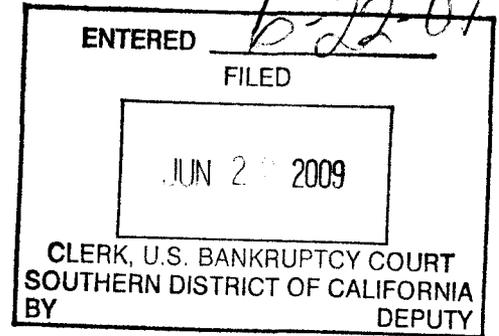


1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

WRITTEN DECISION - NOT FOR PUBLICATION



UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF CALIFORNIA

In re:)
Rocky L. Rudolph and Hilda S. Rudolph) BK. No. 08-09952-LA13
Debtors.) MEMORANDUM DECISION

Debtors, Rocky L. Rudolph and Hilda S. Rudolph (collectively, "Debtors"), filed a Motion for Valuation of Debtors' Residential Real Property and Avoidance of Junior Trust Deed Held by First Security Mortgage (the "Lien Strip Motion"). Debtors allege in the Lien Strip Motion that the value of their residence is less than the total amount owed to the first and second trust deed holders and request that this Court confirm this valuation pursuant to Fed. R. Bankr. P. 3012. As a result, they also seek to strip the trust deed ("Third Trust Deed") held by Wayne Gafford ("Creditor") as beneficiary by assignment from Southern California Mortgage dba First Security Mortgage ("First Security") under 11 U.S.C. § 1322(b)(2).¹

¹ Hereinafter references to code sections refer to Title 11 of the United States Code, also referred to as the "Bankruptcy Code" unless otherwise specified. References to Rule refer to the

1 Creditor disputes Debtors' valuation. Creditor also challenges the validity and amount
2 of the claim asserted by Mr. Rudolph's mother, Margaret Rudolph ("M. Rudolph"), and
3 allegedly secured by a deed of trust (the "Second Trust Deed") senior to the Third Trust
4 Deed. Thus, Creditor asserts that he holds an undersecured rather than unsecured claim and
5 argues that, as a result, Debtors cannot strip or otherwise modify his trust deed.

6 The Court held an evidentiary hearing on May 5, 2009 (the "Evidentiary Hearing").
7 At that time, the Court heard testimony from valuation experts and also heard testimony
8 from Rocky Rudolph, M. Rudolph, and Paul Rios, a representative of First Security. The
9 Court has carefully reviewed the documentary evidence, the written valuation reports, and
10 the testimony of witnesses at the Evidentiary Hearing. The Court now renders its decision.

11
12 **Facts.**

13 1. Debtors filed a voluntary chapter 13 petition on October 7, 2008 (the "Petition
14 Date").

15 2. Their Schedule A filed on October 22, 2008 values their single family home
16 located at 610 Calle Ricardo, Escondido, California (the "Residence") at \$370,000.00.
17 There is no dispute that the Residence is Debtors' principal residence within the meaning of
18 section 1322(b)(2).

19 3. Debtors' Schedules also list:

- 20 a. a claim (the "Senior Secured Claim") secured by a first trust deed
21 against the Residence and in the amount of \$288,519.51;
22 b. the claim of M. Rudolph secured by the Second Trust Deed against the
23 Residence and in the amount of \$141,646.40; and
24 c. a claim of First Security secured by the Third Trust Deed against the
25 Residence and in the amount of \$141,520.00.

26
27 _____
28 Federal Rules of Bankruptcy Procedure, unless otherwise indicated.

1 4. Debtors also filed a chapter 13 plan (the "Plan") on October 22, 2008. The
2 Plan provides for monthly payments of \$630.00 and payment of the greater of 4% or a pro-
3 rata share of \$6,655.70 to unsecured creditors. In addition, at paragraph 19, the Plan
4 provides that: "Debtors request the court to value their principal residence at \$370,000
5 which results in First Security Mortgage, holder of a 3rd deed of trust on debtors' residence,
6 with a wholly unsecured claim and avoidable pursuant to 11 U.S.C. 1322 [sic] and
7 11 U.S.C. 506(a)(2) [sic]. This plan proposes to treat First Security Mortgage's claim on the
8 3rd deed of trust as wholly unsecured. Debtors will serve First Security Mortgage, the
9 holder of the 3rd deed of trust, with notice of a motion to value collateral and strip lien with
10 the required supporting documentation and copy of this plan."

