Judge Neil P. Olack
United States Bankruptcy Judge
Date Signed: September 26, 2016

The Order of the Court is set forth below. The docket reflects the date entered.

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF MISSISSIPPI

IN RE:

SARAH L. COOKS,	**CASE NO. 16-11562-NPO**
DEBTOR.	**CHAPTER 13**

ORDER DENYING CONFIRMATION OF PLAN

This matter came before the Court for hearing on August 25, 2016 (the "Hearing"), on the Chapter 13 Plan (the "Plan") (Dkt. 5) and the proposed Order (the "Proposed Order") (Dkt. 16) filed by the debtor, Sarah L. Cooks (the "Debtor"), in the above-styled chapter 13 bankruptcy case (the "Bankruptcy Case"). At the Hearing, Chris F. Powell ("Powell") represented the Debtor and Adam Sanford appeared on behalf of Locke D. Barkley, the chapter 13 trustee. After fully considering the matter, the Court finds as follows:

Jurisdiction

The Court has jurisdiction over the parties to and the subject matter of the Bankruptcy Case pursuant to 28 U.S.C. § 1334. This is a core proceeding pursuant to 28 U.S.C. 157(b)(2)(L).

Facts

1. The Debtor filed a voluntary petition for relief pursuant to chapter 13 of the Bankruptcy Code on May 4, 2016 (Dkt. 1).

2. The Schedule A/B: Property ("Schedule A") (Dkt. 1 at 10) indicated that the Debtor owns a single-family home at 815 Shamrock Drive, Cleveland, MS 38732-0000 (the "Homestead"), which has a value of $75,000.00. (Schedule A at 1). On Schedule C: The Property You Claim as Exempt (Dkt. 1 at 17), the Debtor claimed that the Homestead is exempt pursuant to MISS. CODE ANN. § 85-3-21.

3. The Debtor filed the Plan on May 5, 2016. In the Plan, the Debtor listed Midland Funding ("Midland") as a secured creditor holding a judgment lien against the Debtor in the amount of $3,226.42 (the "Judgment Lien"). (Plan at 2). The Debtor proposed to pay Midland the amount owed at a 5.00% rate of interest. (*Id.*). The Debtor proposed to pay nothing to unsecured creditors through the Plan. (*Id.*).

4. "Wells Fargo Bank, N.A., as Trustee for Lake Country Mortgage Loan Trust 2006-HE1, by Ditech Financial LLC, as Servicer with delegated authority for the trustee" ("Ditech") filed a proof of claim (the "POC") (Bankr. Cl. No. 10-1) on August 30, 2016, indicating that it has claim of $15,723.42 for "Money Loaned." (POC at 2). According to the POC, Ditech holds a lien on the Homestead, which is secured by a "Deed of Trust Mortg Note" (the "Mortgage") (*Id.*).

5. At the Hearing, Powell stated that the Debtor desires to satisfy the Judgment Lien by paying Midland in full because she wants the certainty it would give her. According to Powell, the Debtor has equity in the Homestead and wants to avoid having a judgment lien on the Homestead's title. According to John Cox ("Cox"), an attorney who regularly conducts title work and testified on behalf of the Debtor, if the Debtor decided to sell her home in the future, the

"partially avoided" Judgment Lien would appear on the title. (Hr'g at 10:14:41).[1] Cox testified that if the Judgment Lien appears on the title as "partially avoided," the person conducting a title search would need to investigate into the value of the Homestead and the amount of the homestead exemption because the Judgment Lien would only be avoided "to the extent of the Debtor's exemption . . . ." (Hr'g at 10:15:40). Cox stated that if the Debtor pays the Judgment Lien in full, it would not appear on a title search and would not adversely affect her ability to sell the home.

Discussion

Pursuant to § 105(a),[2] no provision of the Bankruptcy Code prevents bankruptcy courts from *sua sponte* "taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process." 11 U.S.C. § 105(a). Notwithstanding the absence of an objection to plan confirmation, the Court has the authority, and even the obligation, to deny confirmation of any proposed plan that does not conform to the requirements of the Bankruptcy Code. *United Student Aid Funds, Inc. v. Espinosa,* 559 U.S. 260, 276 (2010). Accordingly, the Court may determine whether the Plan unfairly discriminates against unsecured creditors, even though no unsecured creditor has objected or appeared in this matter.

Section 1325 governs the confirmation of a plan, but in order for a chapter 13 plan to be confirmed, it must comply with all provisions of chapter 13, not just the criteria prescribed by § 1325(a). *See* 11 U.S.C. § 1325(a)(1). Accordingly, if the Plan fails to comply with

[1] The Hearing was not transcribed. Citations are to the time stamp of the audio recording.

