zombie*, REUTERS (Jan. 10, 2013), www.reuters.com/article/2013/01/10/us-usa-foreclosures-zombies-idUSBRE9090G920130110. Abandoned homes are a "danger to neighborhoods," sitting untended and susceptible to damage, squatters, and crime. Ilyce Glink, *"Zombie" Foreclosures hit ex-homeowners*, MONEYWATCH (April 2, 2013), www.cbsnews.com/news/zombie-foreclosures-hit-ex-homeowners/. "Once a bank walks away from a foreclosure, the real rot begins. Living rooms turn into meth labs. Falling shingles menace passers-by. Squatters' cooking fires turn into infernos. The latest iteration of the trend: gas explosions." Conlin, *Special Report supra*.

36. Joseph Schilling, *Code Enforcement and Community Stabilization: The Forgotten First Responders to Vacant and Foreclosed Homes*, 2 ALB. GOV'T L. REV. 101, 104, 110 (2009) (discussing the "broken windows" theory and the community costs of a declining tax base, and citing Margaret Bass *et al.*, VACANT PROPERTIES: THE TRUE COST TO COMMUNITIES, a study that monetizes costs of vacant homes based on correlation with fires and crime).

of assessment-paying members imperils the neighborhood government, amenities, and the finances of association members.[37]

The wider market economy is negatively impacted by vacant properties as well. When defaulted homes remain un-foreclosed, housing inventory is artificially kept off the market, and this unjustifiably limits the supply of properties in the market and drives prices above market realities.[38] The inflated pricing effect can create a drag on economic recovery. The zombie mortgage phenomenon is also working a broader social harm because properties subject to zombie mortgages are concentrated in low-income and minority communities. More than 57% of zombie properties are located in census tracts made up of households in the bottom 40% of income, compared to only 22.5% of zombie properties in communities where household income is in the top 40%.[39] Statistically, if minority households compose at least 80% of a census tract, it is 18% more likely that a foreclosure in that community will end up a zombie mortgage compared with foreclosures commenced in other neighborhoods.[40] "While there have been signs of a general housing recovery, relief in the hardest-hit areas is slow and hard to find."[41] And without solving the zombie mortgage problem, "restoring these communities will be incredibly difficult."[42]

In many cases, borrowers who gave up their homes to mortgage lenders simultaneously filed for bankruptcy in order to escape their debts and start anew.[43] But even bankruptcy does not shield a homeowner from liability related to a zombie mortgage. For example, the Code specifically holds that post-petition homeowner association assessments on property owned by the debtor remain un-discharged in bankruptcy.[44] Homeowner association covenants run with the land and assessment liability continues to accrue throughout ownership of the real property.[45] This continuing accrual of debt

37. Boyack, *supra* note 27, at 76–80.

38. *See* Linda E. Fisher, *Shadowed by the Shadow Inventory: A Newark, New Jersey, Case Study of Stalled Foreclosures and Their Consequences*, 4 UC IRVINE L. REV. 1265, 1266 (2014).

39. Rand, *supra* note 33.

40. *Id.*

41. *Id.*

42. *Id.* The ill-effects of poorly maintained vacant homes persists even more stubbornly for properties in minority neighborhoods, because lenders who have acquired ownership to such homes through foreclosure apparently maintain such properties at vastly lower levels than properties they acquire in white or upper-class neighborhoods. Several scholars and advocates have called this a violation of the Fair Housing Act ("FHA"). *See generally* Stephen M. Dane, Tara K. Ramchandani & Anne P. Bellows, *Discriminatory Maintenance of Reo Properties As A Violation of the Federal Fair Housing Act*, 17 CUNY L. REV. 383 (2014); Stephen M. Dane, *The Exposure of Securitization Trustees to Liability Under the Federal Fair Housing Act for Poorly Maintained Real Estate Owned Properties*, 131 BANKING L.J. 153 (2014).

43. Weber, *supra* note 28 at 37–38; *In re* Heck, No. 09-31512 TEC, 2011 WL 133015, at *1 (Bankr. N.D. Cal. Jan. 13, 2011); *In re* Pigg, 453 B.R. 728, 732 (Bankr. M.D. Tenn. 2011).

44. 11 U.S.C. § 523(a)(16) (2012); *In re* Langenderfer, No. 10-31741, 2012 WL 1414301 (Bankr. N.D. Ohio Apr. 23, 2012) (explaining that Chapter 13 proceedings do not discharge post-petition homeowners association fees); *see also Pigg*, 453 B.R. at 736–737; *In re* Fristoe, No. 10-32887, 2012 WL 4483891 at *4 (Bankr. D. Utah Sept. 27, 2012) (discussing how non-discharged HOA fees negatively impact a debtor's fresh start).

45. *In re* Spencer, 457 B.R. 601, 610 (E.D. Mich. 2011) (holding HOA covenants run with land and

also occurs in the context of other in rem obligations related to property ownership, such as real estate taxes. Furthermore, while the debtor remains the nominal title holder, post-petition tort liability can arise based on the poor or unsafe condition of the home, for example from a nuisance claim or an onsite personal injury. It is unlikely that an owner who has abandoned his home maintains insurance on the property against casualty and injury, so these liabilities would fall squarely on the borrower who may not even know that he still owns the home. A debtor may find himself exiting bankruptcy, but still facing liability for all such costs and charges.[46]

Although bankruptcy can slow down foreclosure, it is more difficult to use bankruptcy to speed up foreclosure. Debtors in bankruptcy have the option of surrendering property to lenders holding security interest in the property, but "[t]hough the Code provides debtors with a surrender option, it does not force creditors to assume ownership or take possession of collateral."[47] There can be no true fresh start until title to vacated property vests in a new owner, but this is difficult to achieve without lender cooperation.[48] Bankruptcy courts have recognized the difficulty this situation poses. Debtors who suffer the loss of their homes and are also denied bankruptcy's promised fresh start, "suffer a wrong without a remedy."[49] The challenge is to craft an effective remedy to the zombie mortgage problem from bankruptcy's existing toolkit.

III. WHY LENDERS DELAY FORECLOSURE

Zombie mortgages arise in varying ways. In some cases, lenders initiated foreclosure proceedings, warned the borrower that foreclosure was pending, and advised the borrower to vacate the home.[50] But some of these foreclosure

---

reoccur post-petition). The court explained that the debtor could avoid incurring these obligations by divesting himself of ownership, but admits that continued ownership in this case was "not by choice, apparently, but rather as a result of the upside down nature of his mortgages." *Id.* at 604.

46. After obtaining a bankruptcy discharge, a debtor must wait eight years (from a Chapter 7 discharge) or four years (from a Chapter 13 discharge) before obtaining a subsequent discharge. 11 U.S.C. § 1328(f). This can limit a debtor from using another bankruptcy to escape post-bankruptcy liabilities; however, in some cases, courts have allowed a debtor to have a "chapter 20," meaning the debtor can strip wholly unsecured mortgages from a residence in a Chapter 7 followed by a Chapter 13 before the discharge eligibility deadline has run. After all, the Code limitation on subsequent discharge does not prevent a debtor from filing a Chapter 13 petition on the heels of a Chapter 7 discharge, just obtaining a discharge under such a subsequent Chapter 13 proceeding. *See* JEFF FERRIELL & EDWARD J. JANGER, UNDERSTANDING BANKRUPTCY 707–708 (3d ed. 2013).

47. *In re* Canning, 442 B.R. 165, 172 (Bankr. D. Me. 2011). In *Canning*, the bankruptcy court rejected the claim that a lender's failure to release a pre-petition mortgage lien that had not been foreclosed was unlawful debt collection.

48. Bankruptcy can wipe out unsecured debt, but liens on property survive bankruptcy. Lenders can still assert their rights as mortgagees after a bankruptcy case ends. Chapter 7 bankruptcies end in a matter of months, and Chapter 13 bankruptcies last throughout three-to-five year repayment plans. ELIZABETH WARREN, ET AL., THE LAW OF DEBTORS AND CREDITORS: TEXT, CASES, AND PROBLEMS 206 (7th ed. 2014). A Chapter 13 plan can provide for payments to cure a defaulted loan or can provide for abandonment of collateral. It is difficult for a court to order a lender to accept title to collateral abandoned in bankruptcy. *See infra* notes 119-129 and accompanying text.

49. Pigg, 453 B.R. at 734.

50. *See generally* Weber, *supra* note 28; Judith Fox, *The Foreclosure Echo: How Abandoned*

cases were never pursued to completion, and title remained in the name of the borrower. Other zombie mortgages exist on properties that were offered to the mortgage lender in satisfaction of the debt, perhaps through a failed deed in lieu of foreclosure or rejected bankruptcy surrender.[51] Some borrowers have tried to arrange short sales of properties overburdened with mortgage debt, but were unable to obtain lender consent to complete the conveyance.[52] In other cases, borrowers—perhaps not understanding the law—have merely abandoned possession and literally have sent the keys to the lender in an attempt to surrender homeownership.

The current volume of mortgage defaults creates systemic stress and has lengthened the time it takes to complete a foreclosure. In 2014, home mortgage foreclosures took an average of more than 500 days to complete.[53] In New Jersey, the average time to foreclose is more than 1,000 days.[54] In some states, lengthy foreclosure proceedings are symptoms of an overburdened court system. In the aftermath of the 2008 financial crisis, the sheer number of defaulted mortgage loans was staggering and the quantity of pending foreclosures unprecedented. The volume of foreclosures during the year following the financial crisis jumped to ten times the prior annual rate.[55] Even in 2010, the annual mortgage default rate remained more than five times the annual default rate that had held steady during the twenty-five years leading up to the crisis.[56] This recent, massive increase in foreclosure volume has overwhelmed foreclosure systems in many parts of the country,[57] particularly in states that rely exclusively on foreclosure through a judicial procedure.[58]

Foreclosures are Re-Entering the Market through Debt Buyers, 26 LOY. CONSUMER L. REV. 25 (2014).

51. Weber, *supra* note 28, at 38; Fox, *supra* note 50, at 32.

52. Weber, *supra* note 28, at 55–56; Fox, *supra* note 50, at 52.

53. NAT'L ASS'N OF REALTORS, *Average Days to Complete Foreclosure: 572* (Apr. 11, 2014), *available at* http://realtormag.realtor.org/daily-news/2014/04/11/average-days-complete-foreclosure-572.

54. *Id.*; *see also* Julie Schmit, *Foreclosure backlogs could take decades to clear out* (Nov. 8, 2011), *available at* http://usatoday30.usatoday.com/money/economy/housing/story/2011-11-07/foreclosure-pipeline/51126600/1 (citing data that in New York and New Jersey "it would take lenders more than 50 years at their current pace to clear pipelines of homes that are seriously delinquent or already in the foreclosure process").

55. Alex Viega, *Foreclosure Rate: Americans on Pace for 1 Million Foreclosures in 2010*, HUFFINGTON POST (July 15, 2010), http://www.huffingtonpost.com/2010/07/15/foreclosure-rate-american_n_647130.html.

56. John Krainer & Elizabeth Laderman, *Prepayment and Delinquency in the Mortgage Crisis Period* (Fed. Reserve Bank of S.F. Working Paper Series 2011), *available at* http://www.frbsf.org/economic-research/files/wp11-25bk.pdf. Prior to the crisis, the annual foreclosure rate was fairly stable. *Id.*

57. Finley, *supra* note 29.

58. "States with a non-judicial foreclosure process have generally been able to work through the backlog of foreclosures faster." Jaison R. Abel & Richard Deitz, *Foreclosures Loom Large in the Region*, Liberty Street Econ. (Apr. 10, 2013), http://libertystreeteconomics.newyorkfed.org/2013/04/foreclosures-loom-large-in-the-region.html#.VW88E2a1VOc; *see also* Linda E. Fisher, *Shadowed by the Shadow Inventory: A Newark, New Jersey, Case Study of Stalled Foreclosures and Their Consequences*, 4 UC IRVINE L. REV. 1265, 1294 (2014). Judicial foreclosures are far more time consuming than non-judicial foreclosures. For example, currently it takes about 900 days to accomplish judicial foreclosure in New York, whereas a non-judicial foreclosure in Texas can take as little as 27 days. *Foreclosure Activity at 40-Month Low*, REALTYTRAC (May 12, 2011), http://www.realtytrac.com/content/press-releases/foreclosures-activity-at-40-month-low-6578; *Texas Foreclosure Laws*, REALTYTRAC, http://www.realtytrac.com/foreclosure-laws/texas-foreclosure-laws.asp (last visited June 3, 2011). "Judicial foreclosure is the exclusive or generally used method of foreclosure in Arkansas, Connecticut, Delaware, Florida, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana,

Recent estimates predict that it will take more than five years to clear the backlog of un-foreclosed mortgages in judicial foreclosure states, and even in non-judicial foreclosure states, it will take more than three years.[59] In some states, it would take decades to complete all pending foreclosures if the process continues at the current rate.[60]

In addition to quantity increase, foreclosure proceedings during the financial crisis became lengthier and more complicated, drawing out the process. Some of the increased complexity arose from legislative attempts and judicial efforts to protect borrowers and save homes.[61] Although these efforts may have been justified with respect to borrowers still residing in their homes, some mandates were overbroad, applying to all home mortgages whether or not the borrower had vacated. In addition, the crisis and its aftermath saw widespread lender misbehavior and incompetency in the context of the mortgage origination,[62] assignment,[63] and foreclosure processes.[64] As courts grappled with poorly documented originations, transfers, and foreclosures, the length of time from default to foreclosure sale grew. Lender abuses in the context of foreclosures led to ineffective title transfers and, in October 2010,

---

Montana, Nebraska, New Jersey, New Mexico, New York, North Dakota, Ohio, Pennsylvania, South Carolina, Vermont, and Wisconsin." GRANT S. NELSON ET AL., REAL ESTATE FINANCE LAW 605 n.259 (6th ed. 2014). In thirty-five other jurisdictions, lenders can opt to foreclose extra-judicially based on a power of sale granted in the mortgage documents; often such documents are styled as deeds of trust. *Id.* at 634. Non-judicial foreclosure is still regulated by exacting notice and sale requirements in state statutes. *Id.* at 634–35. Even so, non-judicial foreclosures are significantly faster—and cheaper—than judicial foreclosures. Grant S. Nelson & Dale A. Whitman, *Reforming Foreclosure: The Uniform Nonjudicial Foreclosure Act*, 53 DUKE L.J. 1399, 1403 (2004). On the other hand, non-judicial foreclosures have been recently demonized by consumer advocates who stress the lack of court oversight and widespread lender abuses of the power of sale. *See generally* Florence Wagman Roisman, *Protecting Homeowners from Non-Judicial Foreclosure of Mortgages Held by Fannie Mae and Freddie Mac*, 43 REAL EST. L.J. 125 (2014).