11 5. Consistent with the Plan, on November 4, 2008, the Debtors filed the Lien
12 Strip Motion and set this matter for hearing on December 9, 2008.

13 6. Debtors initially supported the Lien Strip Motion with the Declaration of
14 Mr. Rudolph wherein he opined as an owner that the value of the Residence was
15 \$370,000.00.

16 7. Creditor filed an opposition to the Lien Strip Motion (the "Opposition") on
17 November 24, 2008. The Opposition argues, based on a broker's price opinion dated
18 November 19, 2008, that the probable final value of the Residence is \$425,000.00. The
19 Opposition also challenged the validity and amount of the M. Rudolph claim and argued,
20 among other things, that any claim filed by M. Rudolph could not include interest accrual
21 because the alleged loan "is due only if debtors 'sell or refinance' the property." (Opposition,
22 4:19) As a result of Creditor's valuation estimate and position regarding the Second Trust
23 Deed, the Opposition asks the Court to conclude that Creditor's lien is not wholly unsecured
24 and to deny the Lien Strip Motion.

25 8. The Debtors filed a response to the Opposition (the "Response") on
26 December 4, 2008 together with a Declaration of Appraiser Laurie Lutton. Ms. Lutton
27 valued the Residence as of November 22, 2008 at \$365,000.00 and attached a complete
28 appraisal report (the "Lutton Appraisal") to her declaration. Debtors also requested and the

1 Court allowed additional time to provide further evidence as to the validity of the Second
2 Trust Deed.

3 9. On December 10, 2008, M. Rudolph filed a proof of claim in the total amount
4 of \$104,294.74, and, on December 22, 2008, Debtors filed a supplemental response that
5 included a declaration of M. Rudolph.

6 10. On January 13, 2009, the Court scheduled an evidentiary hearing for
7 March 25, 2009 in order to resolve the valuation issues and to determine the validity and
8 amount of M. Rudolph's claim. The Court also issued a scheduling order for the filing and
9 exchange of briefs, declarations and appraisals, witness lists, and proposed exhibits.
10 Pursuant to this schedule, Creditor filed the Declaration of Craig Brock, his valuation
11 expert. Mr. Brock valued the Residence at \$395,000 and attached a copy of a Residential
12 Appraisal Field Review Report outlining his analysis to his declaration.

13 11. The Court subsequently continued the Evidentiary Hearing to May 5, 2009.

14 **Legal Background.**

15 The Bankruptcy Code expressly provides that a chapter 13 plan may "modify the
16 rights of holders of secured claims, other than a claim secured only by a security interest in
17 real property that is the debtor's principal residence, . . ." 11 U.S.C. § 1322(b)(2). In
18 *Nobelman v. American Savings Bank*, 508 U.S. 324 (1993), the Supreme Court confirmed
19 that a section 1322(b)(2) modification of a claim secured by a debtor's primary residence is
20 not available when a section 506(a) valuation establishes that a lender's claim is partially
21 secured. After *Nobelman*, however, the Ninth Circuit Court of Appeals, along with the
22 majority of other circuit courts, held that the anti-modification protection of
23 section 1322(b)(2) does not prohibit modification of the rights of a creditor holding a lien on
24 a debtor's primary residence where senior liens exceed the value of the residence such that
25 the junior creditor is wholly unsecured². *Zimmer v. PSB Lending Corp. (In re Zimmer)*,
26 313 F.3d 1220 (9th Cir. 2002).

27
28 ² Such modification is commonly referred to as "lien stripping."

1 In this case, Debtors seek to modify the rights held by Creditor pursuant to
2 section 1322(b) and request that the Court determine the secured status of Creditor's claim
3 pursuant to section 506(a). Section 506(a) provides that such "value shall be determined in
4 light of the purpose of the valuation and of the proposed disposition or use of such property,
5 and in conjunction with any hearing on such disposition or use or on a plan affecting such
6 creditor's interest." In this case, Debtors intend to retain the Residence, to avoid Creditor's
7 lien entirely, and to pay Creditor's claim under their chapter 13 plan as a wholly unsecured
8 claim (*i.e.* Creditor to receive a pro rata share of \$6,655.70.) To accomplish this goal, the
9 value of the Residence cannot exceed the amount owed to the holders of liens against the
10 Residence that are senior to Creditor's lien.

