UNITED STATES BANKRUPTCY COURT
For the Southern District of Iowa

In the Matter of JOHN DEAN FLANERY VIRGINIA K. FLANERY,	:	Case No. 83-228-C H
Debtors.	:	Adv. No. 87-0248
JOHN DEAN FLANERY VIRGINIA K. FLANERY,	:	Chapter 7
Plaintiffs,	:	
vs.	:	
GUTHRIE COUNTY STATE BANK, FIRST NATIONAL BANK OF OMAHA, AND THE UNITED STATES OF AMERICA FOR AND ON BEHALF OF THE FARMERS HOME ADMINISTRATION,	:	
Defendants.	:	

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ORDER--MOTIONS TO DISMISS, MOTIONS FOR SUMMARY JUDGMENT, AND TRIAL ON COMPLAINT TO DETERMINE THE VALIDITY, PRIORITY AND EXTENT OF LIENS

On June 1, 1988, hearings were held on Defendants' motions to dismiss and alternative motions for summary judgment, and a trial was held on the complaint to determine the validity, priority and extent of liens on Debtors' property. The following attorneys appeared on behalf of their respective clients: James L. Spellman for Debtors; F. L. Burnette, II, for Defendants, Guthrie County State Bank and First National State Bank of Omaha, (hereinafter "Banks"); and Kevin R. Query, Assistant U.S. Attorney, for Defendant, United States of America

for and on behalf of the Farmers Home Administration (hereinafter "FmHA"). At the conclusion of said hearings and trial, the Court took the matters under advisement upon a briefing deadline of June 30, 1988. All parties have submitted briefs, and the Court considers the matter fully submitted.

This is a core proceeding pursuant to 28 U.S.C. §157(b)(2)(K). The Court, upon review of the pleadings, evidence admitted, arguments of counsel, and briefs submitted, now enters its findings and conclusions pursuant to F.R. Bankr. P. 7052.

FINDINGS OF FACT

1. On February 18, 1983, Debtors filed for relief under Chapter 11 of the Bankruptcy Code. During the following 20 months, Debtors attempted to reorganize their farming operation, but on October 25, 1984, they voluntarily converted the case to a Chapter 7 liquidation.

2. At the time the original bankruptcy petition was filed, Debtors owned 5 tracts. These tracts total 560 acres.

3. FmHA holds mortgages on all 5 tracts. Banks are loan participants sharing a mortgage which is junior to that of FmHA.

4. Debtors offered appraisals, testimony and other evidence at the time of trial that the fair market value of the 5 tracts at or about the time of trial was as follows:

Tract 1	160 acres	$33,600.00
Tract 2	160 acres	68,000.00
Tract 3	40 acres	15,000.00
Tract 4	120 acres	64,000.00
Tract 5	80 acres	90,750.00
Total	560 acres	$271,350.00

5. FmHA offered evidence at the time of trial that the fair market value of the 5 tracts at or about the time of trial was as follows:

Tract 1	$ 52,000.00
Tract 2	102,400.00
Tract 3	13,000.00
Tract 4	73,440.00
Tract 5	74,187.00
	$315,027.00

6. On December 28, 1984, the Trustee abandoned said real estate to Debtors.

7. On March 5, 1985, Debtors received their discharge.

8. On March 22, 1985, Debtors filed a 43-page pro se complaint in the United States District Court for the Southern District of Iowa, alleging many violations of law by the Guthrie County State Bank, and praying for avoidance of all mortgages, liens, judgments, and security interest, recoupment of all interest and finance charges, and actual and punitive damages. On October 21, 1985, this action was dismissed.

9. On April 3, 1986, Debtors filed an action in the Iowa District Court for Guthrie County against Banks and

officers of the Guthrie County State Bank. This petition alleged essentially the same allegations as those dismissed in the action filed in the Federal Court. On July 31, 1986, this action was dismissed by order of the Iowa District Court.

10. Shortly thereafter, Debtors filed a notice of appeal of this order. On December 15, 1986, the appeal was dismissed by the Supreme Court of Iowa for failure to prosecute the appeal. Debtors' application for reinstatement of the appeal was denied on January 15, 1987.