59. Steve Cook, *Real Estate: Nothing to Fear from Zombie Houses*, UPI (Apr. 2, 2013), http://www.upi.com/Business_News/Real-Estate/2013/04/02/Real-Estate-Nothing-to-fear-from-zombie-houses/2381364937924/.

60. *Id.*

61. Some governmental regulation and programs center around required modification procedures that are to be undergone prior to foreclosure. For example, under the Economic Stabilization Act of 2008 ("EESA"), the United States Treasury instituted a number of programs, including the Making Home Affordable Act. *Housing*, U.S. DEP'T OF THE TREASURY (Jan. 6, 2015), http://www.treasury.gov/initiatives/financial-stability/TARP-Programs/housing/Pages/default.aspx. The "Home Affordable Modification Act" was part of the Making Home Affordable initiative. *Id.* The National Mortgage Settlement Act is a part-federal, part-state government contract with the purpose of providing more modifications to a greater number of borrowers by obligating servicers to comply with new servicing standards. *See* Press Release, U.S. DEP'T OF JUSTICE, *Fed. Gov't and State Att'ys Gen. Reach $25 Billion Agreement with Five Largest Mortg. Servicers to Address Mortg. Loan Servicing and Foreclosure Abuses* (Feb. 9, 2012), *available at* http://www.justice.gov/opa/pr/2012/February/12-ag-186.html; *see generally* Melissa B. Jacoby, *The Value(s) of Foreclosure Law Reform*, 37 PEPP. L. REV. 511 (2010) (discussing further calls for reform).

62. Andrea J. Boyack, *Laudable Goals and Unintended Consequences: The Role and Control of Fannie Mae and Freddie Mac*, 60 AM. U. L. REV. 1489, 1510–18 (2011) (discussing how underwriting standards, even for prime mortgage loans, declined in the years leading up to the financial crisis).

63. *See generally* Sharon McGann Horstkamp, *MERS Case Law Overview*, 64 CONSUMER FIN. L.Q. REP. 458 (2010) (referencing many cases dealing with issues of standing, right to foreclose, adequacy of transfer, and other issues related to the Mortgage Electronic Registration System).

64. *See generally* Peter A. Holland, *The One Hundred Billion Dollar Problem in Small Claims Court: Robo-Signing and Lack of Proof in Debt Buyer Cases*, 6 J. BUS. & TECH. L. 259 (2011) (discussing the problem of robo-signing and other lender foreclosure misbehavior).

resulted in foreclosure moratoria in every one of the twenty-three states that rely on judicial foreclosure.[65] Following the moratoria announced in October 2010, attorneys general in all fifty states began investigating servicer misconduct in the context of foreclosures.[66] Some states halted or significantly slowed down foreclosures in order to guard against such abuses.[67]

Many instances of servicer misconduct coincided with questionable mortgage assignments through the Mortgage Electronic Registration System ("MERS"). Prior to the advent of MERS in the mid-1990s, mortgage assignments were cumbersome and required that the original lender endorse and physically deliver the promissory note to the secondary mortgage lender (the purchaser of the debt) as well as execute and record a mortgage assignment.[68] As the volume of mortgage-backed securitizations skyrocketed, however, the securitization industry innovated a digital counterpart to individual note delivery and assignment recordation. This was MERS.[69] MERS acted as the "nominee" holder of mortgages so that true beneficial ownership could be transferred seamlessly, without the need to re-record assignments or to physically transfer notes.[70] This process worked well in theory, but ran into a host of legal stumbling blocks when borrower-advocates argued, sometimes successfully, that assignment through the MERS system had been ineffective or that failure to record a mortgage assignment robbed the assignee of its right to enforce a note against the collateral.[71] Eight years after the foreclosure crisis began, these legal issues are finally being settled, and it seems increasingly clear that the mortgage and attendant right to foreclose belong to whatever entity has the legal right to enforce the note.[72] Nevertheless,

---

65. In reaction to increased judicial scrutiny of sloppy, and sometimes fraudulent, servicer foreclosure procedures, Bank of America, J.P. Morgan Chase, and Ally Financial, three of the largest mortgage lenders in the United States at the time, all announced foreclosure moratoria in the twenty-three judicial foreclosure states in October 2010. *See* Ariana Eunjung Cha & Brady Dennis, *Judges Revisiting Foreclosure Cases May Help Owners but Clog Market*, WASH. POST (Oct. 5, 2010), http://www.washingtonpost.com/wp-dyn/content/article/2010/10/04/AR2010100407285.html.

66. *See* Ariana Eunjung Cha, Steven Mufson & Jia Lynn Yang, *Momentum Builds for Full Moratorium on Foreclosures*, WASH. POST (Oct. 9, 2010), http://www.washingtonpost.com/wp-dyn/content/article/2010/10/08/AR2010100806850.html (reporting that consumer advocacy calls for a government-mandated national moratorium on foreclosures); Jia Lynn Yang & Ariana Eunjung Cha, *Obama Vetoes Foreclosure Bill as Anger Grows*, WASH. POST. (Oct. 8, 2010), http://www.washingtonpost.com/wp-dyn/content/article/2010/10/07/AR2010100707155.html (reporting that legislation streamlining foreclosure proceedings had been vetoed).

67. Finley, *supra* note 29. For example, Washington, D.C. halted all non-judicial foreclosures pending investigation of lender misconduct. *Id.*

68. Dale A. Whitman, *What We Have Learned from the Mortgage Crisis About Transferring Mortgage Loans*, 49 REAL PROP. TR. & EST. L.J. 1, 6–7 (2014).

69. *Id.* at 7, *see also* Christopher L. Peterson, *Losing Our Homes, Losing Our Way, Or Both? Foreclosure, County Property Records, and the Mortgage Electronic Registration System*, 40 CAP. U. L. REV. 821, 829 (2012); Christopher L. Peterson, *Two Faces: Demystifying the Mortgage Electronic Registration System's Land Title Theory*, 53 WM. & MARY L. REV. 111, 116 (2011).

70. Whitman *supra* note 68, at 7.

71. *Id.*

72. *Id.* at 9–11. "[O]rdinarily, whoever can establish a claim to the obligation automatically gets with it the security interest in the land, provided the interest is still in existence." *Id.* at 37. The right to enforce a note is governed by the Uniform Commercial Code, specifically Article 3 in the case of a negotiable note, as well

the widespread confusion and concern regarding MERS and the challenges of securitization and mortgage servicing have further slowed down the foreclosure process. And title uncertainty surrounding questions regarding the efficacy of mortgage assignment prior to foreclosure has potentially chilled third party foreclosure sale bids, further retarding the process.

The problem of the growing length of time it takes to foreclose is exacerbated by strategic lender delays. At most residential mortgage foreclosure sales, the only bidder is the lender who credit bids some or all of the mortgage debt.[73] Upon or shortly after acquiring title at a foreclosure sale, the lender, as new owner of the property, becomes liable for all costs of ownership.[74] But if foreclosure is never completed (or never even started), then title remains with the borrower, and the borrower remains on the hook for all costs of ownership.

Ownership of a home can be both an asset and a liability. An individual can use the home as a place in which to reside. Increasing real estate prices can build owner equity and wealth. And the possibility of renting out a home can make a real property asset revenue producing. Owning a home can therefore be a good investment.[75] Homeownership also can protect income from tax liability and perhaps builds community ties and social stability.[76] But homeownership can be costly. Owners of real property must maintain that property and can face citations and attendant liabilities if they fail to do so.[77] Potential liabilities can arise from municipal maintenance requirements, homeowner association requirements, and the common law of nuisance. Owners must pay rehabilitation costs if a property has fallen into disrepair. Homeowners bear costs to secure and insure property and are personally liable for real estate taxes and assessments. They are obligated to pay homeowner association dues and condominium assessments.[78] They are also liable for

---

as the provisions of Article 9. *See generally id.*

73. Michael A. Graham, *Resolving Title Issues in Distressed Real Estate Transactions*, S.C. LAW, March 2013, at 20 (explaining that unless a third party buyer submits qualifying bids in excess of the indebtedness at a foreclosure sale, the lender will credit bid and take title to the property).

74. Bulletin from the Office of the Comptroller of the Currency, Guidance on Potential Issues with Foreclosed Residential Props. (Dec. 14, 2011), *available at* 2011 WL 7067447, at *1. This is typically true for all lenders, although there are specific statutorily mandated steps that FHA-insured mortgage lenders must take upon acquiring property in foreclosure, including recordation of ownership, complying with appraisal and accounting requirements, and maintaining insurance.

75. A. Mechele Dickerson, *Public Interest, Public Choice, and the Cult of Homeownership*, 2 UC IRVINE L. REV. 843, 846 (2012); Eric Belsky & Joel Praken, *Housing Wealth Effects: Housing's Impact on Wealth Accumulation, Wealth Distribution and Consumer Spending*, JOINT CTR. FOR HOUS. STUDIES OF HARV. UNIV. 4–5, 7 (2004), *available at* http://www.jchs.harvard.edu/sites/jchs.harvard.edu/files/w04-13.pdf; THE NEW IMPERATIVE FOR EQUALITY, IN SEGREGATION: THE RISING COSTS FOR AMERICA 15 (James H. Carr & Nandinee K. Kutty eds., 2008); U.S. DEP'T OF HOUS. & URBAN DEV., ECONOMIC BENEFITS OF INCREASING MINORITY HOMEOWNERSHIP 7 (2002), *available at* http://archives.hud.gov/initiatives/blueprint/econreport-101502.pdf.

76. JOINT COMM. ON TAXATION, PRESENT LAW AND BACKGROUND RELATING TO TAX TREATMENT OF HOUSEHOLD DEBT 23–24 (2011), *available at* https://www.jct.gov/publications.html?func=startdown&id=3802; Kristen David Adams, *Homeownership: American Dream or Illusion of Empowerment?*, 60 S.C. L. REV. 573, 593–94 (2009).

77. *See supra* note 1.

78. *E.g.*, *In re* Hall, 454 B.R. 230, 238 (Bankr. N.D. Ga. 2011); *In re* Rivera, 256 B.R. 828, 835 (Bankr.

personal and property injury claims arising from dangers on their property.[79] If a home is rented, the owner bears landlord responsibilities, for example a landlord must ensure that the home will be and remain in habitable condition.[80] Protective legislation limits a landlord's ability to terminate leases, even following foreclosure of a superior mortgage.[81]

The benefit of residence can offset a property's carrying costs for individuals who reside in their homes, but borrowers who have moved out and lenders who hold property as inventory after foreclosure do not obtain this benefit. When a lender takes title to real property that has served as loan collateral, ownership of this collateral asset enlarges the lender's risk to include operating risk, ownership risk, valuation risk, compliance risk, and reputation risk.[82] Furthermore, financial institutions bear extra costs in hiring and training staff to handle real estate that the institution ends up owning post-foreclosure ("REO properties") and to manage related third-party relationships.[83] For a lender, the home that served as collateral was never an acquisition target; it was merely security for a capital transaction.[84]

Illiquidity of real property assets and the high transaction costs associated with real property conveyances impose further costs on lenders who take title in foreclosure. It is expensive to sell real property, and a lender must bear advertising, brokerage, and closing costs when disposing of REO properties. Real estate is notoriously illiquid, and in a slow housing market, liquidity is further decreased. Slow markets involve higher numbers of properties for sale relative to a comparatively limited pool of would-be buyers. In addition, mortgage capital has become less available in the post-crisis period, further reducing the number of potential buyers.[85] A slow housing market means that lenders may not be able to expeditiously sell their REO property, and because the lender is unable to live on the property and often is unwilling to rent it, there is little offsetting benefit to obtaining and holding onto title. A lender holding REO property cannot avoid the out-of-pocket, non-recoverable costs of

---

M.D. Fla. 2000); Allen v. Timberlake Ranch Landowners Ass'n, 119 P.3d 743, 752 (N.M. Ct. App. 2005).

79. *E.g.*, Tower Ins. Co. of New York v. Diaz, 58 A.D.3d 495 (N.Y. App. Div. 2009).

80. *E.g.*, Wade v. Jobe, 818 P. 2d 1006, 1009 (Utah 1991); Knight v. Hallsthammar, 623 P.2d 268, 271 (Cal. 1981); Fair v. Negley, 390 A.2d 240, 243 (Pa. Super. Ct. 1978); Teller v. McCoy, 253 S.E.2d 114, 117–18 (W. Va. 1978).

81. Protecting Tenants at Foreclosure Act of 2009 protects tenants from post-foreclosure eviction without ninety days' notice, regardless of whether the tenant has a rental agreement.