11 Here, both valuation experts valued the Residence as of November 22, 2008 (the
12 "Valuation Date"). At the conclusion of the Evidentiary Hearing, Creditor's counsel
13 questioned this date of valuation suggesting that the Court should value the Residence as of
14 the Petition Date. Given the evidence of market decline previously provided by Debtors'
15 valuation expert, Creditor likely intended to assert that the Court, thus, could assume a
16 Petition Date value higher than the Valuation Date value. Ultimately, however, the parties
17 stipulated to November 22, 2008 as the appropriate date for valuation, and the Court
18 conducted its analysis as requested by the parties.

19 The case law as to the appropriate date for valuation in connection with a lien strip
20 motion is divided with some courts utilizing the petition date and other courts choosing
21 other dates such as the confirmation date. Given the agreement of the parties, however, and
22 given that the Valuation Date is only approximately 45 days after the Petition Date, the
23 Valuation Date is an acceptable date for valuation purposes.

24 The selection of the Valuation Date, however, does present an additional challenge
25 for the Court as the evidence of the amount of senior debt is as of the Petition Date.
26 Notwithstanding, the Court can reach a final decision. For purposes of this analysis, the
27 Court can assume either that Petition Date debt calculations can be utilized or that the
28 Debtors are making payments on the Senior Secured Claim. As there is no evidence that

1 this claim is not regularly amortizing, the Court can assume that it is not increasing. The
2 evidence establishes that the M. Rudolph claim does not require regular post-petition
3 payments. Thus, the Court assumes that it increased during the period between the Petition
4 Date and the Valuation Date. The evidence available to the Court, however, allows the
5 Court to calculate this increase.

6 **Discussion.**

7 In this case, the Court first must determine whether the M. Rudolph claim is valid, in
8 the amount of \$104,294.74 as of the Petition Date, and secured by a lien senior to Creditor's
9 Third Trust Deed. If the Court determines that M. Rudolph's claim is valid at the above
10 referenced amount and secured by a senior lien, then the Court must determine the value of
11 the Residence as Creditor remains a partially secured creditor at the value reached by its
12 valuation expert. If the Court adopts the Creditor's suggested value, the Court must finally
13 verify that Creditor remains partially secured as of the Valuation Date notwithstanding
14 interest accrual on the M. Rudolph claim or adopt the Petition Date as the appropriate date
15 for calculating senior secured debt.

16 **1. M. Rudolph Holds a Valid Claim Secured by a Senior Lien.**

17 Prior to trial, Creditor challenged M. Rudolph's claim arguing, in the alternative, that
18 it should be disregarded as a sham or that it should be allowed only as to principal. At the
19 Evidentiary Hearing, Creditor emphasized the alleged inappropriateness of allowing interest
20 accrual on the M. Rudolph claim and, in particular, argued in closing that it would be unfair
21 to do so in that M. Rudolph did not actually intend collection of interest. The Court having
22 considered all evidence and argument determines that, as of the Petition Date, M. Rudolph
23 held a valid claim in the amount of \$104,294.74 and that this claim is secured by the Second
24 Trust Deed.

25 First, the evidence establishes that M. Rudolph advanced the principal amounts
26 allegedly owed by Debtors. Mr. Rudolph and M. Rudolph both testified that M. Rudolph
27 made a series of loans to her son over a period of time that allowed him to purchase the
28

1 Residence, to become current on the amounts owed in the connection therewith, and/or to
2 otherwise meet his obligations.

3 Second, the evidence supports the validity of the note and note terms that form the
4 basis for M. Rudolph's calculation of the principal and interest amount owed by Debtors.
5 The evidence establishes that M. Rudolph initially made undocumented loans to Debtors
6 but eventually determined that these loans should be formally documented. As a result, in
7 2004, the Debtors executed and delivered a note and deed of trust.³ The deed of trust was
8 properly recorded on March 16, 2004.