[2] All code sections refer to the Bankruptcy Code found in title 11 of the U.S. Code unless specified otherwise.

§ 1322(b)(1), which prohibits unfair discrimination against unsecured creditors, the Court will not confirm the Plan. Thus, the Court must determine whether allowing the Debtor to pay the Judgment Lien in full would result in unfair discrimination. First, the Court must consider whether the Judgment Lien should be treated as an unsecured debt, which requires a determination of whether the Judgment Lien could have been avoided by the Debtor.

I. Judgment Lien can be avoided

Judgment liens are created only when a judgment is enrolled pursuant to MISS. CODE ANN. § 11-7-191. Under this statute, a judgment lien is created as follows:

> **Enrolled judgment as lien.** A judgment so enrolled shall be a lien upon and bind all of the property of the defendant within the county where so enrolled, from the rendition thereof, and shall have priority according to the order of such enrollment, in favor of the judgment creditor, his representatives or assigns, against the judgment debtor and all persons claiming the property under him after rendition of the judgment. A judgment shall not be a lien on any property of the defendant thereto unless the same be enrolled. . . .

MISS. CODE ANN. § 11-7-191. Further, pursuant to MISS. CODE ANN. § 11-7-197:

> Judgment and decrees…shall not be a lien upon or bind the property of the defendant within the county in which such judgments or decrees may be rendered, until an abstract thereof shall be filed in the office of the clerk of the circuit court of the county and enrolled on the judgment roll, ...

MISS. CODE ANN. § 11-7-197. Accordingly, under Mississippi law, a judgment does not become a lien on property until the judgment is enrolled. Further, a "judgment shall take effect as to third parties and have priority only from the time of its enrollment." *Herrington v. Heidelberg,* 141 So. 2d 717, 720 (Miss. 1962). Because the Debtor refers to the Judgment Lien as a "judgment lien," the Court will presume that Midland has enrolled its judgment in accordance with MISS. CODE ANN. § 11-7-191. The Plan proposed to pay the Judgment Lien in full while paying nothing to unsecured creditors. In order to determine whether the Plan should be confirmed, the Court must

first determine whether the Debtor could have avoided the Judgment Lien, and, if so, whether the Judgment Lien would have become an unsecured debt after avoidance.

A. Avoidance Actions under § 522(f)

Section 522(f) was enacted by the Bankruptcy Reform Act of 1978, and has been in effect since that time. 4 COLLIER ON BANKRUPTCY ¶ 522.11[1] (16th ed. 2016). It allows "a debtor to wipe out the interest that a creditor has in particular property if the debtor's interest in that property would be exempt but for the existence of the creditor's lien or interest." *Id.* Despite Powell's arguments at the Hearing, and Cox's supporting testimony, if the Judgment Lien is fully avoided, it will be cleared from the Homestead's title.

Pursuant to § 522(f), a debtor "may avoid the fixing of a lien on an interest of the debtor in property to the extent that such lien impairs an exemption to which the debtor would have been entitled" but for the creditor's lien or interest. 11 U.S.C. § 522(f). The debtor may only use the avoiding power provided by § 522(f) "to the extent that the lien impairs the debtor's exemption." Section 522(f) was enacted by the Bankruptcy Reform Act of 1978, and has been in effect since that time. 4 COLLIER ON BANKRUPTCY ¶ 522.11[1]. Only certain types of liens are subject to the debtor's avoiding power under § 522(f), including "judicial liens on otherwise exempt property . . . under section 522(f)(1)(A)." *Id.*

Federal Rule of Bankruptcy Procedure 4003(d) governs § 522(f) lien avoidance and, "unlike other lien avoiding power actions, which are brought as adversary proceedings pursuant to Rule 7001, a proceeding to avoid a lien under section 522(f) is brought as a motion subject to Rule 9014 governing contested matters." *Id.* Determining whether a judgment lien can be avoided is a two-step process: (1) the property must be exempt under § 522(b); and (2) the lien must be

avoidable under § 522(f). *In re Evans,* 548 B.R. 449, 451 (Bankr. N.D. Miss. 2016). Applying these elements, the Court will determine whether the judgment lien may be avoided.