82. Bulletin from the Office of the Comptroller of the Currency, Guidance on Potential Issues with Foreclosed Residential Props. (Dec. 14, 2011), *available at* 2011 WL 7067447, at *1.

83. *See* WALT HARVEY, BUYING BANK OWNED PROPERTIES (REO), http://www.realestateabc.com/homeguide/reo.htm (last visited April 18, 2015).

84. *E.g.*, Ass'n of Co-Owners v. Naviera, 6 P.R. Offic. Trans. 119 (1977).

85. *See* Maia Woluchem & Taz George, *Obtaining a mortgage loan*, URB. INST.: METRO TRENDS (Jan 12, 2015), *available at* http://blog.metrotrends.org/2015/01/obtaining-mortgage-loan-hard-easy-right/. The Mortgage Bankers Association's Mortgage Credit Availability Index shows a precipitous loss of capital availability to mortgage borrowers from 2007 to 2014, falling from a rate of 900 to 100. *Id.*; *see also* Mortgage Bankers Association, *Mortgage Credit Availability Index Increases in March*, *available at* https://www.mba.org/news-research-and-resources/forecasts-data-and-reports/single-family-research/mortgage-credit-availability-index.

maintaining, securing, and insuring the property and paying all associated assessments. A sluggish resale market for homes is additionally problematic for banks because the Office of the Comptroller of the Currency ("OCC") has imposed holding period limits on how long banks are permitted to retain title to REO property after foreclosure.[86]

Because of the unavoidable costs and the lack of benefits from holding REO property, mortgage lenders sometimes rationally avoid foreclosing, even in the face of mortgage default.[87] Strategic lender delay and the resulting zombie mortgage is more common with respect to a lower value property, where costs to repair a home and pay for a foreclosure proceeding compounded with post-closing property carrying costs exceed the asset's value.[88] In studying the problem of zombie mortgages, the Consumer Financial Protection Bureau ("CFPB") found "it was extremely common" for servicers to charge off low-balance loans and not even bother to tell borrowers or municipalities that foreclosure would not be forthcoming.[89]

IV. ATTEMPTS TO DISCLOSE, CONTROL, AND RESOLVE THE ZOMBIE MORTGAGE PROBLEM

A. Outside of Bankruptcy

Outside of bankruptcy, the problem of strategic lender foreclosure delay can be addressed from three directions: (1) mandating or incentivizing lenders to foreclose on vacant properties, (2) requiring that lenders maintain their real property collateral pre-foreclosure, and (3) obligating mortgage lenders to adequately notify borrowers and local governments when commenced foreclosure proceedings are abandoned or stalled.

Governments can do little to force mortgage lenders to complete foreclosure and assume caretaking responsibilities with respect to homes vacated by their borrowers. Government efforts to force lenders to assume title of properties haunted by their zombie mortgages have been largely unsuccessful,[90] but more subtle "nudges" that incentivize vacant property foreclosure—through mandating pre-foreclosure maintenance, for example—

---

86. *See* Office of the Comptroller of the Currency, *Comptroller's Handbook: Other Real Estate Owned* (Sept. 2013), *available at* http://www.occ.gov/publications/publications-by-type/comptrollers-handbook/a-oreo.pdf. The holding period is typically five years. *Id.*

87. Stephan Whitaker & Thomas J. Fitzpatrick IV, *Deconstructing distressed-property spillovers*, 22 HOUS. ECON. 79, 80 (2013) (regarding selective foreclosures).

88. Kate Berry, *CFPB Takes Aim at "Zombie" Foreclosures*, MORTGAGE SERVICING NEWS (Sept. 29, 2014), www.nationalmortgagenews.com/news/servicing/cfpb-case-aim-at-zombie-foreclosures-1041319-1.html.

89. *Id.*

90. *See generally* Lee Anne Fennell, *Forcings*, 114 COLUM. L. REV. 1297 (2014) (discussing "coercively imposed ownership" as the mirror image of eminent domain "takings," and explaining the constitutional problems involved in such government coercion).

may prove more effective.[91] Under existing law, however, it is difficult to cause a lender to foreclose against its will. Officials in some jurisdictions in California and New Jersey recently proposed to use eminent domain to seize un-foreclosed mortgages and thereby solve the problem of strategic foreclosure delay.[92] These creative, but legally questionable, proposals fizzled in the face of investor lawsuits and federal regulatory policy statements.[93] In 2013, the Federal Housing Finance Agency ("FHFA"), regulator of Fannie Mae, Freddie Mac, and the Federal Home Loan Banks, cautioned municipalities that it had "serious concerns" regarding the use of eminent domain to acquire un-foreclosed mortgages.[94] President Obama's 2015 appropriations bill explicitly restricted FHFA, Fannie Mae, and Freddie Mac involvement in any such schemes.[95]

The zombie mortgage problem manifests itself differently in the context of common interest communities (CICs).[96] In CICs, the association will often maintain at least the exterior of abandoned homes, but on the other hand, in CICs, the economic harm of a zombie mortgage in the neighborhood is clearer and more direct because CICs are funded by assessments and owners of abandoned homes often will not pay their share.[97] The obligation to pay assessments is supported by an association lien on the property, and several states have enacted or beefed up association lien priority, granting true super-priority status to the lien, securing some limited amount of unpaid community assessments for the home, typically capped at an amount equal to a certain

---

91. *See generally id.*; RICHARD A. THALER & CASS R. SUNSTEIN, NUDGE: IMPROVING DECISIONS ABOUT HEALTH, WEALTH, AND HAPPINESS (2009) (describing systemic and design changes that a government could adopt in order to subtly incentivize desired behaviors among its citizenry).

92. Nick Timiraos, *In California, a Novel Use of Eminent Domain Hits Headwinds; Divisive Plan Would Buy Mortgages—but Not Homes—to Reduce Residents' Debt Burdens*, WALL ST. J. (Sept. 16, 2014), *available at* http://www.wsj.com/articles/in-california-a-novel-use-of-eminent-domain-hits-headwinds-1410887814 (discussing proposals to use eminent domain to purchase un-foreclosed mortgages in Richmond, California and Newark and Irvington in New Jersey). The eminent domain proposal in Richmond progressed further than those in New Jersey and was attacked in an unsuccessful investor lawsuit challenging the proposed use of the takings power as unlawful. Sam Forgione, *Investors Withdraw Appeals Against California Eminent Domain Plan*, REUTERS (May 16, 2014), *available at* http://www.reuters.com/article/2014/05/17/us-mortgages-investing-eminentdomain-idUSBREA4G00A20140517; *see also* Robert C. Hockett, *It Takes a Village: Municipal Condemnation Proceedings and Public/Private Partnerships for Mortgage Loan Modification, Value Preservation, and Local Economic Recovery*, 18 STAN. J.L. BUS. & FIN. 121 (2012).

93. The appeal of the Richmond, California investor lawsuit was eventually withdrawn after the evaporation of local political will to pursue the eminent domain plan. Forgione, *supra* note 92.

94. "In August 2013, the Federal Housing Finance Agency (FHFA) published a notice explaining its 'serious concerns on the use of eminent domain to restructure existing financial contracts and has determined such use presents a clear threat to the safe and sound operations of Fannie Mae, Freddie Mac and the Federal Home Loan Banks.' " SIFMA, EMINENT DOMAIN RESOURCE CENTER, http://www.sifma.org/eminent-domain/ (last visited April 18, 2015).

95. In the Fiscal Year 2015 Omnibus Appropriations bill, President Obama included a restriction on FHFA and GSE involvement in mortgage acquisition through eminent domain. *Id.*

96. A common interest community ("CIC"), is defined by the Restatement (Third) of Property to be a "development or neighborhood in which individually owned lots or units are burdened by a servitude" that cannot be avoided by nonuse or withdrawal. RESTATEMENT (THIRD) OF PROP.: SERVITUDES § 6.2 (2000). CICs include condominiums and homeowner associations. Approximately twenty percent of the population of the United States resides in a CIC. Boyack, *supra* note 27, at 58 n.8.

97. *See generally* Boyack, *supra* note 27.

number of months of regular assessments.[98] A limited super-priority assessment lien means that amounts charged to the home by a private governing association can, to some extent, trump a first mortgage lien, and foreclosure of the super-priority association lien can therefore threaten the security of the entire mortgage loan.[99] The super-priority status of association liens gives associations some leverage with respect to holders of zombie mortgages, but because the super-priority lien is capped, a first mortgage lender can just make a one-time payment of a liquidated sum to the association in order to preserve its priority. Association lien priority solutions are currently limited (in terms of amount and in terms of the number of states that have any super priority at all) thus have failed to adequately address the zombie mortgage problem in CICs.[100]

Unless a lender takes title, the only source of a lender's legal obligation to maintain property would be contract or legislation. Attempts to hold lenders liable in tort for poorly maintained collateral property and foreclosure delay, under a theory of public nuisance, have been unsuccessful.[101] Certain contract provisions impose affirmative maintenance obligations on certain banks, but only based on these institutions' roles as servicer for pools of debt. Fannie Mae and Freddie Mac have pooling and servicing agreements that require the loan servicer to take steps to preserve the mortgage collateral's value.[102] The Department of Housing and Urban Development ("HUD") has similar requirements for lenders with respect to mortgages it insures.[103] A lender may escape these contractual maintenance obligations with respect to vacant collateral property only if it opts to release its lien rather than foreclose, and this sort of release is permitted in case of property that is already abandoned, in disrepair, and not of sufficient value to justify the cost to take title or fulfill the

98. *See* Boyack, *supra* note 27, at 98–111. The Uniform Common Interest Ownership Act (UCIOA) that has been adopted by eight states to date includes a six-month super-priority for association assessment liens. UNIF. COMMON INTEREST OWNERSHIP ACT §§ 3-116 (1982). The lien priority approach of UCIOA has been adopted by ten other states as well. Boyack, *supra* note 27, at 100–101 n.222–39 (citing statutes creating association lien super-priority in the eight UCIOA states of Alaska, Colorado, Connecticut, Delaware, Minnesota, Nevada, Vermont, and West Virginia, as well as ten additional jurisdictions: Alabama, Florida, Illinois, Maryland, Massachusetts, New Jersey, Pennsylvania, Rhode Island, Washington, and the District of Columbia). Two of these states—Nevada and Florida—have a super-priority position a bit longer than the six-month model (nine and twelve months, respectively), and one state—Maryland—has a super-priority position that is limited to three months of assessments. *Id.* at 100–103, 108–111.

99. Chase Plaza Condo. Ass'n, Inc. v. JPMorgan Chase Bank, N.A., 98 A.3d 166, 175 (D.C. 2014) (holding that association "foreclosure pursuant to the super-priority lien extinguished JPMorgan's first deed of trust"); SFR Invs. Pool 1, LLC v. U.S. Bank, 334 P.3d 408, 419 (Nev. 2014), *reh'g denied* (Oct. 16, 2014) (holding that foreclosure sale on a HOA's super-priority lien extinguished all junior interests, including first deed of trust); Summerhill Vill. Homeowners Ass'n v. Roughley, 289 P.3d 645, 647–48 (Wash. Ct. App. 2012) (same under Washington law).

100. Boyack, *supra* note 27, at 112–15 (discussing the limitations of a six-month super-priority).

101. *See* Cleveland v. Ameriquest Mortg. Secs., 62 F. Supp.2d 513, 536 (N.D. Ohio 2009).

102. BULLETIN FROM THE OFFICE OF THE COMPTROLLER OF THE CURRENCY, GUIDANCE ON POTENTIAL ISSUES WITH FORECLOSED RESIDENTIAL PROPS. (Dec. 14, 2011), *available at* 2011 WL 7067447, at *1. Of course, these requirements arise from servicing responsibilities, not from the status of lender.

103. 24 C.F.R. § 203.377 requires that a mortgagee that benefits from HUD insurance inspect vacant property monthly and "take reasonable action to preserve such property."

contractual obligations as servicer or as HUD-insured lender.

Legislation sometimes requires lenders to pay for property upkeep even prior to foreclosure. One municipal tactic has been to enact vacant property registration ordinances ("VPROs") that require a lender to notify the local government of collateral property that it knows or should know is vacant.[104] VPROs also in many cases require lenders to make affirmative maintenance efforts with respect to those vacant properties that secure such lender's loans.[105] VPROs can also impose liability on such a lender for nuisance and related harms from an inadequately maintained home.[106] Some states have responded to the zombie mortgage problem by proposing new legislation that would directly require lenders to maintain abandoned collateral property pre-foreclosure.[107] In other cases, however, resistance from Fannie Mae and Freddie Mac have undercut the effectiveness of VPROs.[108]

Other legislation focuses on requiring lenders to provide affirmative notice of foreclosure status to borrowers and municipalities. For example, a Hawaii statute mandates lender disclosure regarding any foreclosure delay or dismissal.[109] This is an important requirement because anecdotal evidence indicates that oftentimes borrowers are informed that foreclosure has commenced but are unaware of whether the foreclosure sale has actually occured. Upon being warned of an imminent foreclosure sale, borrowers may vacate the property, only to discover years later that the foreclosure was never completed and they are liable for all accrued property-related costs during the

---

104. Weber, *supra* note 28, Part I.B; Robert Klein, *Vacant Property Ordinances: A Look Through the Rearview Mirror, available at* http://www.mortgageorb.com/issues/SVM1310/FEAT_04_Vacant-Property-Ordinances-A%20Look-Through-The-Rearview-Mirror.html; *see also* David P. Weber, *Cities and States Battle Back: Taking the Fight to the Zombie (Mortgages) and Abandoned Properties*, 29 PROB. & PROP. 42, 42 (2015); Richard E. Gottlieb, Margaret J. Rhiew & Brett J. Natarelli, *Reckless Abandon: Vacant Property Ordinances Create Legal Uncertainties*, 68 BUS. LAW. 669 (2013). The Mortgage Bankers Association established a Vacant Property Registration ("VPR") Committee to consider the zombie mortgage problem. The VPR Committee advocated giving municipalities access to MERS records in order for local governments to discover the identity of the holders of mortgage debt on abandoned homes. *See* SAFEGUARD PROPS., *Mortgage Banking - The MERS Alternative to Vacant-Property Registration Ordinances, available at* http://safeguardproperties.com/News/Safeguard_in_the_News/2009/09/Mortgage_Banking_-_The_MERS_Alternative_to_Vacant-Property_Registration_Ordinances.aspx.

