

PRESENTED AT

35<sup>th</sup> Annual Jay L. Westbrook Bankruptcy Conference

November 17-18, 2016

Austin, Texas

**Underwater Homeowner to Uncooperative  
Mortgage Lender: Take My Home, Please!  
Does Dirt for Debt Work in Chapter 13?**

**Eugene R. Wedoff**

# Bankruptcy Law Letter

SEPTEMBER 2016 | VOLUME 36 | ISSUE 9

## Underwater Homeowner to Uncooperative Mortgage Lender: Take My Home, Please! Does Dirt for Debt Work in Chapter 13?

*Eugene R. Wedoff*

Consider this situation: A couple with only moderate income has had to relocate, and the mortgage on their vacated home is underwater, with a balance greater than the home's value. The homeowners can't sell the home unless their mortgage lender agrees, and the mortgage lender won't agree to a sale and chooses not to foreclose the mortgage. So the homeowners still have the obligation to make mortgage payments on the vacated home—and insure it, and maintain it, and pay its property taxes, and (if it's a condo) pay their homeowners' assessments—but now they also have whatever costs are incurred in their new living space. They don't have enough income to cover all of these expenses. A bankruptcy could help them by discharging their personal liability for the mortgage payments, but could it also remove the other obligations of ownership? Specifically, can a bankruptcy filing require their lender to assume the ownership obligations by taking the home in payment of its secured claim?

This method of treating a secured claim, known colloquially as making the creditor take "dirt for debt," is recognized in Chapter 11 cases, but the cost of proceeding in that chapter makes it impractical for most homeowners. For most homeowners, the dirt for debt option would only be viable in Chapter 13. Its availability under that chapter, though, is debatable, with a set of conflicting decisions on the question,<sup>1</sup> and at least two cases now pending at the circuit level.<sup>2</sup>

This *Law Letter* takes a closer look at dirt for debt in Chapter 13, first outlining the settled law in Chapter 7 and 11 and then examining the arguments made in the Chapter 13 decisions.<sup>3</sup> The conclusion is that Chapter 13 does offer the same dirt-for-debt option that Chapter 11 does.

### Paying Claims with Estate Property Outside of Chapter 13

#### *Chapter 7*

In Chapter 7 there is no provision for payment of claims other

### IN THIS ISSUE:

<b>Underwater Homeowner to Uncooperative Mortgage Lender: Take My Home, Please! Does Dirt for Debt Work in Chapter 13?</b>	<b>1</b>
Paying Claims with Estate Property Outside of Chapter 13	1
Chapter 7	1
Chapter 11	2
Paying Claims with Estate Property in Chapter 13	3
Surrender of estate property—the definition of "surrender"	4
Surrender of estate property—the impact of the Pratt decision	4
Surrender of estate property—other considerations	5
The alternative approach: paying secured claims with estate property	6
Approving payment of secured claims with estate property—Kerwin	6
Rejecting payment of secured claims with estate property—Lemming	7



than in cash. The trustee's duty under Code § 704(a)(1) is to "reduce to money" the property of the debtor's estate and then, under § 726, to pay creditors in the specified priority from the liquidated estate.<sup>4</sup> To reduce the estate property to money, of course, the trustee often has to sell the property, including property subject to liens, but underwater property will probably be sold only with the mortgage holder's consent.<sup>5</sup> Most important for underwater homeowners, the trustee is given no authority to transfer property to a lienholder rather than selling it. The almost universal treatment of underwater property in Chapter 7, then, is abandonment by the trustee under Code § 554(c), leaving the debtor as the owner of the property,<sup>6</sup> with

personal liability for whatever ownership expenses are not discharged.<sup>7</sup> So Chapter 7 offers only limited relief to a debtor holding underwater property—and certainly does not offer a live possibility of requiring the mortgage holder to take dirt for debt.