9 Creditor asserts that this documentation does not reflect the true intent of M. Rudolph
10 and the Debtors. Initially, Creditor supports his theory by questioning M. Rudolph's failure
11 to enforce her note at its stated maturity date in 2005. M. Rudolph and Mr. Rudolph both
12 testified in response that prior to maturity it was clear that Debtors were unable to repay the
13 note at maturity and that, as a result, M. Rudolph agreed to extend the maturity date and to
14 require payment in full at the time of a refinance or sale of the Residence. Given the family
15 relationship, and having assessed the candor of the witnesses, the Court determines that this
16 testimony accurately evidences the current status of the M. Rudolph loans and adequately
17 counters Creditor's argument.

18 Creditor also supports his argument that this loan is illusory by questioning
19 M. Rudolph regarding partial refinances that occurred after the date of the oral loan
20 modification. The Court finds M. Rudolph's explanation convincing. In short, the loan
21 proceeds were not sufficient to pay off the obligation and the proceeds were otherwise
22 necessary to protect and preserve the Residence and/or to meet other family needs of
23 Mr. Rudolph.

24 The Court finds that M. Rudolph adequately explained her willingness to wait for
25 repayment. She stated that she believes the loans to be a good investment and that the
26

27 ³ The note is actually payable to the Harris Living Trust dated April 10, 1997 a family trust of
28 which M. Rudolph is a Trustee. The Court inquired regarding this possible inconsistency, but is
satisfied that M. Rudolph's testimony regarding the loans was not inconsistent with fact and simply
lacked precise differentiation between amounts advanced personally and amounts advanced through

1 Residence is a nice piece of property. Clearly, she believes that ultimately she will receive
2 payment in full. Given her age, M. Rudolph also has made accommodations in her estate
3 plan to reduce Mr. Rudolph's inheritance by the amounts Debtors owe to her so that a failure
4 to repay the loans prior to her death does not negatively impact the inheritance of her other
5 children. Thus, the Court concludes that the evidence regarding anticipated repayment
6 effectively refutes Creditor's argument that M. Rudolph does not require repayment.⁴

7 Creditor also asserts that even if the M. Rudolph loans are valid as to principal that
8 interest is not properly payable. This argument is not supported by any evidence; the
9 M. Rudolph note includes an interest provision.

10 Finally, Creditor suggests that M. Rudolph was duplicitous in communications with
11 First Security regarding the amount owed on her loan and her interest rate intentions and
12 that these actions support an elimination or reduction in the amount that she properly can
13 claim as senior to Creditor's claim. The Court, however, finds no evidence to support this
14 assertion. First, there is no evidence that Creditor or First Security ever asked M. Rudolph
15 for a payoff balance or inquired regarding interest. Mr. Rios' testimony confirmed that the
16 communications with M. Rudolph were designed to determine whether her loan was in
17 default – a question that M. Rudolph answered accurately given the oral loan modification.
18 Mr. Rios' testimony indicates that he clearly understood the nature of M. Rudolph's loans
19 and understood that she did not require regular payments.

20 Thus, the Court determines that M. Rudolph held a valid claim in the amount of
21 \$104,294.74 as of the Petition Date.

22 **2. The Creditor's Assertions as to Value Are Better Supported by the**
23 **Evidence.**

24 In this case, the Debtors' expert values the Residence at \$365,000, while the
25 Creditor's expert values the Residence at \$395,000. The Debtors suggested in closing

26 _____
27 her family trust.

28 ⁴ The Court acknowledges that the estate planning referenced above likely occurred as a result
of questions raised at M. Rudolph's deposition. Having observed M. Rudolph's testimony, however,
the Court concludes that this modification was motivated by a genuine desire to do fairness to Mr.

1 argument that the Court should resolve this difference by simply splitting the difference
2 between the two valuations. While the Court does have discretion to utilize a number
3 different from that selected by either of the appraisers, the Court after considering the
4 evidence in this case determines that it would be inappropriate to do so. First, the Court
5 acknowledges its lack of expertise as an appraiser. Second, the Court acknowledges that it
6 lacks the information necessary for precise and objective adjustments to the expert analysis
7 contained in the underlying valuation reports. Here, the appraisers took entirely different
8 approaches as to the appropriate comparables and as to the appropriate adjustments to value
9 necessary to derive value. As a result, the Court rejects the suggestion that it arbitrarily split
10 the difference and, as a result, engages in the task of analyzing the valuations to determine
11 which is more credible.