105. Weber, *supra* note 28, Part I.B.

106. Dan Immergluck, Yun Sang Lee & Patrick Terra, *Local Vacant Property Registration Ordinances in the U.S. An Analysis of Growth, Regional Trends, and Some Key Characteristics* (Aug. 12, 2012) (*available at* papers.ssrn.com/sol3/papers.cfm?abstract_id=2130775); Joseph Schilling, *Code Enforcement and Community Stabilization: The Forgotten First Responders to Vacant and Foreclosed Homes*, 2 ALB. GOV'T L. REV. 101 (2009).

107. *See* N.Y.C.'S DEP'T OF HOUS. PRES. AND DEV., *Property Registration*, http://www1.nyc.gov/site/hpd/owners/compliance-register-your-property.page (last visited Apr. 18, 2015).

108. In Chicago, for example, the Federal Housing Finance Agency challenged the city's authority to compel Fannie Mae and Freddie Mac to comply with a VPRO, and the City and the FHFA eventually reached a settlement agreement whereby Chicago agreed not to apply the ordinance to any loans held by Fannie Mae or Freddie Mac. Weber, *supra* note 104, at 43; Ben Lane, *FHFA Reaches Settlement with City of Chicago over Vacant Property Lawsuit: Settlement Ends Legal Battle That Began in 2011*, HOUSINGWIRE (Apr. 8, 2014), *available at* www.housingwire.com/articles/29606-fhfa-reaches-settlementwithcity-of-chicago-over-vacantproperty-lawsuit.

109. Hawaii state law requires that notice be given if a foreclosure is stopped prior to completion. SB 960, 27th Leg. (Haw. 2013).

interim. The OCC's guidelines explicitly instruct lenders to "notify, or attempt to notify, the borrower" if a foreclosure is stalled or abandoned,[110] but lenders do not always follow this instruction. Commentators have suggested that pooling and servicing agreements should explicitly require servicers to regularly communicate with borrowers, municipalities, and courts regarding the status of un-completed foreclosures.[111] And after announcing in March 2014 that the agency would be taking a close look at the problem of "abandoned properties and zombie foreclosures,"[112] the CFPB adopted the position that the Truth in Lending Act already requires lenders to make periodic statements to borrowers regarding the status of any foreclosure proceedings.[113] The CFPB concluded that "[t]here is direct borrower harm if a borrower believes a foreclosure on their property has been conducted and they are no longer responsible, and months or years later find out that they are, that there was never a foreclosure and they have large financial responsibilities that they never knew about."[114] Some commentators have suggested that the CFPB has the regulatory power to ameliorate the zombie mortgage problem: perhaps by establishing an industry standard definition for "abandonment," by mandating a streamlined foreclosure process for vacant homes, by creating a national registry of zombie properties, or by requiring that lenders better communicate with borrowers and municipalities with respect to the status of un-completed foreclosures.[115]

Notifying borrowers of un-completed foreclosures is a start, but mere notice inadequately defends borrowers against the threat of zombie mortgages. In many cases, even if a borrower knew that he remained on the hook for property costs, he still might have been unable to avoid incurring those costs by divesting its title. Until someone other than the borrower—a land bank, non-profit organization, local government, third party buyer, or lender—actually takes title and assumes responsibility for a vacant property, the zombie mortgage problem persists.[116]

---

110. Bulletin from the Office of the Comptroller of the Currency, Guidance on Potential Issues with Foreclosed Residential Props. (Dec. 14, 2011) (*available at* 2011 WL 7067447, at *5).

111. *See generally* Rand, *supra* note 33; Berry, *supra* note 88.

112. Berry, *supra* note 88.

113. Finley, *supra* note 29. Such Truth in Lending Act notification requirements would not apply to mortgages that are charged off by lenders.

114. Berry, *supra* note 88 (quoting Laurie Maggiano, CFPB's Servicing and Secondary Markets Program Manager).

115. *See generally* Michael S. Waldron, *CFPB Considering Action on Zombie Foreclosures*, 68 CONSUMER FIN. L.Q. REP. 49 (2014).

116. FGB Realty Advisors, Inc. v. Keller, 923 P.2d 520 (Kan. Ct. App. 1996). Sometimes a borrower's counsel will argue that the statute of limitations should provide relief for a borrower's debt obligation under a vintage zombie mortgage. *Id.* This argument is unlikely to be successful. *Id.* The statute of limitations for a mortgage loan runs from the maturity date, and this usually is decades *after* the mortgage default. *Id.*

B. Inside Bankruptcy

Not all borrowers who have defaulted on their mortgages and abandoned their homes seek bankruptcy. But if a borrower does file for bankruptcy, the law provides tools to address the zombie mortgage problem that would be otherwise unavailable. The Code's provisions and the general equitable powers of a bankruptcy court can perhaps force a lender to take title or to fund property maintenance. Alternately, a bankruptcy court may also be able to order a sale of vacant, un-foreclosed property, even over a lender's objection.

Section 1325(a)(5)(c) of the Code provides that a bankruptcy debtor may surrender secured property to the lender.[117] Courts typically agree that the lender has the "prerogative to decide whether to accept or reject the surrendered collateral."[118] A lender can refuse to accept the proffered property by failing to foreclose even after the borrower's surrender. "Absent some further action, such as foreclosure, deed in lieu of foreclosure or short sale of the property, surrender does not divest a debtor of ownership and its obligations."[119] Prior to the foreclosure crisis, it was rare for a lender to reject a borrower's proffer of collateral in bankruptcy, but this is becoming more and more common.[120]

Some courts have responded to lenders' failure to act upon a borrower's surrender of collateral by ordering title of the collateral to be vested in the lender upon confirmation of the debtor's plan, based on the provisions of § 1322(b)(9). For example, an Oregon bankruptcy court recently held that by approving a debtor's Chapter 13 plan that called for surrender of property to a mortgagee, the court would actually cause title in the property to vest in the senior lienholder, whether the lender wanted it to or not.[121] The court in *In re Watt* held that it was empowered by § 1322(b)(9) to order "vesting of property of the estate," over the senior lienholder's objection, because that section allows the court, through plan confirmation, to vest title "in the debtor, or in any other entity."[122] Citing the problem of post-petition financial liabilities that the debtor would face if title remained in the debtor, in particular the continuing obligation to pay HOA assessments, the court held that vesting of title in the mortgagee in this case was justified.[123]

---

117. 11 U.S.C. § 1322(b)(9) (2012).

118. *In re* Canning, 706 F.3d 64, 70 (1st Cir. 2013). The Supreme Court, in dicta, did suggest that perhaps "surrender" has a more active effect. Assocs. Commercial Corp. v. Rash, 520 U.S. 953, 954 (1997) ("When a debtor surrenders the property, a creditor obtains it immediately, and is free to sell it and reinvest the proceeds."). For a detailed discussion of the law regarding surrender of property to a secured creditor, see David G. Baker, *Putting Teeth in "Surrender" Under Chapter 13*, 26 NACTT Quarterly 23–26 (July/Aug./Sept. 2014).

119. *In re* Watt, 520 B.R. 834, 837 (Bankr. D. Or. 2014); *see also In re* Spencer 457 B.R. 601, 612 (E.D. Mich. 2011); *In re* Moore, 477 B.R. 918 (Bankr. S.D. Georgia 2012); *In re* Brown, 477 B.R. 915 (Bankr. S.D. Georgia 2012).

120. *See, e.g.*, *Watt*, 520 B.R. at 841 *accord In re* Sagendorph, No. 14-41675-MSH (Mass. Cent. Bankr., June 22, 2015).

121. *Watt*, 520 B.R. at 841.

122. 11 U.S.C. § 1322(b)(9) (2012).

123. Watt, 520 B.R. at 840. The court explained that "a homeowner's duty to pay HOA assessment is not

The *Watt* bankruptcy court's reasoning is somewhat logical and the policy goals it advances are legitimate. There is an argument that the plain language of § 1322(b)(9) specifically permits a bankruptcy court to approve a plan and cause "the vesting" of property in a designated entity. "Vesting" is not defined in the Code, but Black's Law Dictionary defines "vesting" to include actual transfer of title, not just an offer to convey.[124] The choice of the word "vest," rather than "surrender" suggests that a court in confirmation can cause what a debtor in surrender only offers to occur.[125] Nothing in § 1322(b)(9) requires consent as a prerequisite for vesting. Of course, a debtor's plan must be made in good faith, and presumably a plan that calls for title to be vested in some unrelated entity without an interest in the property would be difficult to justify.[126]

In spite the fact that using § 1322(b)(9) to justify a title transfer to a recalcitrant lender holds some appeal (logically and politically), the only appellate decision to consider the issue so far has rejected this approach. The Oregon District Court held that even though "surrender" and "vesting" are not defined in the Code, § 1322(b)(9) does not modify § 1325(a)(5), and thus a bankruptcy court is only empowered to confirm a surrender, not order a vesting, unless the specific protections of § 1325(a)(5) are satisfied.[127] This means that a court can confirm a plan that makes property available for lender to take, but cannot order the lender to actually take it.[128] The Oregon District Court's opinion in *Watts* has recently been appealed to the Ninth Circuit.[129]

It is less controversial when a bankruptcy court can cite a § 1325(a)(5) basis for vesting title in a secured lender through plan confirmation. Section 1325(a)(5) sets out several protections for secured lenders in the context of a reorganization, including a requirement that the secured creditor accept the plan, that the payment to the creditor is sufficient to cover the value of the claim and the creditor retains its lien, or the property is surrendered.[130] If a mortgagee consents to title transfer, or if its consent can be implied, then arguably

---

based on a prepetition contractual right, but rather is based on ownership of the property subject to the assessment. Accordingly, the debtor is obligated to pay those [post-petition] assessments for so long as she retains an ownership interest in the Property. *In re Anderson*, No. 12-27458-tmb13, Hr'g Tr. 23-14, May 16, 2013." *Id.* at 837. Unlike several other states, Oregon lacks any super-priority status for HOA assessment liens, and this lack of super-priority not only makes it difficult to push lenders to foreclose outside of bankruptcy, but also creates a further disincentive to lender foreclosure on a vacant home located in a CIC. *Id.* at 837 n.2 (citing to various states that establish some sort of super-priority status for association liens). *See also* Boyack, *supra* note 27, at 100–01.

124. BLACK'S LAW DICTIONARY 1699 (9th ed. 2009).

125. *Compare* 11 U.S.C. § 1325(a)(5)(C) (giving the debtor the right to *surrender* property –) *with* § 1322(b)(9) (giving the court power to vest title in the debtor or in "any other entity").

126. If a debtor's plan calls for vesting of title in a party who is unrelated to and holds no interest in the property (say President Obama), then there would be no good faith reason to vest title in such person.

127. *See* Bank of NY Mellon v. Watt, No. 3:14-cv-02051-AA (Dist. Ct. Or., April 22, 2015) (overruling the *In re Watt* bankruptcy court decision).

128. *See* Bank of NY Mellon v. Watt, No. 3:14-cv-02051-AA (Dist. Ct. Or., April 22, 2015) (overruling the *In re Watt* bankruptcy court decision).

129. Bank of N.Y. Mellon v. Watt, No. 15-35484 (9th Cir. June 16, 2015).

130. 11 U.S.C. § 1325(a)(5).