### Chapter 11

The situation in Chapter 11 is different. Code § 1123, titled "Contents of plan," sets out, in subsection (a), a number of provisions that a plan must include for dealing with creditor claims and, in subsection (b), a number of optional provisions. Among the mandatory provisions, § 1123(a)(5) requires that each Chapter 11 plan "provide adequate means for the plan's implementation," and in a list of possible means for implementation, it includes subparagraph (D): "sale of all or any part of the property of the estate, either subject to or free of any lien, or the distribution of all or any part of the property of the estate among those having an interest in such property of the estate."<sup>8</sup> *In re Sandy Ridge Dev. Corp.*, the leading case on dirt-for-debt plans in Chapter 11, the Fifth Circuit reads subparagraph (D) as plainly allowing such plans.<sup>9</sup> It points out that the subparagraph makes a sale of estate assets, as would take place in Chapter 7, only the first of two alternatives—emphasizing the word "or"—with the second alternative being a direct "distribution" of estate property to secured creditors. *Sandy Ridge* concludes, then, that "a plan may include a 'give-back' to creditors."<sup>10</sup>

*Sandy Ridge* also recognizes the major limitation on dirt-for-debt plans in Chapter 11. In addition to § 1123, governing the content of a plan, § 1129 sets out requirements for plan confirmation. If the holders of secured claims do not accept the plan, § 1129(b)(1) requires that the plan treat their claims fairly and equitably. Requirements for fair and equitable treatment are in turn set out in § 1129(b)(2). For secured claims, under § 1129(b)(2)(A), that treatment must include satisfaction of the claims in one of three ways: (i) cash payments with the debtor retaining the collateral subject to the creditors' liens, (ii) sale of the collateral with liens to attach to the proceeds, or (iii) "the realization by such holders of the indubitable equivalent of such claims."<sup>11</sup> Since dirt-for-debt

---

EDITOR IN CHIEF: Ralph Brubaker, Carl L. Vacketta Professor, University of Illinois College of Law

CONTRIBUTING EDITORS: Bruce A. Markell, Professor of Bankruptcy Law and Practice, Northwestern University School of Law  
Kara Bruce, Associate Professor, University of Toledo College of Law  
Ben H. Logan, Lecturer in Law, University of California at Los Angeles School of Law, Affiliate Lecturer in Law, University of Washington School of Law  
Eugene R. Wedoff, U.S. Bankruptcy Judge, Northern District of Illinois (retired)

PUBLISHER: Jean E. Maess, J.D.

MANAGING EDITOR: Clay Mattson, J.D.

©2016 Thomson Reuters. All rights reserved.

This publication was created to provide you with accurate and authoritative information concerning the subject matter covered; however, this publication was not necessarily prepared by persons licensed to practice law in a particular jurisdiction. The publisher is not engaged in rendering legal or other professional advice and this publication is not a substitute for the advice of an attorney. If you require legal or other expert advice, you should seek the services of a competent attorney or other professional.

For authorization to photocopy, please contact the **West's Copyright Clearance Center** at 222 Rosewood Drive, Danvers, MA 01923, USA (978) 750-8400; fax (978) 646-8600 or **West's Copyright Services** at 610 Opperman Drive, Eagan, MN 55123, fax (651) 687-7551. Please outline the specific material involved, the number of copies you wish to distribute and the purpose or format of the use.

**BANKRUPTCY LAW LETTER** (USPS 674-930) (ISSN 0744-7871) is issued monthly, 12 times per year; published by Thomson Reuters, 610 Opperman Drive, P.O. Box 64526, St. Paul, MN 55164-0526. Periodicals postage paid at St. Paul, MN, and additional mailing

**Subscription Price:** For subscription information call (800) 221-9428, or write West, Credit Order Processing, 620 Opperman Drive, P.O. Box 64833, St. Paul, MN 55164-9754.

**POSTMASTER:** Send address changes to: *Bankruptcy Law Letter*, 610 Opperman Drive, P.O. Box 64526, St. Paul, MN 55164-0526.

Also available as part of the eCourse

[2016 Bankruptcy eConference](#)

First appeared as part of the conference materials for the  
35<sup>th</sup> Annual Jay L. Westbrook Bankruptcy Conference session  
"The Early Innings: Vesting and Surrendering Real Property"