1. Property is exempt.

Pursuant to § 541, when a debtor files for bankruptcy relief, most of his or her assets become property of his or her bankruptcy estate. 11 U.S.C. § 541. A debtor may subsequently remove certain property from his or her bankruptcy estate by claiming that property as exempt. 11 U.S.C. § 522; *Schwab v. Reilly,* 560 U.S. 770, 774 (2010). "Exemptions allow a debtor to maintain a minimal standard of living 'so that the debtor is not a ward of society after the bankruptcy.'" *In re Evans,* 548 B.R. at 452 (citation omitted). Pursuant to Federal Rules of Bankruptcy Procedure 4003(a) and 1007, a debtor must file a list of property he or she is claiming as exempt, and the property is subsequently considered exempt unless a party in interest objects. 11 U.S.C. § 522(1). Although § 522(d) lists types of property that a debtor may claim as exempt under federal law, states may opt-out of the federal exemption scheme and require the debtor to utilize state law exemptions. 12 COLLIER ON BANKRUPTCY INTRO.02[2] (16th ed. 2016). Mississippi has "opted out" of the federal exemptions scheme. MISS. CODE ANN. § 85-3-1. "Thus, Mississippi debtors are permitted to exempt property only under state law, or federal law other than § 522." *In re Lush,* 544 B.R. 575, 585 (Bankr. N.D. Miss. 2015) (citing 12-MS COLLIER ON BANKRUPTCY MS.syn. (16th ed. 2013)).

Mississippi's homestead exemption provides that a citizen who owns a house "shall be entitled to hold exempt from seizure or sale, under execution or attachment, the land and buildings owned and occupied as a residence by him, or her . . . the value thereof, inclusive of improvements, save as hereinafter provided, [not to exceed] the sum of Seventy-five Thousand Dollars

($ 75,000.00) . . . ." MISS. CODE ANN. § 85-3-21. The Debtor indicated on Schedule A that the value of the Homestead is $75,000.00, the maximum amount she is allowed to claim as exempt under MISS. CODE ANN. § 85-3-21. According to the POC, however, the Homestead is encumbered by the $15,723.42 Mortgage. (POC at 2). The Debtor, therefore, has $59,276.58 of equity in the Homestead,[3] assuming that the Judgment Lien is avoided. Accordingly, the Debtor is permitted to exempt her homestead up to the amount of $59, 276.58.

2. Lien is avoidable.

Pursuant to § 522(f), a debtor "may avoid the fixing of a lien on an interest of the debtor in property to the extent that such lien impairs an exemption to which the debtor would have been entitled" but for the creditor's lien or interest. 11 U.S.C. § 522(f). Because lien avoidance is governed by the Bankruptcy Code, "even where a state, such as Mississippi, has opted-out of the federal exemptions, the federal law still controls lien avoidance." *In re Evans,* 548 B.R. at 453 (citing 11 U.S.C. § 522(f)). In *Owen v. Owen,* 500 U.S. 305 (1991) (superseded by statute on other grounds), the United States Supreme Court addressed the impairment requirement for avoidance under § 522(f). The debtor's former spouse in *Owen* obtained a $160,000.00 judgment against him, but the debtor did not own property at the time the judgment was recorded. *Id.* at 307. He subsequently acquired property, and the judgment lien attached to the property. *Id.* When he filed for bankruptcy, the debtor claimed a homestead exemption on the property and sought to avoid the judgment lien pursuant to § 522(f). *Id.* The Supreme Court held that in determining whether the judgment lien could be avoided under § 522(f), courts should consider "whether [the lien] impairs an exemption to which [the debtor] *would have been entitled* but for the

[3] $75,000.00 – $15,723.42 = $59,276.58.

lien itself." *Id.* at 310-11. "[Section] 522(f) [establishes the baseline] against which impairment is to be measured, not an exemption to which the debtor '*is* entitled,' but one to which he '*would have been entitled* . . . . '" *Id.* at 311. In order to determine whether the Judgment Lien was avoidable, therefore, the Court must determine whether it impairs the Debtor's homestead exemption.