§ 1325(a)(5) is satisfied, and a court would be free to order vesting in the lender under § 1322(b)(9). This was the approach taken in *In re Rosa.*[131] The court in *Rosa* would not order a "cramdown" of the plan to vest title over a lender's explicit objection, nor would it hold that mere surrender could operate to transfer title, but the court did hold that because the lender in that case had failed to object to the plan after receiving adequate notice, its consent could be implied, and title could be duly vested in the lender.[132] In the context of plan approval, courts frequently characterize a lender's failure to object as acceptance.[133]

Bankruptcy courts have broad equitable powers to achieve the goals of bankruptcy, including ensuring a fresh start for debtors. Some courts have relied on these general equitable powers to order a foreclosure sale or lender's acceptance of a quitclaim deed or deed in lieu of foreclosure from a bankruptcy debtor when a lender has failed to respond to a surrender offer. The court in *In re Pigg*,[134] for example, employed its equitable powers to order foreclosure as a way to save the debtor from post-bankruptcy carrying costs associated with an abandoned home.[135] The court explained that the without title transfer, the debtor "cannot truly be given a fresh start because [homeowners association] fees are still accumulating until a lender chooses to foreclose. If the lender never forecloses, that homeowner's liability for the HOA fees continues in perpetuity . . . [which] deprives the debtor of a fresh start, and thwarts the goals of the entire Bankruptcy Code."[136] The court further noted that it would be unfair to require the debtor who had surrendered property or the HOA (essentially the debtor's neighbors) to continue to fund maintenance of the lender's collateral, and that debtor or neighborhood funding of such maintenance caused unjust enrichment of the lender, and restitution principles further justified foreclosure relief.[137] Although noting that Congress broadened § 523(a)(16) to clarify that post-bankruptcy HOA assessments do continue to accrue as debtor obligations,[138] the court in *Pigg* indicated that Congress "could not have foreseen the . . . financial crisis that crashed Wall Street, sunk the real estate market, and affected, to some degree, almost every American."[139] The court explained that in 2005, widespread strategic lender foreclosure delay was unanticipated, as well as the problems of "homeowners in limbo."[140]

Other courts have agreed with the approach of *Pigg*. The court in *In re*

---

131. 495 B.R. 522, 524 (Bankr. D. Haw. 2013).
132. *Id.*
133. *In re* Andrews, 49 F.3d 1404, 1409 (9th Cir. 1995).
134. 453 B.R. 728 (Bankr. M.D. Tenn. 2011).
135. *Id.* at 735 (citing 11 U.S.C. § 105(a) ("The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title.")).
136. *Id.* at 733.
137. *Id.* at 732 n.5; Boyack, *supra* note 27, at 129–130.
138. 11 U.S.C. § 523(a)(16) (2012).
139. *In re* Pigg, 453 B.R. 728, 733 (Bankr. M.D. Tenn. 2011).
140. *Id.*

Spencer[141] suggested that equity requires secured lenders to accept surrender in certain situations.[142] *In re Perry*[143] cited equitable powers in ordering a mortgage lender to either timely foreclose or take a debtor's quitclaim deed within sixty days.[144] The court in *In re Rose*,[145] however, refused to order this sort of relief and force a lender to either foreclose or accept the deed, even though the Chapter 13 plan providing for property surrender had been approved, and the property had been turned over to the lender, more than a year before.[146] The court in *Rose* resisted the idea that a court could compel a lender to accept title.[147] "As long as the secured creditor's actions do not 'constitute a subterfuge intended to coerce payment of a discharged debt,' the 'secured creditor . . . has the prerogative to decide whether to accept or reject the surrendered collateral.' "[148] *In re Fristoe*[149] likewise refused to find sufficient equitable power to force title transfer on an unwilling zombie mortgage lender.[150] Reaching a similar conclusion, *In re Arsenault*[151] reasoned that a bankruptcy court's equity power is limited by the Code, and that neither the Code nor general principles of good faith require a secured lender to accept a debtor's surrender or consent to a sale of its collateral.[152] Congress—not the court—is better situated to address problems arising from foreclosure delay, the court opined.[153]

In calculating secured claims, the Code does empower bankruptcy courts to strip liens that are unsupported by collateral value.[154] In other words, if a senior mortgage lien is for an equal or greater amount than the property's value, then in a Chapter 13 proceeding, any junior lien can be deemed wholly unsecured and be released by the bankruptcy court.[155] According to similar

141. 457 B.R. 601 (E.D. Mich. 2011).
142. *Id.* at 615.
143. No. 12-01633-8-RDD, 2012 WL 4795675 (Bankr. E.D.N.C., Oct. 9, 2012).
144. *Id.* at *2.
145. *In re* Rose, 512 B.R. 790 (Bankr. W.D.N.C. 2014).
146. *See generally id.*
147. *Id.* at 793–94.
148. *Id.* at 794. This conclusion brought immediate criticism from commentators who pointed out that not only did this decision perpetuate a zombie mortgage, but it was "not supported by the plain language of § 1325(a)(5)" and neglected to give full effect to § 1322(b)(9). Roksana D. Moradi, *Dealing with Mortgage Owners Who Won't Foreclose – A Possible Bankruptcy Option*, CENT. DIST. INSIDER (Aug 5, 2014), http://centraldistrictinsider.com/2014/08/05.
149. *In re* Fristoe, No. 10-32887, 2012 WL 4483891 (Bankr. D. Utah, Sept. 27, 2012).
150. *See generally id.*
151. 456 B.R. 627 (Bankr. S.D. Ga. 2011).
152. *See generally id.*
153. *Id.*
154. 11 U.S.C. §§ 506(a), 1325(a)(5) (2012).
155. *In re* Heck, No. 09-31512 (Bankr. N.D. Cal. 2011). Although Chapter 13 debtors can use § 506 and § 1322(b)(2) to "strip off" a completely unsecured junior lien (a lien subordinate to undersecured senior secured debt), in June 2015 the Supreme Court held that this "strip off" right is unavailable to Chapter 7 debtors. Bank of Am., N.A. v. Caulkett, 135 S.Ct. 1995 (2015). The unanimous Court in *Caulkett* refused to distinguish the case of a completely unsecured junior lien from that of an undersecured lien in Chapter 7, previously held to be unavailable for strip down. *Id. See* Dewsnup v. Timm, 502 U.S. 410 (1992), (ruling that undersecured liens survive Chapter 7 bankruptcy, and Chapter 7 debtors may not use § 506(d) to "strip down" such liens). The *Caulkett* court was not asked to overrule *Dewsnup*, but a footnote (joined by 6 justices),

logic, at least a portion of a first mortgage on an "underwater" property[156] should be deemed unsecured based on bifurcating the claim into the secured portion (equal to collateral value) and the unsecured loan (any excess loan amount).[157] Although the ability to strip away a worthless lien can be helpful with respect to junior liens, it extends only insofar as loans exceed property value, and therefore lien stripping alone fails to completely address the problem of foreclosure delay for first mortgage loans.

V. A BANKRUPTCY CODE SECTION 363 APPROACH TO ZOMBIE MORTGAGES

Section 363 of the Code promises a more workable alternative to address the zombie mortgage problem.[158] This Section permits a bankruptcy trustee or debtor in possession, which has all the powers of a trustee, to seek a court ordered asset sale.[159] Property sales in the ordinary course of business are permitted under § 363(a), and property can be sold outside the ordinary course of business after notice and a hearing pursuant to § 363(b).[160] Sales under § 363 can be "accomplished very quickly," making this section an expeditious choice for wiping out a zombie mortgage, as long as clear title to the property can be conveyed to a willing buyer.[161] Section 363(f) is a particularly important subsection that lays out the situations in which a court may permit property to be sold "free and clear" of all interests.[162] The title clearing potential of subsection (f), combined with subsection (m), "which essentially moots the ability to appeal a sale," creates "a degree of finality to the sale that is very appealing to prospective purchasers."[163] Because a § 363(f) sale wipes out all other interests in property, including liens and similar claims, it operates similar to a foreclosure. Like a foreclosure sale, it both transfers title away from the debtor and clears title for the purchaser.[164] A sale that wipes out liens and

---

suggested that the Court may be open to do so in the future. *Caulkett*, 135 S. Ct. 1999–2000.

156. "Underwater properties" refer to homes that have a value that is less than the aggregate mortgage loans secured by the home. As of 2013, RealtyTrac estimated that 10.9 million homes nationwide are worth less than the face value of their mortgage loans. Barbara Liston, *More than 300,000 Homes are Foreclosed "Zombies," Study Says*, REUTERS (Mar. 28, 2013), www.reuters.com/article/2013/03/28/us-usa-housing-zombies-idUSBRE92R0YQ20130328.

157. *See in re* Pratt, 462 F.3d 14 (1st Cir. 2006); *In re* Casarotto, 407 B.R. 369 (Bankr. W.D. Mo. 2009); *In re* Schlictmann, 375 B.R. 41 (Bankr. D. Mass. 2007) (stripping the surviving lien because it served no "legitimate economic purpose").

158. 11 U.S.C. § 363 (2012).

159. Section 1303 and 1107 grant debtors in possession the same rights as a trustee in bankruptcy. Under § 363 a trustee in bankruptcy may use, sell or lease property of the estate. *Id.* § 363(f).

160. *Id.* § 363(a), (b).

161. *See* Douglas E. Deutsch & Michael G. Distefano, *The Mechanics of a § 363 Sale*, AM. BANKR. INST. J. (Feb. 2011) ("[Section] 363 sales can be accomplished very quickly, generally taking between two to three months to complete, but a sale can be completed in a much-shorter timeframe.").

162. 11 U.S.C. § 363(f); *see also* FERRIELL & JANGER, *supra* note 46, at 285 (explaining how § 363(f) changes the state law non-bankruptcy rule that sales of property would be made subject to a secured creditor's rights).

163. Deutsch & Distefano, *supra* note 161.

164. Foreclosures by definition transfer the property free and clear of all junior liens and interests. *See* Andrea J. Boyack & William E. Foster, *Muddying the Waterfall: How Ambiguous Liability Statutes Distort*

transfers clear title to real property effectively relieves a debtor of the threat of post-bankruptcy accumulation of property-related debt and the attendant cloud on the debtor's fresh start. It also efficiently solves the community and market problems associated with vacant, un-foreclosed homes and lingering lien liability. A free and clear sale of the realty gives the property a pathway back into the stream of commerce and is the best way to vest title in a caretaking owner while freeing a debtor and a community from the financial drain caused by badly maintained property.[165]

Achieving these ends through a § 363(f) asset sale is more effective, and less legally problematic, than ordering a lender to take title after a borrower's surrender. In addition, a court-ordered asset sale is a preferable zombie mortgage solution because it causes no prejudice to a secured lender, who obtains proceeds in lieu of a lien and is paid the liquidated value of its claim. Free and clear property sales made to willing third-party buyers avoids the "forcing" problem of requiring a lender to take title to property itself.[166] This expeditious transfer to a willing caretaker effectively addresses the social ills related to zombie mortgages and simultaneously promotes the fresh start goals of bankruptcy, all without crossing questionable legal or constitutional lines.

A debtor or trustee can use § 363(f) to sell assets stripped free of liens in both a Chapter 13 and a Chapter 11 bankruptcy. Under § 1303 and § 1107, a debtor in possession has the same powers as a bankruptcy trustee, including the power under § 363(b)(1) to use, sell, and lease property.[167] Upon making a motion to sell property free and clear, together with pleadings and supporting documents providing a supporting evidentiary basis, a court will order the asset sale unless a party in interest objects.[168] The Code permits a court to charge the bankruptcy estate for the costs associated with an asset sale. Under § 506(c), such asset sale transaction costs, including the costs of preparing property for sale and the costs of marketing and conveying the property, can be

Creditor Priority in Condominium Foreclosures, 67 ARK. L. REV. 225, 234–237 (2011). This can be contrasted with a conveyance by private sale or through a deed in lieu of foreclosure. In such situations, junior liens and claims against the property remain intact, still burdening title of the asset conveyed. *Id.*

165. A purchaser can be confident that an asset sale under § 363(f) conveys clear title, because even if the sale is subsequently overturned on appeal, pursuant to § 363(m), the purchaser's claim is protected as bona fide and the purchaser's title claims will not be affected. *See* Joseph S. Bolnick, *Revisiting Clear Channel - Acquiring Real Property in A Section 363 Bankruptcy Sale "Free and Clear" of Liens*, 20 AM. BANKR. INST. L. REV. 517, 517 (2012). *In re PW, LLC* called into question the scope and impact of § 363 to convey clear title to a good faith purchaser. 391 B.R. 25, 47 (B.A.P. 9th Cir. 2008). But the mootness holding in this case has been of "limited precedential value" because most courts have rejected that holding, still upholding the effectiveness of § 363(m) to protect titles transferred under § 363(f). Bolnick, at 522.

166. Fennell, *supra* note 90, at 1310–11 (discussing the legal issues surrounding attempts to coerce mortgage lenders to take ownership of vacant properties that are burdened by a zombie mortgage).

167. 11 U.S.C. §§ 1303, 1107; GEORGE W. KUNEY, MASTERING BANKRUPTCY, 102 (Carolina Academic Press 1st ed. 2008).

168. 11 U.S.C. § 102. Increasingly, § 363 sales are used as an alternative liquidation procedure or an alternative to a plan of reorganization that effectively calls for selling the debtor or all its assets. NATHALIE MARTIN & OCEAN TAMA, INSIDE BANKRUPTCY LAW: WHAT MATTERS & WHY 235 (2d ed. 2011). Section 363 sales do not apply to exempted property, for example a homestead; but if the debtor plans divestment of the realty, the debtor should merely opt out of claiming the exemption. *Id.*

charged to the estate as an administrative expense.

Any holder of an "interest" in property subject to a § 363(f) sale can object to the sale proposal as being improper under the restrictions of that section.[169] This is because all such interests—including any claim or lien on the property—can be wiped out in a § 363(f) sale.[170] Courts can evaluate lienholder objections and will expedite the sale if there is a good business reason to do so, if procedural requirements, particularly notice, are met, and if the sale is being made in good faith and for a reasonable price.[171] A lienholder can, however, still credit bid at a § 363 sale under subsection (k), although in some instances the amount of the credit bid can be limited by the court.[172]

Section 363(f) sets forth the requirements for a sale of property free and clear of all interests.[173] Subsection (1) provides that if non-bankruptcy law permits a free and clear sale, then the same sort of interest-clearing sale will be permitted in bankruptcy. After all, there is no reason to give parties in bankruptcy *fewer* rights and remedies in connection with a liquidation or reorganization asset sale. Accordingly, if a debtor could have sold property free and clear outside of bankruptcy, then this can be done in bankruptcy too. The only difference would be that a sale within bankruptcy would relieve the debtor from having to follow applicable procedural requirements associated with a sale outside bankruptcy. This can save the estate time and money.[174]

In addition to Subsection (1), § 363(f) details four other ways that a sale may be made free and clear of interests. Subsection (2) of § 363(f) permits a sale of property to be free and clear of an interest if the interest-holder consents. The biggest issue in applying this section is determining whether consent can be deemed from the lack of an objection after notice. Under subsection (f)(3), a sale can also be made free and clear of a lien if the sale price is greater than the "aggregate value of all liens on such property."[175] This provision does not explain how the "value" of liens is determined, and courts are split on this issue. Subsection (f)(4) indicates that a sale can be free and clear of an interest that is subject to a *bona fide* dispute. Courts have interpreted this to mean that there is a good faith dispute as to the existence or validity of the interest.[176] Finally, according to § 363(f)(5), property can be sold free and clear of an interest if the entity holding such interest "could be compelled, in a legal or equitable

---

169. *See* KUNEY, *supra* note 167, at 102; George W. Kuney, *Misinterpreting Bankruptcy Code Section 363(F) and Undermining the Chapter 11 Process*, 76 AM. BANKR. L.J. 235 (2002).