11. On November 20, 1987, Debtors filed this adversary proceeding.

12. In said complaint, Debtors allege FmHA holds a first mortgage on the five tracts to secure a claim of $300,000.00, plus interest. The complaint also alleges Banks hold a second mortgage to secure a claim of approximately $380,000.00. Debtors further allege the value of their real estate is less than the amount of money claimed by FmHA and pray that the Court determine the validity and extent of the value of Defendants' interest in the real estate, if any, avoid any lien on said real estate of each Defendant to the extent it secures a claim against Debtors that is not an allowed secured claim, and determine the maturity, amount, and method of repayment by Debtors on any secured portion of the claims.

13. Defendants responded by filing their respective answers in which they allege the Court does not have jurisdiction to grant the relief requested in their prayer for relief. Defendants also filed their respective motions to dismiss, and alternative motions for summary judgment, alleging the Court has no jurisdiction to award the requested relief since the real estate was abandoned and Debtors have been discharged.

DISCUSSION

The issue in this case is whether a Chapter 7 debtor can use §506(d) to avoid a mortgage lien on the debtor's abandoned real estate to the extent it exceeds the value of the property.

> Section 506(d) provides:
>
> To the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void unless--
>
> (1) such claim was disallowed only under section 502(b)(5) or 502(e) ...or
>
> (2) such claim is not an allowed secured claim due only to the failure of any entity file a proof of such claim under section 501....

11 U.S.C. §506(d). This provision must be read in conjunction with §506(a) which states:

> An allowed claim of a creditor secured by a lien on property in which the estate has an interest...is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property...and is an

> unsecured claim to the extent that the value of such creditor's interest...is less than the amount of such allowed claim. Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest.

11 U.S.C. §506(a).

Many courts have addressed an identical or similar issue to the one presented in the case at bar and a split of authority exists. The leading case allowing a Chapter 7 debtor to avoid mortgage liens under §506(d) is In re Tanner, 14 B.R. 933 (Bankr. W.D. Pa. 1981). The Tanner court listed three reasons for concluding §506(d) could be used to avoid real property mortgage liens: 1) the plain meaning of §506; 2) the overall scheme of the Bankruptcy Code and the relevant legislative history; and 3) the fresh start policy of the Code.

Cases following the Tanner rationale in allowing §506(d) lien avoidance include: Matter of Vigne, 18 B.R. 946 (Bankr. W.D. Pa. 1982); Brace v. State Farm Mut. Ins., 33 B.R. 91 (Bankr. S.D. Ohio 1983); In re Gibbs, 44 B.R. 475 (Bankr. N.D. Ill. 1984); In re Lyons, 46 B.R. 604 (Bankr. N.D. Ill. 1985); In re Cleveringa, 52 B.R. 56 (Bankr. N.D. Iowa 1985); In re Lindsey, 64 B.R. 19 (Bankr. C.D. Ill. 1986), aff'd 823 F.2d 189 (7th Cir. 1987); In re O'Leary, 75 B.R. 881 (Bankr. D. Or. 1987); In re Crouch, 76 B.R. 91

(Bankr. W.D. Va. 1987); In re Garnett, 88 B.R. 123 (Bankr. W.D. Ky. 1988).

The leading case not allowing a Chapter 7 debtor to avoid mortgage liens under §506(d) is In re Mahaner, 34 B.R. 308 (Bankr. W.D. N.Y. 1983). The Mahaner court listed three reasons for concluding §506(d) could not be used to avoid real property mortgage liens: 1) it would render meaningless the redemption provisions of §722; 2) it would permit a debtor to receive more in Chapter 7 than in Chapters 11 and 13, contrary to Congress' policy of encouraging rehabilitation over liquidation; and 3) it would amount to an unconstitutional taking because it deprives the creditor's right to enjoy any appreciation in the value of the property.

Many other bankruptcy courts have reached the Mahaner conclusion including: In re Cordes, 37 B.R. 582 (Bankr. C.D. Ca. 1984); In re Sloan, 56 B.R. 726 (Bankr. D. Colo. 1986); In re Maitland, 61 B.R. 130 (Bankr. E.D. Va. 1986); In re Gaglia, 76 B.R. 82 (Bankr. W.D. Pa. 1987); In re Smith, 79 B.R. 650 (Bankr. D. Md. 1987); In re Dewsnup, 87 B.R. 676 (Bankr. D. Utah 1988); Matter of Hoyt, ____ B.R. ____ (S.D. Iowa 1988).