12 To aid in this endeavor, the Court focused on those factors typically utilized by other
13 courts such as the appraisers' methodologies, the quality of the appraisal report, their
14 testimony on direct and cross examination, and the appraisers' respective ability to
15 substantiate the basis for the valuation. The relative experience of the appraisers was
16 relevant. After careful consideration of the evidence, the Court concludes that the Creditor's
17 opinion of value is the more credible.

18 **a. Mr. Brock Provided a Coherent Framework for Valuing the**
19 **Residence.**

20 Mr. Brock provided testimony outlining the factors that buyers consider when
21 moving into the Residence's market area that well supports his valuation analysis. He
22 testified, in short, that buyers are looking for view, privacy, and lot size. The Court finds
23 this testimony compelling and concludes that the Residence which offers a panoramic view
24 on over two and a half acres with a private driveway well meets these buyer needs.⁵
25 Ms. Lutton provided no contrary evidence in this regard, and her testimony suffered from
26 the lack of such a market driven approach to valuation.

27
28 Rudolph's siblings rather than a nefarious attempt to better support an illusory claim for repayment.
⁵ He also pointed out that this property is adjacent to the amenities of Escondido while

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

b. Mr. Brock Provided Superior Comparables and Value

Adjustments.

Despite the small difference in value, the parties utilized not a single common comparable. In reviewing the comparables, the Court determines that those used by Ms. Lutton were less appropriate. First, she utilized properties that had significantly less acreage in two cases. The Residence sits on over two and a half acres, while two of the comparables utilized by Ms. Lutton were located on less than half an acre. And the comparable closest in acreage to the Residence was located approximately eight miles away. Mr. Brock persuasively testified that this comparable was too far away to be appropriately considered. And Ms. Lutton's own testimony provided support for this conclusion. The Court finds Mr. Brock's testimony that acreage is important to buyers in the Residence's market area to be compelling and concludes that Ms. Lutton did not appropriately consider acreage when selecting her comparables.

The Court also concludes that Ms. Lutton underestimated the value of the view from the Residence as compared with her comparables. Pictures of her comparables show homes that lack panoramic views. The Court did not find her testimony that these views were "comparable" to the view from the Residence to be persuasive. In her testimony, she appeared to struggle as she attempted to square the photographic evidence with the uncontroverted testimony that the Residence enjoys a desirable view.

The Court also disregards her suggestion that Mr. Brock's adjustments on account of view were too high. Given her complete failure to adjust for view in her own valuation analysis, her criticism lacks credibility. Ms. Lutton's errors in this regard are significant given Mr. Brock's persuasive testimony that buyers in this market strongly desire view properties. Mr. Brock described the Residence view as panoramic with mountains on all sides and a view down to the city of Escondido. Mr. Rudolph acknowledged a panoramic view from one side of his property, but noted that it was blocked by foliage on the other side. The Court understands this to be an acknowledgement that with landscaping a

providing the privacy and view desired by buyers in this community.

1 panoramic view is possible. Thus, the testimony strongly supports the Court's conclusion
2 that the Residence has a view that would be highly desirable to buyers and that Ms. Lutton
3 failed to take this factor into appropriate consideration.

4 In contrast, Mr. Brock's analysis utilized comparables that were geographically closer
5 to the subject, more similar in size of lot, and carefully adjusted on account of comparable
6 view. Ms. Lutton suggested that one comparable should be disregarded as a result of the
7 fact that the home was a "manufactured home." The Court disagrees. Mr. Brock made an
8 appropriate adjustment to indicate the superior quality of the Residence. Further,
9 Ms. Lutton suggested that she better selected comparables in terms of sale dates. The Court
10 determines, however, that the range of sale dates utilized by Mr. Brock was not
11 unreasonable. Thus, the Court determines that Mr. Brock's analysis is superior and, as a
12 result, values the Residence at \$395,000 as of the Valuation Date.

13 **c. The Court is Unable to Conclude That Mr. Rudolph's Evidence**
14 **Regarding Need for Repair Negatively Impacts the Valuation Testimony Otherwise**
15 **Given.**

16 At the Evidentiary Hearing, Mr. Rudolph testified that the Residence requires
17 approximately \$20,000 in repairs as a result of a leak and resulting wood rot. The Court
18 ultimately determines that this testimony does not require a deviation from either of the
19 expert opinions regarding value. First, both appraisers reviewed the Residence interior and
20 both agreed that the condition of the Residence was good. Thus, while the Court does not
21 disbelieve Mr. Rudolph, the conditions are not such that they were viewed by either
22 appraiser as materially affecting their overall assessment of improvement condition and/or
23 requiring adjustment for improvement condition relative to comparables.