170. *In re* Transworld Airlines, Inc., 322 F.3d 283, 288–90 (3d Cir. 2003).

171. *In re* Lionel, 722 F.2d 1063, 1066; *In re* Med. Software Solutions, 286 B.R. 431, 439–40 (Bankr. D. Utah 2002).

172. *See infra* Section V.D.

173. 11 U.S.C. § 363(f) (2012).

174. KUNEY, *supra* note 167, at 104.

175. 11 U.S.C. § 363(f)(3).

176. *In re* Patriot Place, Ltd., 486 B.R. 773, 815 (Bankr. W.D. Tex. 2013); *In re* Sims, 994 F.2d 210, 221 (5th Cir. 1993).

proceeding, to accept a money satisfaction of such interest."[177] Further discussions on applying subsections (f)(2), (f)(3), and (f)(5) to a zombie mortgage situation follow.

A. Deemed Lienholder Consent

If a mortgagee affirmatively consents to a sale of collateral property, that sale can be made free and clear of the lien pursuant to the provisions of § 363(f)(2). If a mortgagee affirmatively objects to such a collateral sale, then subsection (2) will not apply. But it is less clear whether this section permits lienholder consent to be implied from lender inaction in the face of a proposed § 363(f) asset sale. Courts are split on this issue.[178] Many bankruptcy courts deem consent to occur after a lender fails to object to a proposed asset sale thus allowing property to be sold free and clear of the lender's interest based on the interest-holder's implied consent.[179] Some other bankruptcy courts, however, refuse to imply consent for the purposes of § 363(f)(2), reasoning that fairness requires the holder of the interest to expressly consent for a sale free of the interest to be justified, and that mere failure to object is insufficient.[180] Some legal scholars agree, reasoning that the statute is best read as requiring "actual consent, not 'deemed consent' based on a failure to object."[181]

Requiring affirmative lender consent in order to qualify any free and clear sale under § 363(f)(2) has some logical appeal, but in the context of lender foreclosure delay, requiring affirmative assent practically runs into the same issues that caused the zombie mortgage problem to begin with, namely that lenders and servicers are unwilling or unable to pay attention to all their defaulted mortgages and in-progress foreclosures. One of the most frustrating aspects of mortgage default post-crisis is the lack of lender and servicer attention to individual borrower needs. If a lender's explicit consent is a prerequisite to a free and clear sale of the mortgaged home, then a lender's strategic delay or even a lender's incompetence or inattentiveness can hold up the proceeding that otherwise could provide an efficient solution to a property in limbo.

In addition, a lender is not materially harmed by calling its lack of objection consent in the context of a sale of collateral free and clear of its lien.

---

177. 11 U.S.C. § 363(f)(5).

178. *Compare In re* Tabone, Inc., 175 B.R. 855, 858 (Bankr. D.N.J. 1994) *with In re* Roberts, 249 B.R. 152, 154–57 (Bankr. W.D. Mich. 2000). *But see* United Student Aid Funds, Inc., v. Espinosa, 559 U.S. 260, 275 (2010) (holding that a creditor's lack of objection, after good service of notice of a plan that provided for discharge of the creditor's claim, would be deemed creditor consent to that discharge and rendered the plan binding on the creditor).

179. *E.g.*, *In re* Pigg, 453 B.R. 728, 736 (Bankr. M.D. Tenn. 2011). This is the majority view of how this section applies. *See American Law Reports Special Commentary: Sales of Property, Other than in the Ordinary course of Business, of Bankruptcy Estate Free and Clear of Consensual and Nonconsensual Liens, Claims, and Encumbrances under § 363(f) of the Bankruptcy Code*, 22 A.L.R. FED. 2d 579, § 12 (2007).

180. *In re* Arsenault, 456 B.R. 627 (Bankr. S.D. Ga. 2011).

181. KUNEY, *supra* note 167, at 104.

After all, the lender will receive proceeds from the sale to apply to the loan, and prompt resolution of outstanding debt benefits lenders as well as debtors. Furthermore, no one wins when vacant property lacks a caretaker and falls into disrepair. This can give rise to borrower liability under municipal or homeowner association upkeep requirements and can cause lender liability as well, particularly in jurisdictions that have adopted a VPRO.[182] A servicer, if there is one for the mortgage, likely also incurs liability when vacant property is not adequately maintained.[183] And a lender suffers a detriment when the value of its collateral deteriorates. Fairness does not mandate requiring an affirmative assent in this case, because the right lost in allowing the sale to proceed—lender autonomy in connection with whether collateral should be sold or kept—is completely overshadowed by the primary lender right that is preserved—the economic right to be paid the collateral value.

B. Greater than the Value of Liens

Section 363(f)(3) permits property to be sold free and clear of interests if the sale price will exceed the "aggregate value of all liens" on the property, but courts are split on how such "value" should be calculated.[184] The value of a claim is described in another section of the Code, namely section § 506(a) that caps the value of a secured claim at the value of the collateral that is the debt's security.[185] Under § 506(a), if a secured lender is owed more debt than the fair market value of the collateral securing the debt, then the claim is bifurcated into a secured claim and an unsecured claim.[186] Following the economic-value approach of § 506(a), a debtor could argue that the sale price required to qualify for a free and clear sale under § 363(f)(3) need only cover the fair market value of the collateral because the market value of the collateral is synonymous with the value of the secured claim and, thus, the lien. For real estate, if a sale follows proper procedures and is a market sale, the price obtained is typically considered to be the fair market value of the property.[187] If, however, the value of a lien is capped by the property's sale price, then the price obtained at a fair sale would never be *less* than the value of the lien. And on the other hand, it would also be rare that the price obtained at the sale would exceed the value of

---

182. *See supra* notes 104–108 and accompanying text.

183. *See supra* note 111 and accompanying text.

184. MARTIN & TAMA, *supra* note 168 (discussing whether § 363(f)(3) should mean face value or § 506(a) "stripped down" "economic value" and concluding that a majority of courts have adopted the face-value approach). In the context of § 363(f)(3), "federal courts are sharply divided as to the meaning of the term 'value of all liens.' " *Id.*; *see also In re* Collins, 180 B.R. 447, 450 (Bankr. E.D. Va. 1995); *In re* Terrace Chalet Apartments, Ltd., 159 B.R. 821, 825 (N.D. Ill. 1993).

185. 11 U.S.C. § 506(a) (2012).

186. *Id.*

187. *Collins*, 180 B.R. at 447; *In re* Milford Grp., Inc, 150 B.R. 904, 904–05 (Bankr. M.D. Pa. 1992); *In re* WPRV-TV, Inc., 143 B.R. 315, 319–21 (D.P.R. 1991); *In re* Oneida Lake Dev., Inc., 114 B.R. 352, 375 (Bankr. N.D.N.Y. 1990); *Terrace Gardens Park P'ship*, 96 B.R. at 713; *In re* Beker Indus. Corp., 63 B.R. 474, 474 (Bankr. S.D.N.Y. 1986).

the lien; in most cases, these two numbers would be equal. The ambiguity of the phrase "value of all liens" in § 363(f)(3) is thus compounded by the subsidiary question of whether the price obtained must merely cover this value or whether it must exceed it. Requiring the price to exceed the value makes little sense when the value is defined by reference to the price, but if all that is required by subsection (f)(3) is that the sale price cover the collateral value, then this subsection would justify a free and clear sale in nearly every instance.[188]

The tautological conundrum of approving a sale price based on lien valuation that is itself based on the sale price suggests that perhaps the "aggregate value of all liens" in § 363(f)(3) was initially intended to refer to something other than the price obtained at sale—perhaps the face value of the liens.[189] In the 1984 amendments to the Code, Congress changed the language in § 363(f)(3) from "value of such interest" to "value of all liens on the property."[190] This suggests that there was legislative intent to have the *lien* value mean something distinct from the value of the *interest*, so perhaps lien value was in fact intended to reference the face-value of the debt.[191] Some courts have adopted such a face-value interpretation, holding that the "aggregate value of all liens on the property" is the sum total of all debt secured by that property, whether or not these loans are themselves under or over secured.

The most well-known case adopting this interpretation is the highly criticized Ninth Circuit Bankruptcy Appellate Panel decision of *In re PW, LLC* ("*Clear Channel*").[192] The court in *Clear Channel* made much of the

188. To avoid the conclusion that this language would justify the use of § 363(f)(3) in any and all sales, some courts stress that § 363(f)(3) requires that the sale price be *greater* than the lien value, not merely *equal* to it. *See, e.g.*, *In re* Stroud Wholesale, Inc., 47 B.R. 999, 1002 (E.D.N.C. 1985).

189. *See, e.g.*, *In re* PW, LLC, 391 B.R. 25, 40 (B.A.P. 9th Cir. 2008); *In re* Perroncello, 170 B.R. 189 (Bankr. D. Mass. 1994); *Terrace Chalet Apartments*, 159 B.R. at 826; *In re* Heine, 141 B.R. 185, 189 (Bankr. D.S.D. 1992); *Stroud Wholesale*, 47 B.R. at 1002. This approach was initially in line with the predominant treatise on bankruptcy law. *See* 3 COLLIER ON BANKRUPTCY ¶ 363.06[4][a] (Alan N. Resnick & Henry J. Sommer eds., 15th ed. rev. 2008). But in 2014, the new edition of Collier on Bankruptcy clarified that § 363(f)(3)'s "value of the collateral" references the economic value and "not the face amount of the debt." 8 COLLIER ON BANKRUPTCY, ¶ 1303[5], 1303–08 (Alan N. Resnick & Henry J. Sommer, eds., 16th ed. rev. 2014).

190. For original version of the act, *see* Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (1978). The current version is in 11 U.S.C. § 363(f)(3) (2012).

191. In discussing § 363(f), the House and Senate Reports stress that "[t]he trustee may sell free and clear if . . . the sale price of the property is greater than the *amount secured by the lien*." H.R. REP. NO. 95–595, at 345 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6301–02 (emphasis added); S. REP. NO. 95–989, at 56 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5842 (emphasis added). These reports expressly provide that Congress intended § 363(f) to protect the amount of secured debt, not the actual economic value of the lien. *Terrace Chalet Apartments*, 159 B.R. at 826. Even though the 1984 amendments seem to have sought to endorse the face value interpretation, the plain language uses the term "value of all liens on the property" which references the concept of *valuing* a lien, reminiscent of § 506. KUNEY, *supra* note 167, at 104–105; 11 U.S.C. § 506(a), (d). The ambiguous statements of legislative intent are insufficient to necessarily overcome the accepted interpretative approach to reading a statute as a whole, and this "leave[s] the issue in dispute among the bankruptcy courts."

192. 391 B.R. 25 (B.A.P. 9th Cir. 2008). *Clear Channel* has been called the most controversial of recent cases concerning § 363 sales and has been "seriously criticized by commentators." *See* Douglas E. Deutsch & Michael G. Distefano, *The Mechanics of a § 363 Sale*, AM. BANKR. INST. J. (Feb. 2011).

distinction between the word *liens* in § 363(f)(3) and the word *claims* in § 506(a) and refused to apply the valuation approach of § 506(a) to determine the value of *liens*.[193] Although the face-value approach makes it very difficult for a proposed sale to satisfy the restrictions of § 363(f)(3), *Clear Channel* found nothing in the Code justified the opposite conclusion: that Congress intended that § 363(f)(3) allow a sale free and clear of liens in nearly every instance.[194]

Several other bankruptcy courts have also adopted this face value interpretation for § 363(f)(3).[195] The Fourth Circuit endorsed this approach, ruling that a bankruptcy court "should not order the sale of property free and clear of interests and liens unless the court is satisfied that the sale proceeds will fully compensate the secured lienholders and produce some equity for the estate."[196] Relying on purported congressional intent, bankruptcy courts in the Seventh Circuit have similarly required the sale price exceed the face value of liens rather than merely the liens' economic value.[197] Some bankruptcy scholars endorse the face value interpretation as well.[198]

Notwithstanding some logic, legislative history, and judicial support for the face value approach, the language of § 363(f)(3) is sufficiently unclear—and policies to the contrary are sufficiently compelling—to justify numerous other courts adoption of the economic value interpretation instead.[199] Several courts and commentators have reasoned that general interpretive principles

---

193. *Id.* at 39. The *Clear Channel* court further pointed out the that if the "aggregate value of all liens" was based on a § 506(a) formulation (economic rather than face value), then in almost every case the sale price would be *equal* to the value, and would be neither more nor less than the lien value. *Id.*; *see also In re* Gen. Bearing Corp., 136 B.R. 361, 366 (Bankr. S.D.N.Y. 1992).

194. *In re PW, LLC*, 391 B.R. at 39. This interpretation relies on finding that "greater than" includes a sale price that is equal to the aggregate lien value, and this is not the unanimous interpretation of the section. *Id.*

195. *E.g.*, *In re* WDH Howell, LLC, 298 B.R. 527 (Bankr. D.N.J. 2003); *In re* Canonigo, 276 B.R. 257 (Bankr. N.D. Cal. 2002); *In re* Feinstein Family P'ship, 247 B.R. 502 (Bankr. M.D. Fla. 2000); *In re* Perroncello, 170 B.R. 189, 191–92 (Bankr. D. Mass. 1994); *Terrace Chalet Apartments*, 159 B.R. at 826–28; *In re* Heine, 141 B.R. 185, 189 (Bankr. D.S.D. 1992); *In re* Stroud Wholesale, Inc., 47 B.R. 999, 1002–03 (E.D.N.C. 1985); *see also In re* Healthco Int'l, Inc., 174 B.R. 174 (Bankr. D. Mass. 1994); *In re* Gen. Bearing Corp., 136 B.R. 361, 366 (Bankr. S.D.N.Y. 1992).

