US Supreme Court Decision in Bank of America, N.A. v. Caulkett

PUBLISHED ON
July 2, 2015

In a 9-0 decision released on June 1, 2015, the US Supreme Court ruled, in *Bank of America, N.A. v. Caulkett*, 135 S. Ct. 1995 (2015), that a debtor in a Chapter 7 bankruptcy proceeding may not void a junior mortgage lien under 506(d) of the Bankruptcy Code when the debt owed on a senior mortgage lien exceeds the current value of the collateral if the "underwater" creditor's claim is both (1) secured by a lien and (2) allowed under 502 of the Code. The Court grappled with the definition of "secured claim" and ultimately relied on *Dewsnup v. Timm*, 502 U.S. 410 (1992), which construed the term in 506(d) to mean a claim supported by a security interest in property, regardless of whether the value of that property would be sufficient to cover the claim. Thus, the Court concluded that because Bank of America's junior positions were both secured by liens and allowed under 502, they could not be voided under the definition given to the term "allowed secured claim" by *Dewsnup*. The question then remains whether this decision prevents debtors in Chapters 11, 12, or 13 from "stripping" underwater liens or whether the *Caulkett* decision is limited solely to Chapter 7 cases and thus debtors outside of Chapter 7 can remove these liens as they always have.

The answer might not be completely clear. A creditor could argue that this case is not limited to Chapter 7 and thus "underwater" liens cannot be "stripped" because nothing in the *Caulkett* decision restricts the holding to Chapter 7 cases. Also, historically speaking, US Supreme Court decisions interpreting the Bankruptcy Code are not necessarily limited to proceedings filed under any specific chapter and thus are sometimes applied evenly throughout the entire Code unless the opinion expressly states otherwise. For example, courts all across the country have applied *Till v. SCS Credit Corp.*, 541 U.S. 465 (2004)-a Chapter 13 case-to cases filed under Chapter 11. Conversely, a debtor might argue that *Caulkett* does not extend to Chapters 11, 12, and 13 and therefore "underwater" liens can be "stripped off," because *Caulkett* was a Chapter 7 case and "underwater" lien creditors are in a better position to recover portions of unpaid debt in cases filed under Chapters 11, 12, and 13. Importantly, 1322(b)(2), 1222(b)(2), and 1123(b)(5) allow bankruptcy courts to modify the rights of holders of secured claims. These sections allow debtors in Chapters 11, 12, and 13 to devote plan payments to creditors in order to liquidate undersecured claims, which can include a secured creditor's collateral deficiency. In essence, secured creditors in Chapters 11, 12, and 13 may be forced to exchange a speculative lien-which may gain value if the collateral appreciates in value-for treatment under a plan that proposes partial or full payments on the deficiency. This remedy, however, is not available to Chapter 7 secured creditors because, in a Chapter 7 case, any collateral deficiency will simply be wiped out and the creditor will have to "get in line" with all other unsecured creditors and share in liquidation proceeds.

Notably, the more likely outcome is that *Caulkett* does not apply outside of Chapter 7 because courts have

already declined to extend *Caulkett* into Chapter 13. Since the June 1 decision, two courts have allowed debtors to strip wholly unsecured junior liens pursuant to 1322(b)(2). *See In re Turman*, No. BK14-80062, 2015 WL 3745304 (Bankr. D. Neb. June 12, 2015); *In re Wilson*, No. 14-CV-9543, 2015 WL 3561476 (S.D.N.Y. June 5, 2015). In so holding, both decisions cite in a footnote that *Caulkett* does not extend beyond Chapter 7 and therefore Chapter 13 debtors can strip underwater liens. That being said, it still remains unclear whether *Caulkett* applies outside of Chapter 7 in other jurisdictions.

Practical Points

Moving forward, what should "underwater" lienholders do to protect themselves? While much of the *Caulkett* opinion fails to give guidance for cases outside of Chapter 7, one thing remains clear: "underwater" lienholders must file a proof of claim. An unmistakable part of the Court's holding is that a Chapter 7 debtor may not void an "underwater" lien if the junior mortgage creditor's claim is both (1) secured by a lien, and (2) allowed under 502 of the Code. Section 502(a) states that "a claim or interest, *proof of which is filed under 501 of this title*, is deemed allowed, unless a party in interest . . . objects." (Emphasis added). Thus, it is extremely important that an "underwater" lienholder files a proof of claim as a secured claim, indicating that the claim is secured by a lien on the property. If the creditor fails to file a proof of claim or if a party successfully objects to the claim, then the claim is not an allowed claim and the lien could be stripped.

However, it is important to remain mindful that filing a proof of claim could carry unwanted ramifications, such as subjecting the filer to jurisdiction in the bankruptcy courts. Therefore, creditors should proceed with caution by assessing each mortgage lien individually and considering the risks and rewards associated with filing a proof of claim.*We are tracking any further changes or commentary set forth by the Courts on this rule.*

*This legal update was co-authored by Brian Korman. Brian is a rising third year law student currently attending Elon University School of Law and working as a summer associate at Barley Snyder.

WRITTEN BY:

Scott F. Landis

Partner

Tel: (717) 399-1503

Email: slandis@barley.com