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Bank of America v. Caulkett

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Chapter 7 bankruptcy debtor may not void junior mortgage when debt owed on senior mortgage exceeds present value of property.

Bank of America v Caulkett (2015) ___ US ___, 135 S Ct 1995

Two debtors filed for Chapter 7 bankruptcy and sought to use 11 USC §506(d) to void their junior mortgages on the basis that the junior lienholders had no real equity in the property because the senior lien exceeded the value of the property (*i.e.,* the debtors were wholly underwater). The cases were consolidated and the bankruptcy court voided the junior mortgages under §506(d). After both the district courts and the Eleventh Circuit affirmed, the U.S. Supreme Court reversed and remanded the case.

Both debtors had two mortgage liens on their property. In each case, the senior mortgage lien exceeded the home's current market value. Thus, if the homes were sold, the junior lienholder would receive no money. The debtors characterized this as having no equity in the bankruptcy property and thus voidable under 11 USC §506(d) as a lien "that is not an *allowed secured* claim." (Emphasis added.) The parties agreed that the bank's claims were "allowed" but the debtors argued they were not "secured." The Supreme Court, however, interpreted *Dewsnup v Timm* (1992) 502 US 410, 417, 112 S Ct 773,reported at 15 CEB RPLR 138 (Apr. 1992), to hold 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." 135 S Ct at 1999. The *Dewsnup* holding cannot be restricted to claims that are backed with some value because that would illogically give §506(d) two different definitions, depending on the value of the collateral, and a different definition than that contained in §506(a). Moreover, "constantly shifting" real estate values could result in completely arbitrary results under the suggested definition, *e.g.*, junior liens judged as having at least one dollar of collateral could not be stripped. 135 S Ct at 2001.

THE EDITOR'S TAKE: A junior mortgage lien cannot be stripped off in a Chapter 7 bankruptcy just because it is entirely underwater. California law pretty much says the same; see *Barbieri v Ramelli* (1890) 84 C 154, holding that a secured creditor's demonstration that the mortgages senior to hers exceed the value of the property is not enough to let her bypass the one-action rule and sue on her note. On the other hand, if the senior has actually foreclosed his superior lien, then she is a "sold-out junior" who can sue directly on her note without foreclosing. See *Savings Bank v Central Mkt. Co.* (1898) 122 C 28 (junior creditor holding recourse, nonpurchase money obligation whose security is rendered worthless by senior foreclosure sale may bring action directly on its note without first going through pointless foreclosure proceeding).

In the nonbankruptcy situation, an underwater junior often hopes for the senior to foreclose, but in bankruptcy the junior probably prefers to not have that occur, anticipating that someday she will find some new value in the security that makes her lien less useless, and not shrunken into nothingness by the strip-down and discharge functions of that procedure.—*Roger Bernhardt*