196. *Stroud Wholesale*, 47 B.R. at 1002.

197. *E.g.*, *Terrace Chalet Apartments*, 159 B.R. at 826 (explaining that allowing a free and clear sale based on finding the sale price covered lenders' economic interests rather than face value interests treats lienholders less deferentially than mandated in the context of a cramdown under § 1129(a) and (b), even though the effect on a creditor is the same. *See* Marguerite Lee De Voll, *Neither "Free" nor "Clear": The Real Costs of In re PW, LLC: A Look at § 363(f)(3) and How to Protect Creditors*, 26 EMORY BANKR. DEVE. J. 167 (2009). *Perroncello*, 170 B.R. at 191–92.

198. Steven M. Shishko, *Selling Out Undersecured Creditors: "Value" Under Section 363(f) of the Bankruptcy Code*, 8 CARDOZO L. REV. 1251, 1265–66 (1987); *see* Brad B. Erens & David A. Hall, *Secured Lender Rights in 363 Sales and Related Issues of Lender Consent*, 18 AM. BANKR. INST. L. REV. 535 (2010). *But see* 8 COLLIER ON BANKRUPTCY, ¶ 1303[5], 1303–08 (Alan N. Resnick & Henry J. Sommer, eds., 16th ed. rev. 2014) (clarifying that § 363(f)(3)'s "value of the collateral" references the economic value and "not the face amount of the debt").

199. Several courts have held that § 363(f)(3) can permit property to be sold free and clear of "out of the money" liens. *E.g.*, *In re* Collins, 180 B.R. 447, 450–51 (Bankr. E.D. Va. 1995); *In re* Milford Group, Inc., 150 B.R. 904, 906 (Bankr. M.D. Pa. 1992); *In re* WPRV-TV, Inc., 143 B.R. 315, 320 (D.P.R. 1991); *In re* Oneida Lake Dev., Inc., 114 B.R. 352 (Bankr. N.D.N.Y. 1990); *In re* Terrace Gardens Park P'ship, 96 B.R. 707 (Bankr. W.D. Tex. 1989); *In re* Beker Indus. Corp., 63 B.R. 474, 476–77 (Bankr. S.D.N.Y. 1986).

require that the ambiguity of the phrase "aggregate value of all liens" be resolved through reference to other provisions of the Code.[200] And because § 506(a) arguably clears up this ambiguity by detailing how secured claims are valued in bankruptcy, this definition should apply.[201] The principles of § 506(a) carry over into several other parts of the Code and provide a general bankruptcy justification and methodology for lien stripping (for example of junior liens that are supported by no collateral value) and for "cramdown" confirmation of a reorganization plan.[202] There are some enumerated instances in which a secured lender's claim is not reduced pursuant to § 506(a),[203] but these exceptions explicitly disclaim the general rule. For example, according to § 1322(b)(2), a Chapter 13 plan must provide for full payment of the face value of a mortgage on a principal residence, not just the economic value of the underlying home.[204] This limitation only applies to homes that are and remain a debtor's principal residence, however. There is no limitation for prior residences that have been abandoned, as is the case for vacant property burdened by a zombie mortgage.

In re Beker Industries Corp.[205] is the foundational case adopting the economic value approach and rejecting the face value interpretation.[206] The court held that the plain language of § 363(f)(3) requires sale price "to or greater than the aggregate *value* of the liens asserted against it, not their *amount.*"[207] The court reasoned that the "value" of a lien is determined by reference to § 506(a) and is capped by collateral value ("the amount by which the lienholder's claim is actually secured").[208] Many courts have found this economic value interpretation compelling.[209] The court in *In re WK Lang Holdings, LLC*[210] enthusiastically adopted the economic view as the better interpretation, rejecting the reasoning of *Clear Channel.* The court in *WK Lang*

200. *Collins*, 180 B.R. at 450. "When construing statutory language, [ambiguous terms] are to be interpreted in line with that meaning, and in light of other provisions of the statute." *Id.* at 451 (citing *Beker Indus.*, 63 B.R. at 475).

201. Although, once again, § 506(a) creates a term mismatch, as it speaks to valuation of *claims* rather than the value of *liens*.

202. *In re* Heck, No. 09–31512 TEC, 2011 WL 133015 (Bankr. N.D. Cal. Jan. 13, 2011); *see also In re* Fristoe, No. 10–32887, 2012 WL 4483891 (Bankr. D. Utah Sept. 27, 2012).

203. For example, § 1325(5)* (the hanging paragraph) explicitly provides that § 506(a) valuation and strip-down of a lien does not apply in the context of first mortgage loans on the debtor's residence and a purchase money car loan obtained within 910 days of filing the petition.

204. 11 U.S.C. § 1322(b)(2) (2012).

205. 63 B.R. 474 (Bankr. S.D.N.Y. 1986).

206. *Id.*

207. *Id.* at 476 (emphasis added); *see also In re* Bos. Generating, LLC, 440 B.R. 302, 332 (Bankr. S.D.N.Y. 2010).

208. *In re Bos. Generating, LLC*, 440 B.R. at 332; *see also Beker Indus.*, 63 B.R. at 475; *see also* United Sav. Ass'n of Tex. v. Timbers of Inwood Forest Assocs., Ltd., 484 U.S. 365, 372 (1988) ("The phrase 'value of such creditor's interest' in § 506(a) means 'the value of the collateral.' ")

209. *See generally In re* Nashville Senior Living, LLC, 620 F.3d 584 (6th Cir. 2010); *In re* Oneida Lake Dev., 114 B.R. 353 (Bankr. N.D.N.Y. 1990); *Beker Indus.*, 63 B.R. 474; *In re* Hatfield Homes, 30 B.R. 353 (Bankr. E.D. Pa. 1983); *see also In re* Warner Springs Ranchowners Ass'n, No. 13CV1170-WQH-WVG, 2014 WL 1028829, at *2 (S.D. Cal. Mar. 13, 2014).

210. No. 13-11934, 2013 WL 6579172 (Bankr. D. Kan. Dec. 11, 2013).

stressed, however, that in order for a sale to qualify for free and clear conveyance under § 363(f)(3), the sale price must be *greater* than the collateral value, not merely equal thereto.[211] The court also indicated that true collateral value may not necessarily be equal to the price obtained at a § 363 sale, because such a sale may fetch only a below-market price.[212] Thus, even if a court adopts an economic value approach to § 363(f)(3) valuation, a particular sale could still fail to meet the requirements for property to be conveyed free and clear of interests.[213]

The lack of certainty as to the meaning of "aggregate value of all liens" in § 363(f)(3) makes it difficult for a secured creditor to credit bid at a sale and obtain the property free and clear of other interests.[214] Uncertainty also impacts the ability of property to be sold free of liens to a willing buyer. A face value interpretation severely limits the scope in which this subsection can operate to address the zombie mortgage problem. On the other hand, lenders have argued that the economic value approach could unfairly reduce a secured lender's repayment in bankruptcy.[215] The concern for lender under-recovery is ameliorated by the cautious approach most courts take with respect to applying the economic value approach to justify a free and clear asset sale. Most courts make a finding that the sale price in the given situation was itself fair and that the sale will benefit the estate.[216] Commentators argue that this sort of judicial attention to fairness of the sale price is necessary in applying a § 506(a) approach to lien valuation that essentially strips the security of the lender, and that such judicial valuation and oversight cures any potential unfairness from the economic value approach to applying § 363(f)(3).[217]

If a court independently determines that a sale price of a vacant home is equal to its fair market value, then it is difficult to assert that a sale of that property free and clear of the lien creates any actual harm to the mortgage lender. After all, a secured lender can demand no more payment than the fair market value of its collateral when its borrower is in bankruptcy. A property sale that eliminates the mortgage lender's collateral claim in exchange for

---

211. *Id.* at *8 (holding "this sale does not meet (f)(3) under either view, because the fair market value of the property to be sold exceeds the actual sales price. While meeting the 75% good faith threshold may suffice to gain a sale's approval under § 363(b), it does not stretch to § (f)(3)").

212. *Id.*

213. *Id.*

214. Robert L. Eisenback III, *Will Section 363 "Free and Clear" Sale Orders Survive Appeal? A Recent Appellate Decision Raises New Doubts*, IN THE "RED:" THE BUSINESS BANKRUPTCY BLOG (Aug 18, 2008), http://www.bankruptcy.cooley.com; De Voll, *supra* note 197.

215. *In re* Collins, 180 B.R. 447, 447 (Bankr. E.D. Va. 1997).

216. *In re* Oneida Lake Dev., Inc., 114 B.R. 352, 357 (Bankr. N.D. N.Y. 1990) (adopting the economic value interpretation of *Beker Industries* but noting that "the Court must conclude that the proposed sale price is the best price obtainable under the circumstances"); *see also Collins*, 180 B.R. at 447; *In re* WPRV-TV, 143 B.R. 315, 319–21 (Bankr. D.P.R. 1991); *In re* Terrace Gardens Park P'ship, 96 B.R. 707, 713 (Bankr. W.D. Tex. 1989); *In re* Beker Indus. Corp., 63 B.R. 474, 475–78 (Bankr. S.D.N.Y. 1986); *In re* Hatfield Homes, Inc., 30 B.R. 353, 355 (Bankr. E.D. Pa. 1983).

217. Shishko, *supra* note 198, at 1265–66; De Voll, *supra* note 197, at 171.

payment to the lender of sale proceeds thus not only avoids imposing costs on the lender—it also creates significant benefits. The debtor benefits from avoiding continued financial obligations resulting from involuntary ownership of vacated real property. The bankruptcy system benefits from a better-supported debtor fresh start. And the community benefits from solving the broadly harmful phenomenon of a zombie mortgage in the community. Because a mortgage lender bears no significant economic harm from a sale of collateral that produced cash equal to the asset's value, there is no justifiable reason for a mortgage lender's ability to block the otherwise widely beneficial transaction. There may be less defensible motives behind a lender's refusal to consent to a fair market value sale by less defensible reasons. For example, a lender may desire to retain leverage over the borrower through its "veto-power" with respect to § 363 property sales, or may wish to gamble on future property appreciation while imposing all the interim costs of ownership on the debtor.[218]

C. Creditor Compelled to Accept Monetary Satisfaction

Even in sales that fail to obtain proceeds that are greater than the "value of all liens" on the property (whatever that means), a court can order a sale of property free and clear of all interests if the creditor "could be compelled, in a legal or equitable proceeding, to accept a money satisfaction" of its claim.[219] Subsection (f)(5) applies when there are legal or equitable grounds to force an interest holder to accept money in lieu of the interest. At least one court has indicated that this subsection would apply to wipe out the interest of any secured lender.[220] Secured lenders, unlike holders of other sorts of interests like tenants under a lease or holders of an easement, have an exclusively economic interest in the property. Generally, a lien on property is an interest that can easily be removed through payment. Lenders should be agnostic about having money substituted for a property interest in collateral (or, in theory, should always prefer the money because of its higher level of liquidity).[221] In fact, payment of liens after ordinary course of business sales of collateral under the Uniform Commercial Code and secured loan payment at foreclosure sales

---

218. *See* ELIZABETH WARREN, ET AL., THE LAW OF DEBTORS AND CREDITORS: TEXT, CASES, AND PROBLEMS 711–12 (7th ed. 2014) (explaining that the "Real punch" of the circuit split on defining lien value for purposes of § 363(f)(3) "is how much veto power to accord a credit-bidding secured creditor").

219. 11 U.S.C. § 363(f)(5) (2012); *see In re* Perroncello, 170 B.R. 189, 191 (Bankr. D. Mass. 1994) (explaining that this subsection protects debtor interests even if the face-value approach is used in the context of § 363(f)(3)).

220. *In re* Patriot Place, Ltd., 486 B.R. 773 (Bankr. W.D. Tex. 2013) (explaining that if the interest in the property can be monetized, then it likely falls under § 363(f)(5), and contrasting the interest of a lienholder to the interest of a tenant under a lease); *see also* FERRIELL & JANGER, *supra* note 46, at 288–89 (explaining how the language of § 363(f)(5) "has the potential to permit a sale free and clear in nearly every circumstance"); *In re* WBQ P'ship, 189 B.R. 97, 105 (Bankr. E.D. Va. 1995) (explaining that a lien is an interest, and is always removable upon payment of the liquidated amount represented by the lien).

221. Kuney, *supra* note 169, at 275 ("Secured creditors are little harmed by the fast-track sale approach, arguably even benefitting from it."); George W. Kuney, *Hijacking Chapter 11*, 21 EMORY BANKR. DEV. J. 19, 108–09 (2004).

are perfect examples of proceedings that fall under the rubric of § 363(f)(5).[222] As such, any mortgaged property should in theory be saleable under § 363(f)(5) free and clear of the mortgagee's interest as long as the mortgagee is paid the proceeds of the sale.