When Congress enacted the 1994 bankruptcy amendments, it added a definition for "impairment" in § 522(f)(2), which provides "a mathematical formula for the courts to apply to determine whether a lien impairs the debtor's exemption." 4 COLLIER ON BANKRUPTCY ¶ 522.11[3]. Under § 522(f)(2), a lien "impair[s] an exemption to the extent that the sum of all liens on the property, including the lien under consideration, together with the value that the debtor could claim as exempt in the absence of liens on the property, exceed the value of the debtor's interest in the property if it were totally encumbered." *Id.* Using this formula, it is clear that the Judgment Lien impairs the Debtor's homestead exemption. Under § 522(f)(2), the Judgment Lien impairs the Debtor's homestead exemption if the sum of: (1) the Judgment Lien; (2) all other liens on the property; and (3) the amount of the exemption the Debtor could claim in the absence of any liens on the property, exceeds the value the Debtor would have in the Homestead in the absence of any liens. 11 U.S.C. § 522(f)(i)-(iii). The Judgment Lien is in the amount of $3,226.42, the only other lien on the property, the Mortgage, is in the amount of $15,723.42, and the homestead exemption in Mississippi is $75,000.00. The sum of the figures provided by § 522(f)(i)-(iii), therefore, is $93,949.84.[4] On Schedule A, the Debtor listed the value of the Homestead at $75,000.00. Because the sum of the Judgment Lien, the Mortgage, and the value of

[4] $75,000.00 + $3,226.42 + $15,723.42 = $93,949.84.

the Mississippi homestead exemption exceeds the value of the interest the Debtor would have in the Homestead if there were no liens, the Judgment Lien impairs the Debtor's homestead exemption.

Even if the formulaic test provided by § 522(f)(2) were not satisfied, however, the Judgment Lien impairs the Debtor's homestead exemption under the "practical" test advocated by the bankruptcy court in *In re Anderson*, 496 B.R. 812, 817 (Bankr. E.D. La. 2013). The bankruptcy court in *In re Anderson* found that, in practical terms, "[t]he term impair means 'to weaken, to make worse, to lessen in power, diminish, or relax, otherwise affect in an injurious manner.'" *Id.* (quoting *Henderson v. Belknap* (*In re Henderson*), 18 F.3d 1305, 1310-11 (5th Cir. 1994)). At the Hearing, the Debtor's witness, Cox, testified that if the Judgment Lien remains on the Debtor's title, it would affect the Debtor's ability to sell the Homestead in the future. Likewise, Powell argued at the Hearing that if the Debtor's title is marked with the Judgment Lien, it would affect her ability to sell the house and would reduce the benefit she receives from owning the Homestead. The Court finds that this testimony and argument from the Hearing evidence the impairment that the Judgment Lien places on the Homestead. Accordingly, under both the formulaic test outlined by § 522(f)(2), and the "practical" test utilized by the bankruptcy court in *In re Anderson,* it is apparent that the Judgment Lien impairs the Debtor's homestead exemption.

B. Avoided liens are unsecured claims.

The Fifth Circuit noted in *In re Maddox* that "§ 522(f) converts the creditor's status from secured to unsecured, thereby changing the amount due that creditor." *Tower Loan of Miss., Inc. v. Maddox (In re Maddox),* 15 F.3d 1347, 1352 (5th Cir. 1994). The Fifth Circuit went on to explain that the amount due to the formally secured, now unsecured creditor substantially changes

because "of the interplay between § 522 and § 1325." *Id.* at 1352 n.33. "Under § 1325 that creditor, as a secured creditor with 'an allowed secured claim,' . . . is entitled to receive the present value of his collateral." *Id.* But if the lien is avoided, "this creditor drops to unsecured status with two consequences: He is now only entitled to receive what an unsecured creditor 'would have received' in a chapter 7 liquidation, and, since the lien may only be avoided on property exempt under § 522(b)-which by definition means that that property has been removed from 'property of the estate'-what that unsecured creditor (indeed, any unsecured creditor) 'would have received' on *that* property is nothing under Chapter 7." *Id.* However, because the creditor is unsecured, the Fifth Circuit noted that it would still be entitled to receive a pro-rata share of the payments made by the debtor for that class of creditors. *Id.*

Had the Debtor avoided the Judicial Lien, which, as previously discussed, she was entitled to do, Midland would have become an unsecured creditor. Having determined that the Judgment Lien could have been avoided under § 522(f), which would have made Midland an unsecured creditor, the Court will next determine whether the Plan unfairly discriminates against the Debtor's unsecured creditors.