24 Second, while Mr. Rudolph provides an estimate, there is no evidence that
25 Mr. Rudolph has any particular expertise in the area of home repair and, as a result, the
26 Court must view his assessment as a guess. There was no objection to the testimony and the
27 Court accepts the same. However, the weight to be given this testimony is very limited.
28

1 Finally, and perhaps more importantly, neither expert discussed this factor at the
2 Evidentiary Hearing. Thus, the Court has no evidence to allow it to determine whether the
3 appraisers were unaware of this condition and/or to ascertain if knowledge of this factor
4 would have altered their opinion of value. While it is tempting to simply deduct this amount
5 from Creditor's appraisal (or the Debtors' appraisal) the appraisal process does not support
6 such an approach. As a result, the Court accepts Mr. Rudolph's assessment of certain
7 problems with the Residence, but concludes that such evidence does not require an
8 adjustment to its conclusion of value.

9 **3. Creditor Was an Under Rather Than Unsecured Creditor as of the**
10 **Valuation Date.**

11 As discussed above, the Court appropriately assumes that the amount owed on the
12 Senior Secured Claim did not increase and likely decreased during the 45 days between the
13 Petition Date and the Valuation Date. The M. Rudolph claim, however, increased during
14 this same period as a result of interest accrual. Happily for the Court, M. Rudolph
15 acknowledged in her declaration and testimony that the note bears simple interest and that
16 compounding is not appropriate. As a result, the Court can review the M. Rudolph note,
17 which is in evidence, and, thus, concludes that this interest accrual did not render Creditor
18 wholly unsecured as of the Valuation Date.⁶

19
20
21 ⁶ This case well evidences the problems inherent in cases where valuation and debt levels
22 fluctuate widely during a chapter 13 case. While the Court is not required to decide the issue here
23 given the agreement of the parties as to the appropriate date for valuation, the Court notes that use
24 of the petition date is well-supported in the decisions of other courts and appears to this Court to be
25 the most fundamentally fair point for analysis. Ordinarily, the petition date is the "watershed date
26 of a bankruptcy proceeding." *Johnson v. GMAC (In re Johnson)*, 165 B.R. 524, 528 (S.D. Ga.
27 1994.) And, "...creditors' rights are fixed (as much as possible) as of that date. *Id.* This approach
28 is: "clearly supported by 11 U.S.C. § 502(b) which states the general rule that, when an objection to
a claim is raised....the court, after notice and a hearing, shall determine the amount of such claim
as of the date of the filing of the petition..." *Brager v. Blum (in re Brager)*, 39 B.R. 441, 443
(Bankr. E.D. Pa. 1984). Given that the petition date is a date utilized by other courts in cases such
as this one and given the long gap between the Valuation Date and dates utilized by other courts
such as a confirmation date or plan effective date, the Court feels it prudent to make clear that the
evidence already available supports a conclusion that Creditor was under rather than unsecured at
the Petition Date. The evidence suggests market decline during the fall of 2008. Thus, the Court
can conclude that on the Petition Date the Residence was, if anything, more rather than less

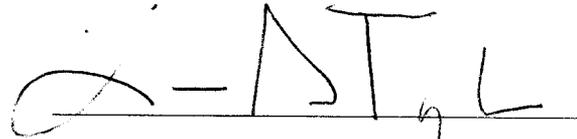
1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

CONCLUSION

Therefore, the Court concludes that the value of the Residence was \$395,000.00 as of November 22, 2008. The Court also concludes that the liens senior to that of the Creditor totaled less than this amount as of that date. As a result, Creditor is an under rather than unsecured creditor. Thus, Debtors are not entitled to use 11 U.S.C. § 1322(b)(2) to strip Creditors' lien.

Creditor is to submit an order consistent with this Memorandum Decision within 10 days. As this is an atypical case, the presumptive fee does not adequately compensate Debtors' counsel for his work on this matter. Thus, counsel for the Debtors may submit his fee application within 30 days if he desires to request fees on account of the Lien Strip Motion in excess of the presumptive fee.

DATED: June 22, 2009



LAURA S. TAYLOR, JUDGE
United States Bankruptcy Court

valuable.