Subsection (f)(5) permits a proposed asset sale to proceed free and clear even if the proceeds do not cover all the debts secured by the property.[223] All that is required under this subsection is that a lienholder be legally obligated to accept the lesser payment amount.[224] Consider the example of foreclosure of a senior lien or a tax lien with super-priority status.[225] In such a case, a junior lienholder would have no grounds to maintain its property security interest. It would have to release its lien upon payment of whatever proceeds it was entitled to under the sale (and if the property was under-secured, that would be an amount less than the face value of its lien). Similarly, courts have held that in cases where the interest is a lien, the existence of a *hypothetical* proceeding that would wipe out the lien in exchange for money qualifies the sale for § 363(f)(5) treatment.[226] For this reason, § 363(f)(5) is frequently used to sell property free and clear of liens securing payment obligations.[227]

Some courts create further support for a § 363(f)(5) determination by pointing out that bankruptcy itself creates superior claims on secured property, such as the costs of administrative expenses of the estate and sale. The court in *In re Grand Slam*,[228] for example, explained that because a debt was subordinate in bankruptcy to the payment of the administrative expenses of the estate under § 724(b), the lien securing that debt could be stripped in a sale of the collateral under § 363(f)(5).[229] In a similar vein, some courts analyze whether an interest would satisfy § 363(f)(5) by imagining a hypothetical cramdown confirmation of a plan.[230] If the interest would be removable in exchange for payments under a Chapter 13 plan, which is itself an "equitable proceeding," then a free and clear sale of the asset is permitted under § 363(f)(5).[231] One court explained that if a creditor could be compelled to

---

222. KUNEY, *supra* note 167, at 105; *see also In re* Bos. Generating, LLC, 440 B.R. 302 (Bankr. S.D.N.Y. 2010).

223. *In re* Jolan, Inc., 403 B.R. 866, 869–70 (Bankr. W.D. Wash. 2009).

224. The bankruptcy court in *Jolan* held that a receiver also may sell free and clear of liens and pay secured lenders from the proceeds, even in cases where the proceeds did not cover the debt amount. *Id.* at 869–870. The court reiterated that "the receiver may sell free and clear of even the interests of first lienholders." *Id.* at 870. Some courts have found that property can always be sold free and clear of liens per § 363(f)(5) because a Chapter 7 trustee could sell property free and clear of liens in a liquidation case. *In re* Trans World Airlines, Inc., 322 F.3d 283, 290–91 (3d Cir. 2003).

225. 26 U.S.C. §§ 6335, 6339(c) (2012); *see also Jolan*, 403 B.R. at 870.

226. KUNEY, *supra* note 167, at 106 ("[F]oreclosure of a hypothetical priming tax lien may conceivably satisfy the condition.").

227. *E.g.*, *In re* Oyster Bay Cove, Ltd., 196 B.R. 251, 255 (E.D.N.Y. 1996); *In re* A. Cardi Constr. Co., Inc., 154 B.R. 403, 405 (Bankr. D.R.I. 1993).

228. 178 B.R. 460 (ED Mich 1995).

229. *Id.*; *see also* KUNEY, *supra* note 167, at 106.

230. 11 U.S.C. § 1129(b).

231. KUNEY, *supra* note 167, at 106.

receive money as "the indubitable equivalent" of the claim in the context of a § 1129 cramdown, then permitting a free and clear asset sale pursuant to § 363(f)(5) would likewise be proper.[232] The concept underlying this section is that if monetary satisfaction makes a lender whole (or at least as "whole" as a lender is entitled to be under bankruptcy law), then the sale of its collateral and payment up to the amount of the loan from the sale proceeds is allowed. Applying § 363(f)(5) in this way allows a debtor to obtain a fresh start without any actual reduction of the lender's claim.

As with the other subsections of § 363(f), courts are in disagreement about how best to interpret subsection (f)(5). *In re WK Lang Holdings* held that because a security interest in property can be enforced, through self-help or foreclosure, and because a secured lender can be compelled to accept less than the face value of the loan, a court could order a § 363 asset sale free and clear under subsection (f)(5).[233] The court was untroubled by a sale that would require a lienholder to relinquish its lien in exchange for less than the face value of its loan because the same result would be permissible in a state law foreclosure sale of the property.[234] If a secured lender wished to avoid obtaining a deficiency judgment post-foreclosure sale, the court said, it could choose to credit-bid up to the amount of its claim.[235] The court explained that the secured lender also has the right to credit-bid under § 363(k), and thus loses nothing when a court orders a free and clear sale of its collateral.[236]

Section 363(f)(5) holds great potential with respect to solving the zombie mortgage problem in bankruptcy. A mortgage lender's interests in its collateral are easily monetized and are exclusively financial. It does not appear unfair to force a lender to accept proceeds from a home sale as the "indubitable equivalent" of its lien, especially in cases where a debtor prefers to divest the title and where the value of the collateral is declining from lack of upkeep. This section permits a third-party buyer to take the property free and clear, without the lender having to actually go through the trouble of foreclosing or consenting to a sale, and without needing to consider whether a sale price exceeds the lien value, and thus avoiding all of the valuation problems attendant with that inquiry. If the lien is a junior lien, it seems obvious that subsection (f)(5) allows a forced money-for-real property collateral substitution. But even in the case of senior liens, the existence of hypothetical senior liens or actual administrative expense claims would justify wiping out the lien in exchange for proceeds from a sale to a third party.

---

232. *In re* Hunt Energy Co., 48 B.R. 472, 485 (Bankr. N.D. Ohio 1985) (explaining that a lender can be forced under § 1129(b)(2)(B) to accept a Chapter 11 or 13 repayment plan that provides a stream of payments to a secured lender with a present value equal to the value of the collateral, with the balance of the claim being unsecured).

233. *In re* WK Lang Holdings, No. 13-11934, 2013 WL 6579172, at *8 (Bankr. D. Kan. Dec. 11, 2013).

234. *Id.*

235. *Id.*

236. 11 U.S.C. § 363(k) (2012).

In addition, bankruptcy courts do have the power to overcome the state law rights of mortgage lenders because bankruptcy is a federal proceeding, and the Supremacy Clause allows the Code to trump provisions of state law to the contrary. The Supreme Court has reiterated that "the Bankruptcy Code has reshaped debtor and creditor rights in marked departure from state law," and that it can, and does, rearrange debtor and creditor rights notwithstanding the state law baseline.[237] Therefore, even if state law provides that a lienor need not accept a "short sale" sort of conveyance for less than the stated amount of the lien, bankruptcy law may provide that such party's consent is unnecessary and that being paid the proceeds from a third-party sale sufficiently compensates a secured party who refuses to foreclose.

D. Limits on Mortgagee Credit Bids in § 363 Asset Sales

Regardless of the provisions of § 363(f), secured lenders are typically permitted to credit bid at a sale of their collateral up to the face amount of the loan under § 363(k).[238] This concept supports a secured lender's interest in its collateral. Section 363(k) provides that the holder of a claim against the property being sold under § 363 may likewise bid at the sale and offset the bid against the claim amount, "unless the court for cause orders otherwise."[239] The "for cause" exception to the right to credit bid the face amount of the loan seems quite narrow. And the Supreme Court, in the 2012 case of *RadLAX Gateway Hotel LLC v. Amalgamated Bank*[240] held that a plan must allow a lender to credit bid at a § 363(b) sale.[241]

The lender's right to credit bid at a § 363 sale will not prevent title to property from being transferred, but it can undermine the objective of transferring title to a willing third-party buyer. If the value of the property is indeed lower than the face value of the loan, then a face-value credit bid will be above-market and will be higher than the amount a third party would be willing to pay. An above-market credit bid results in the lender taking title, and although this result is better than having title remain in the abandoning debtor, it is not optimal. Lenders will not occupy REO inventory property, and thus the home could remain vacant and possibly poorly maintained.[242]

Some recent cases have reconsidered whether a secured lender always retains the ability to credit bid the face value of the loan at a § 363 sale or whether the amount of a lender's credit bid can occasionally be limited.[243] A

---

237. Assocs. Commercial Corp. v. Rash, 520 U.S. 953, 954 (1997).
238. *Id.*
239. *Id.*
240. 132 S. Ct. 2065 (2012).
241. *Id.* at 2067.
242. *See supra* note 42, 80–83.
243. Deutsch & Distefano, *supra* note 161; *see In re* Pac. Lumber Co., 584 F.3d 229 (5th Cir. 2009); *In re* Phila. Newspapers, LLC, 599 F.3d 298 (3d Cir. 2010). These cases addressed the question in the context of a § 1129 reorganization plan.

2014 Delaware bankruptcy case, *In re Fisker Automotive Holdings*,[244] held that a lender's credit bid could be capped at fair market value "for cause."[245] The court in *Fisker* recognized that the *RadLAX* decision requires that a lender be allowed to credit bid, but asserted that there was still an open question as to whether the credit bid could be capped below the amount of the loan.[246] For example, the court cited several cases in which the bank's right to credit bid was limited based on the lender's bad faith and other considerations.[247] The court in *Fisker* asserted that it had the right to credit bid "to ensure the success of the reorganization or to foster a competitive bidding environment."[248]

Fisker opens the door for greater judicial limitations on credit bidding in the future for a variety of reasons.[249] This judicial authority to cap a credit bid "for cause" presents the intriguing possibility that a court could limit a lender's credit bid based on things like its foreclosure delay or the broader public policies and debtor and community need to have title to a vacant home vest in an attentive caretaker owner. Limiting the amount of a lender's credit bid in a § 363 sale should be an exceptional result, however, because it possibly unfairly impacts the valuation of the collateral and thus the lender's secured interest.

VI. CONCLUSION

For the past few years, commentators and legislators have been seeking the best way to address the individual, community, and systemic problem of foreclosure limbo. Living under the shadow of a zombie mortgage and the lingering liabilities associated with abandoned but un-foreclosed homes is devastating for homeowners, particularly for homeowners who have already gone through a bankruptcy in an attempt to achieve a fresh start. Zombie mortgages can undermine the success of a bankruptcy proceeding and threaten the very purposes of the bankruptcy system. And zombie mortgages cause wider societal harm as well. Housing stock inexcusably depreciates when homes lack caretakers, and un-foreclosed, vacant homes harm community

---

244. 510 B.R. 55 (Bankr. D. Del. 2014).

245. *Id.* at 59.

246. *Id.*

247. *Id.* at 59–60 (citing *In re* Aloha Airlines, No. 08–00337, 2009 WL 1371950, at *8 (Bankr. D. Haw. May 14, 2009) (determining that "cause exists to deny the credit bid" under § 363(k))); Greenblatt v. Steinberg, 339 B.R. 458, 463 (N.D. Ill. 2006) (holding the "bankruptcy court did not err in refusing to allow [a secured creditor] to credit bid"); *In re* Antaeus Technical Servs., Inc., 345 B.R. 556, 565 (Bankr. W.D. Va. 2005) (denying the right to credit bid to facilitate a "fully competitive" cash auction); *In re* Theroux, 169 B.R. 498, 499 n.3 (Bankr. D.R.I. 1994) (noting that "there is no absolute entitlement to credit bid").

248. *Id.* at 60 (citing 3 COLLIER ON BANKRUPTCY 363.09[1] ("[T]he Court might [deny credit bidding] if permitting the lienholder to bid would chill the bidding process.")).

249. Paul V. Shalhoub & Daniel I. Forman, *Fisker Automotive Puts the Brakes on Distressed Investors' Right to Credit Bid*, 131 BANKING L.J. 354, 359 (2014); *see also In re* The Free Lance-Star Publ'g Co. of Fredericksburg, VA, 512 B.R. 798, 806 (Bankr. E.D. Va. 2014) *appeal denied sub nom.* DSP Acquisition, LLC v. Free Lance-Star Pub. Co. of Fredericksburg, VA, 512 B.R. 808 (Bankr. E.D. Va. 2014). *But see* Riley Orloff, *Chapter 11 Asset Sales: Will There Be A Chilling Effect on Section 363(K) Credit Bidding After In Re Fisker Automotive Holdings LLC?*, 20 FORDHAM J. CORP. & FIN. L. 269, 290 (2014) (opining that *Fisker* will likely be an outlier in § 363(k) jurisprudence).

safety, local property values, and municipal tax revenues.[250] Furthermore, the costs of zombie mortgages fall unevenly on the most vulnerable segments of society.[251] Public policy dictates another outcome.

It is constitutionally, practically, and politically difficult to force a lender to take title involuntarily, and merely incentivizing foreclosure of vacant properties has been only marginally effective.[252] In the absence of a statute or contract imposing affirmative maintenance obligations on lenders with respect to abandoned homes, lenders can continue to strategically (or incompetently) delay foreclosure and avoid incurring a property's carrying costs.[253]

Section 363(f) of the Bankruptcy Code provides an effective way to kill off a zombie mortgage through a free and clear sale of a vacant home. A § 363 asset sale puts abandoned property back into the stream of commerce and helps adjust property prices to market realities. Selling the property at auction installs a solvent and attentive owner as property caretaker and frees the debtor from the burdensome costs and risks of ownership. Finding a willing owner through a § 363 asset sale avoids the sticky questions raised by forced lender title transfer and recognizes that a lender is poorly suited to be forced into a real property ownership role. Solving the zombie mortgage problem in bankruptcy also avoids the spillover costs that vacant properties impose on neighborhoods and municipalities.

Applying § 363(f) of the Code to allow a debtor to sell a vacated home, free and clear of all mortgages, is not only a logical and reasonable application of the law, it is good policy. A free and clear sale of an abandoned home solves the zombie mortgage problem and ensures that a debtor can start again fresh, unhampered by ownership costs with respect to the abandoned realty. Section 363(f) sales can finally terminate a zombie mortgage that otherwise would continue to afflict the property, the debtor, and the broader community. Ordering a home sale free and clear of a zombie mortgage is thus an effective and justifiable way to ensure that the bankruptcy system lives up to its private—and public—promise and potential.

250. *See supra* notes 36–39 and accompanying text.
251. *See supra* notes 41–44 and accompanying text.
252. *See supra* Section IV.A.
253. *See supra* notes 79–91 and accompanying text.