Upon review of both lines of reasoning, the Court concludes the Mahaner reasoning not allowing Chapter 7 lien avoidance under §506(d) is more persuasive than the Tanner approach of allowing §506(d) lien avoidance. The Court

completely agrees with the three grounds set out in Mahaner. Permitting lien avoidance under §506(d) would render §722 totally surplus. In addition, it is not good policy to permit a debtor to get in Chapter 7 more than he or she could in Chapters 11 or 13. Further, §506(d) lien avoidance amounts to an unconstitutional taking. Pursuant to Iowa Code §615.1 (1987), a mortgagee has two years after judgment in which to commence a foreclosure action. The mortgagee can wait during this period to determine if the property will appreciate and then bid for the property at foreclosure. Thus, a creditor's lien has value and the right to a foreclosure sale is not an empty legal right.

The Court also agrees with the Dewsnup court's response to the "fresh start" policy concerns of the Tanner court:

> The approach suggested by the Court does not impede the debtor's fresh start. They can give up their interest in the property and obtain the fresh start. Moreover, any deficiency claim is clearly within the scope of the debtor's discharge. However, in this case the debtors are attempting to get more than a fresh start. The debtors want to keep their property and be entitled to the future appreciation in the value of the real property without paying the full amount of the obligation secured by the lien. That is something to which they would not be entitled at a forced sale of the property. Absent abandonment, it is also something they would not be entitled to in a bankruptcy proceeding. Pursuant to §551, any interest or value arising out of an avoidance under §506(d) would be preserved for the benefit of the estate and creditors with claims against it.

Dewsnup, 87 B.R. at 683. In the case at bar, Debtors' construction of §506 would not only afford a fresh start but also a gigantic push. This the Court refuses to do.

In addition to those grounds, many courts have extended the Mahaner outcome by ruling that a Chapter 7 debtor cannot use §506(d) to avoid liens against abandoned property. Hoyt, ____ B.R. at ____; Dewsnup, 87 B.R. at 681-83; Gaglia, 76 B.R. at 84; Maitland, 61 B.R. at 134. The reasoning in all four cases centers on the scope of §506(a). As an example, the Maitland court found that §506 is not operative in cases where the estate has no interest in the property:

> Section 506(a) does not contemplate determining the extent to which a claim is allowed for lien avoidance purposes under §506(d) if the property has been abandoned. If the property is not to be administered as an asset of the estate for liquidation, or for retention by the debtor-in-possession in a Chapter 11 reorganization or a Chapter 13 wage-earner plan, then determination as to the extent a claim is an allowed secured claim serves no statutory purpose, other than as specifically provided under §722.

Maitland, 61 B.R. at 134 (emphasis added); see In re Harvey, 3 B.R. 608, 609 (Bankr. M.D. Fla. 1980) ("[§506] was intended to deal with properties of the estate which are being administered under the Code and not to deal with properties which were released as exempt or abandoned."). According to the Maitland

court, the purpose of §506(d) is to facilitate the sale of collateral by a trustee or debtor-in-possession. Id. at 134.

A final reason for not allowing a Chapter 7 debtor to use §506(d) is found in Gaglia where the court pointed out that if a Chapter 7 debtor could use §506(d), then §362(d)(2) would be written out of the Code. Gaglia, 76 B.R. at 84. That would occur because upon a creditor's §362(d)(2) motion, a Chapter 7 debtor could set up a §506 lien avoidance defense, strip the mortgage down and redeem the real property at either market value or reduced payments, even though the creditor could have shown an absolute right to relief under §362(d).

In the case at bar, the Trustee abandoned the property in question nearly three years before Debtors filed their pending §506 complaint. Thus, under reasoning most recently explained by Chief Judge Jackwig in Hoyt, the Court holds Debtors are precluded from using §506(d) to avoid mortgage liens. Assuming arguendo the property was not abandoned, Debtors would still not prevail because the Court holds a Chapter 7 debtor cannot avoid mortgage liens under §506(d). As a result, Debtors' complaint must be dismissed for failure to state a cause of action.

CONCLUSION AND ORDER

WHEREFORE, based on the foregoing analysis, the Court concludes Debtors are precluded from using §506(d) to avoid

their mortgage liens.

IT IS ACCORDINGLY ORDERED that Debtors' complaint is dismissed for failure to state a cause of action.

Dated this 23rd day of December, 1988.

RUSSELL J. HILL
U.S. BANKRUPTCY JUDGE