II. Unfair Discrimination

Instead of avoiding the Judgment Lien and treating it as unsecured claim in order to eradicate the impairment on the Homestead, the Debtor proposed to treat it as fully secured and pay the Judgment Lien in full to accomplish the same result. Section 1322(b)(1) allows a plan to designate a class or classes of unsecured claims as long as it does not unfairly discriminate against one of those classes. 11 U.S.C. § 1322(b)(1). Courts have not reached a consensus regarding the definition of "unfair discrimination," which "leaves much to the discretion of the bankruptcy

court." Keith M. Lundin & William H. Brown, Chapter 13 BANKRUPTCY, 4TH EDITION, §149.1, at ¶ 4, SEC. REV. June 2, 2004, www.Ch13online.com. What does constitute unfair discrimination, however, "normally refers either to the order of distribution or the percentage to be paid to the particular class." 8 COLLIER ON BANKRUPTCY ¶ 1322.05 (16th ed. 2016). "Unless there is some valid justification for paying one class of claims more than another, such discrimination is considered unfair." *Id.*

In regard to the preferential treatment of co-signed debt, the Fifth Circuit has held that "[d]ifferences in treatment are not discriminatory if they rationally further a legitimate interest of the debtor and do not disproportionately benefit the co-signor, e.g. by reimbursing interest where none is due or reimbursing more than the actual amount of the co-signed debt." *Chacon v. Bracher (In re Chacon)* 202 F.3d 725, 726 (5th Cir. 1999). In *Ramirez v. Bracher (In re Ramirez)*, 204 F.3d 595 (5th Cir. 2000), the debtor submitted a plan that proposed to pay co-signed debt in full at a 12.00% rate of interest before any distributions were made to the general, unsecured creditors. Citing *In re Chacon,* the Fifth Circuit held that absent justification for applying such "a high and preferential interest rate," the plan could not be confirmed because it unfairly discriminated against the general, unsecured creditors. *Id.* at 596.

Clearly, the Plan proposes to treat its general unsecured creditors less favorably than Midland. As the Court previously discussed, Midland should be an unsecured creditor because the Debtor should have avoided the Judgment Lien. Instead, the Debtor proposed to pay Midland the full value of its claim, $3,226.42, while proposing to pay nothing to her other general unsecured creditors. (Plan at 2). The Debtor evidently has $3,226.42 available since she proposed to pay the Judgment Lien in full. Because she believes it would be more beneficial, she

desires to treat Midland as fully secured, despite the fact that she could avoid the Judgment Lien and treat Midland as an unsecured creditor. The Court finds that the Debtor should not be allowed to circumvent the Bankruptcy Code by choosing to pay Midland $3,226.42 instead of using that money to fund the Plan. Instead, the Debtor must avail herself of the legal remedies provided by the Bankruptcy Code: exempt the Homestead, avoid the Judgment Lien, and pay Midland a pro-rata portion of $3,226.42 along with her other general unsecured creditors, and, after the plan payments are complete, the unsecured debt of Midland will be discharged along with her other unsecured debts.

The Debtor's proposed treatment of Midland in the Plan would constitute unfair discrimination. Therefore, she must amend the Plan to treat Midland consistently with her treatment of other unsecured creditors. Accordingly, because the Debtor proposed to pay unsecured creditors nothing in the Plan, she must use the $3,226.42 to distribute to unsecured creditors on a pro-rata basis, or, if she still desires to pay $3,226.42 to Midland, she must also pay her unsecured creditors in full.

Conclusion

Powell stated that the Debtor desired to pay the Judgment Lien in full in order to give her "more certainty." Increased certainty, however, is not a remedy provided by the Bankruptcy Code. The Mississippi homestead exemption and lien avoidance under § 522(f) are the remedies provided by the Bankruptcy Code. To prevent the Judgment Lien from impairing her equity in the Homestead, the Debtor may avoid the Judgment Lien because it is impairing her homestead exemption. Further, because the Debtor would be able to exempt the full amount of her equity in the Homestead if the Judgment Lien did not exist, the Judgment Lien can be fully avoided.

Despite Cox's testimony at the Hearing, if the Debtor fully avoided the Judgment Lien, Midland's interest in the Homestead would be extinguished, and the only remaining lien on the property would be the Mortgage.

The Court finds that a plan cannot be confirmed when it proposes to pay an avoidable judgment lien in full while unfairly discriminating against other unsecured creditors. The Debtor could avoid the Judgment Lien and treat Midland as an unsecured creditor, but she has instead attempted to circumvent those provisions of the Bankruptcy Code and treat Midland as fully secured while unfairly discriminating against her other unsecured creditors. Accordingly, the Plan cannot be confirmed, and the Court declines to enter the Proposed Order. In order to have a plan confirmed, the Debtor must distribute her available funds of $3,226.42 to her unsecured creditors, including Midland, on a pro-rata basis through the Plan, or pay all of her unsecured creditors in full.

IT IS, THEREFORE, ORDERED that the Plan is hereby not confirmed.

IT IS FURTHER ORDERED that the Debtor shall have fourteen (14) days from the date of this Order in which to submit an amended plan consistent with this Order.

##END OF ORDER##