THE 11TH CIRCUIT'S MCNEAL RULING DIRECTLY CHALLENGES THE SUPREME COURT'S HOLDING IN *DEWSNUP*—DESPITE CLAIMS TO THE CONTRARY

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The Eleventh Circuit wins the Alexander Graham Bell prize for most inventive interpretation of the Supreme Court's decision in *Dewsnup v. Timm*, 502 U.S. 410, 112 S.Ct. 773 (1992) for its recent decision in *In re McNeal*, case No 11-11352, 2012 WL 1649853 (11th Cir. 2012).

Bell famously stated, "When one door closes, another opens; but we often look so long and so regretfully upon the closed door that we do not see the one which has opened for us." While the majority of courts consider *Dewsnup* as having closed the door on both stripping down partially secured liens and stripping off wholly unsecured liens in Chapter 7 bankruptcy cases, the Eleventh Circuit claims to have discovered a crack in the otherwise sealed door by constructing its opinion around a 23-year-old case, which has been widely overruled or called into doubt by every other case that has bothered to cite it, and is based upon a 1978 version of the Bankruptcy Code—a version of the Code that made no distinction between the terms allowed and secured for purposes of §506(d). See *Folendore v. United States Small Bus. Admin*., 862 F.2d 1537 (11th Cir. 1989).

In *Dewsnup*, the Supreme Court held that §506(d) did not allow a Chapter 7 debtor to "strip down" a creditor's lien on real property to the judicially determined value of the collateral because a creditor's claim was secured by a lien that was allowable pursuant to §502. *Dewsnup* at 417. The Court also reiterated the longstanding principle that a creditor's lien on real property passes through bankruptcy unaffected and stays with real property until the foreclosure. See *Johnson v. Home State Bank*, 501 U.S. 78, 84, 111 S.Ct. 2150, 2154 (1991). ("Rather, a bankruptcy discharge extinguishes only one mode of enforcing a claim—namely, an action against the debtor in personam—while leaving intact another—namely, an action against the debtor in rem.") Although the Eleventh Circuit in *McNeal* acknowledged the Supreme Court's holding that *Dewsnup* precluded a Chapter 7 debtor from "stripping off" a wholly unsecured junior lien, it nonetheless held that Dewnsup was not on point. Instead, the Eleventh Circuit held that *Folendore* controlled within the context of "stripping down" liens stating that "an allowed claim that was wholly unsecured . . . was voidable under the plain language of section 506(d)."

How, you might ask, did the Eleventh Circuit stray so far from a Supreme Court decision? The Court decided that the holding in *Dewsnup* was a narrow ruling (despite all evidence to the contrary) and therefore determined that it was obligated to follow the "prior panel precedent rule." See *Atlantic Sounding Co., Inc. v. Townsend*, 496 F.3d 1282 (11th Cir. 2007). In Townsend, the Court held that "a later panel may depart from an earlier panel's decision only when the intervening Supreme Court decision is 'clearly on point,'" adding that "we are not at liberty to disregard binding case law that is so closely on point and has been only weakened rather than directly overruled, by the Supreme Court" (Townsend at 1284). As such, the Eleventh Circuit reasoned that since *Dewsnup* prohibited only a strip down of a partially secured mortgage lien, but failed to specifically address a strip off of a wholly unsecured lien, so the case was distinguishable and the Eleventh Circuit could follow *Folendore*. While it's true that *Folendore* is set in the context of a lien avoidance adversary, the main issue of the case was whether §506(d) required debtors to make a request that the claim be disallowed under §502. In the Eleventh Circuit's 1989 opinion, the Court found that a request that the claim be disallowed under §502 was necessary, but held that it could construe the *Folendore's* complaint liberally to request the disallowance of the claim under §502, and only then could the claim be disallowed. Although the claim in question happened to be a wholly unsecured lien, as was the case in *McNeal, Folendore* seems a far cry from "clearly on point."

Every other court that has addressed the issue has agreed that Dewsnup precluded the outcome in *McNeal*. The Fourth, Sixth, and Ninth Circuit BAP have all held that *Dewsnup* applies equally to both strip downs of partially secured liens and strip offs of wholly unsecured liens. See *Ryan v. Homecomings Fin*. Network, 253 F.3d 778 (4th Cir. 2001); *Talbert v. City Mortgage Servs*., 344 F.3d 555 (6th Cir. 2003); *In re Laskin*, 222 B.R. 872 (B.A.P. 9th Cir. 1998). This uniformity among other jurisdictions exists because there is simply no distinction between strip downs and strip offs within §506(d)'s operative phrase "allowed secured claim," especially since the same statutory language in §506(a) is held to create no such distinction. Rather, the only valid distinction between strip offs and strip downs is in the context of the anti-modification statute found at §1322(b)(2), *In re Cook*, 449 B.R. 664 (D.N.J. Jun 06, 2011). By recognizing a distinction that does not really exist in the statute, the *McNeal* opinion flies directly in the face of the Supreme Court's holding in *Dewnsup*.

It is interesting to note that in order to make the *McNeal* opinion work, the Eleventh Circuit ignored the three primary reasons the Supreme Court cited in support of its *Dewnsup* ruling. In *Dewnsup*, the Supreme Court reasoned that allowing strip downs would essentially "freeze" the creditor's secured interest at the time of valuation, thus depriving the creditor of any subsequent increase in value and creating a potential windfall for the debtor. Second, the Court reasoned that permitting a debtor to strip down a lien undermines the consensual bargain between debtor and creditor. Finally, the Court observed that, historically, the principle has been that liens pass through bankruptcy. It observed that this principle was recognized as early as the Bankruptcy Act of 1898 and then subsequently in many of the Court's previous decisions, thus it was unlikely Congress intended to depart from it in §506(d), *Dewsnup*, 502 U.S. at 418 (internal citations omitted). The Eleventh Circuit's failure to recognize and apply this reasoning in *McNeal* is conspicuous. If it had, it's holding that *Dewnsup* "merely weakened" the *Folendore* ruling would have very, very difficult to reach.

One thing is certain, though. For the time being, the *McNeal* holding will drastically alter the way creditors' rights firms handle and litigate cases within the Eleventh Circuit's jurisdiction. Anyone who qualifies to file a Chapter 7 case may now strip off a wholly unsecured lien in a fraction of the time required to do the same in a Chapter 13 case. On the other hand, the time and money creditors expend valuing property and enforcing their rights will greatly increase in Chapter 7 cases. At the time of this writing, *McNeal* remains an unpublished opinion, and as such it is not considered binding precedent. However, *McNeal* may be cited as persuasive authority, 11th Cir. R. 36-2.