DEWSNUP LIVES -- EVEN FOR UNDERWATER MORTGAGES

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The U.S. Supreme Court on June 1, 2015, unanimously held in *Bank of America, N.A. v. Caulkett* that a chapter 7 debtor cannot "strip off" even a totally underwater mortgage under § 506(d), reversing the Eleventh Circuit. In so holding, the Court not only reaffirmed but extended its controversial decision in *Dewsnup v. Timm*, 502 U.S. 410 (1992), in which the Court had held that a chapter 7 debtor cannot "strip down" a partially underwater mortgage under § 506(d).

Many observers had thought -- especially after oral argument in *Caulkett* -- that the Court might take this opportunity to overturn its much-criticized *Dewsnup* decision, or at the very least confine it to partially underwater mortgages. Instead, much as Mark Twain once quipped that "the reports of his death were greatly exaggerated," the reports of *Dewsnup*'s demise proved premature. Writing for the Court, Justice Thomas concluded that "*Dewsnup*'s construction of "secured claim" resolves the question presented here."

The technical statutory issue is as follows. Under § 506(d), "'To the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void.'" No one questioned that Bank of America's claims were "allowed" and were "claims," but were they "secured"? The statute appears to say that if they are not secured, they are void. The claims of Bank of America the debtors were seeking to strip off were junior mortgages, and the amounts of the senior liens exceeded the value of the property, meaning that at the time of bankruptcy, the Bank of America liens were valueless. § 506(a) says that ""[a]n allowed claim of a creditor secured by a lien on property . . . 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." Given that the "value of [Bank of America's] interest in [the junior mortgages]" was zero, the debtors argued that it was not a "secured claim" at all. The Eleventh Circuit had agreed.

In *Dewsnup*, however, the Court had held that § 506(d) did not apply at all if the mortgage holder's claim was "allowed" and "secured," and that a claim was "secured" for the purposes of § 506(d) if the mortgagee held an unavoided lien on the collateral -- irrespective of the value of that lien. In *Caulkett*, the Court held that "Because the Bank's claims here are both secured by liens and allowed under § 502, they cannot be voided under the definition given to the term "allowed secured claim" by *Dewsnup*." The Court was unwilling to confine *Dewsnup* to partially underwater liens, noting first that the reasoning of that opinion applied equally whether the lien was partially or totally underwater, and second that otherwise illogical results could result depending on minute variations in valuation. That is,

otherwise, if there were even a dollar of value to support the mortgage, it could not be stripped down at all. The Court thought that for such an all-or-nothing outcome to turn on a dollar's difference in an inexact valuation would be foolish.

Importantly, the Court also noted that its decision in *Nobelman v. American Savings Bank*, 508 U. S. 324 (1993), did not require a different result. In that case, the Court prohibited strip down of a partially underwater mortgage in chapter 13 cases under §1322(b)(2), and similarly rejected a narrow reading of "secured claim" based on § 506(a)(1)'s value-based definition. In *Caulkett*, the Court found that *Nobelman* simply did not address the interpretation of § 506(d). What is interesting is that many Courts of Appeals have held that notwithstanding *Nobelman*, a totally underwater mortgage can be stripped off in chapter 13, even though a secured claim with even a dollar of value cannot be stripped down at all. After *Caulkett*, are those decisions that distinguish between strip down and strip off in chapter 13 now of doubtful validity? Perhaps. One can certainly expect that debtors will soon test this out when their main goal in bankruptcy is to strip off an underwater junior mortgage, since the chapter 7 door to effecting such avoidance has now been closed by the *Caulkett* decision.

It is beyond cavil that *Caulkett* is a huge victory for mortgagees and a significant setback for debtors. Now mortgage liens are sacrosanct in chapter 7, irrespective of whether they are partially or totally underwater. Whether they will be so in chapter 13 remains to be seen, but mortgagees have a plausible argument to extend *Caulkett* there as well.