BANKING & FINANCIAL INSTITUTIONS ALERT

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U.S. Supreme Court Says No to Lien Stripping in a Chapter 7 Bankruptcy.

By Paul A. Giordano, Partner

On June 2, 2015, the United States' Supreme Court issued the opinion in the case of *Bank of America v. Caulket,* where the Court ruled that a Debtor whose home is 'underwater' cannot "Strip off" or void a junior lien when filing for Chapter 7 Bankruptcy protection. The Court in a unanimous decision answered the question of whether 11 U.S.C. §506(d) allows Chapter 7 debtors to void certain liens on their home. The Court stated, in a an opinion written by Justice Thomas,

> "A debtor in a Chapter 7 bankruptcy proceeding may not void a junior mortgage lien under §506(d) when the debt owed on a senior mortgage lien exceeds the current value of the collateral if the creditor's claim is both secured by a lien and allowed under §502 of the Bankruptcy Code. … The debtors here prevail only if the bank's claims are "not . . . allowed secured claim[s]." The parties do not dispute that the bank's claims are "allowed" under the Code. Instead, the debtors argue that the bank's claims are not "secured" because §506(a)(1) provides that "[a]n allowed claim . . . is a secured claim to the extent of the value of such creditor's interest in . . . such property" and "an unsecured claim to the extent that the value of such creditor's interest . . . is less than the amount of such allowed claim." … "Because the value of the bank's interest here is zero, a straightforward reading of the statute would seem to favor the debtors. This Court's construction of §506(d)'s term "secured claim" in *Dewsnup* v. *Timm,* 502 U. S. 410, however, forecloses that reading and resolves the question presented here. In declining to permit a Chapter 7 debtor to "strip down" a partially underwater lien under §506(d) to the value of the collateral, the Court in *Dewsnup* concluded that an allowed claim "secured by a lien with recourse to the underlying collateral . . . does not come within the scope of §506(d)." . . . "Thus, under *Dewsnup,* a "secured claim" is a claim supported by a security interest in property, regardless of whether the value of that property would be sufficient to cover the claim. This Court declines to limit *Dewsnup* to partially underwater liens. *Dewsnup's* definition did not depend on such a distinction. Nor is this distinction supported by *Nobelman* v. *American Savings Bank,* 508 U. S. 324, which addressed the interaction between the meaning of the term "secured claim" in §506(a)—a definition that *Dewsnup* declined to use for purposes of §506(d)—and an entirely separate provision, §1322(b)(2). See 508 U. S., at 327–332. Finally, the debtors' suggestion that the historical and policy concerns that motivated the Court in *Dewsnup* do not apply in the context of wholly underwater liens is an insufficient justification for giving the term "secured claim" a different definition depending on the value of the collateral. Ultimately, the debtors' proposed distinction would do nothing to vindicate §506(d)'s original meaning and would leave an odd statutory framework in its place."

While the Court did not overrule *Dewsnup*, it hinted that it might be ready to do it if the issue came before them again. The Court reasoned that allowing a lender's secured status to be contingent on the "constantly shifting" value of the collateral could lead to arbitrary results.

What does this mean for lenders? Well, lenders (or other parties) with junior liens now have a place at the bargaining table and lenders with senior liens will have to consider these junior liens in their mortgage modification negotiations.

For the full opinion, click HERE.

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