Nos. 13-1421, 14-163

IN THE

Supreme Court of the United States

BANK OF AMERICA, N.A.,
Petitioner,

v.

DAVID B. CAULKETT,
Respondent.

and

BANK OF AMERICA, N.A.,
Petitioner,

v.

EDELMIRO TOLEDO-CARDONA,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Eleventh Circuit

BRIEF OF *AMICI CURIAE* THE NATIONAL ASSOCIATION OF CONSUMER BANKRUPTCY ATTORNEYS AND AARP IN SUPPORT OF THE RESPONDENTS

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INTEREST OF *AMICI CURIAE*[1]

Incorporated in 1992, the National Association of Consumer Bankruptcy Attorneys ("NACBA") is a non-profit organization with a membership of more than 3,000 consumer bankruptcy attorneys nationwide. NACBA's mission includes educating the bankruptcy bar and the community at large on the uses and misuses of the consumer bankruptcy process. Additionally, NACBA advocates nationally on issues that cannot adequately be addressed by individual member attorneys. It is the only national association of attorneys organized for the specific purpose of protecting the rights of consumer bankruptcy debtors. NACBA has filed *amicus curiae* briefs in various courts on behalf of consumer bankruptcy debtors. *See, e.g.*, *Lamie v. U.S. Trustee,* 124 S.Ct. 1023 (2004) (discussing § 330); *Hamilton v. Lanning*, 130 S. Ct. 2464 (2010); *United Student Aid Funds Inc. v. Espinosa*, 130 S. Ct. 1367 (2010); *Mort-Ranta v. Gorman,* 721 F.3d 241 (4th Cir. 2013); *Weber v. SEFCU,* 719 F.3d 72 (2d Cir. 2013).

AARP is a non-profit, nonpartisan organization, with a membership that helps people turn their goals and dreams into real possibilities, seeks to strengthen

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[1] Pursuant to Supreme Court Rule 37.6, counsel for *amici* represent they authored this brief in its entirety and that none of the parties or their counsel, nor any other person or entity other than *amicus*, its members, or its counsel, made a monetary contribution intended to fund the preparation or submission of this brief. Petitioner Bank of America, N.A. has consented to the filing of *amici curiae* briefs and a letter reflecting its consent was filed contemporaneously with this brief. Respondents David Caulkett and Edelmiro Toledo-Cardona have filed a blanket consent to the filing of any amicus brief, which was docketed on November 18, 2014.

communities, and fights for the issues that matter most to families such as healthcare, employment and income security, retirement planning, affordable utilities and protection from financial abuse. AARP has advocated in this Court on behalf of homeowners and others who seek a fresh start under the Bankruptcy Code. *Till v. SCS Credit Corp.,* No. 02-1016; *Rousey v. Jacoway,* No. 03-1407.

In recent years, older Americans have been forced into bankruptcy in increasing numbers as a result of lost jobs, depleted retirement savings, and escalating medical bills. Prior to the recent financial crisis, many put their homes on the line to secure mortgages that were unsustainable and, in some cases, designed to fail. Because of the decline in property values, the debt on their homes far exceeds the value of the property.

Because of their age, it is far more difficult for older people to bounce back from enormous financial setbacks such as these. For many, the ability to avoid a second mortgage that is unsupported by any equity is the difference between keeping their homes and losing them.

STATEMENT

The question in this case is whether § 506 of the U.S. Bankruptcy Code,[2]—which provides that a lien in excess of the value of the collateral is "void"—permits a Chapter 7 debtor to extinguish or "avoid" a mortgage lien on his personal residence where the collateral to which the lien attaches, is found to have no value. Permitting debtors to avoid such valueless liens is consistent with the plain language of the Code, with basic constitutional principles that underlie treatment

[2] 11 U.S.C. § 101 *et. seq*. (the "Code").

of secured creditors under modern bankruptcy law, and with sound economic and foreclosure policy.

Section 506 embodies the fundamental principle that runs throughout the entire Code that a creditor's claim is treated as a "secured claim" only to the extent that there is actual value to support it and that the excess is "void." As § 506(a) provides, an allowed claim is a secured claim "to the extent" of the value of the collateral. The balance of the claim is a separate unsecured claim, a point that is noted again in § 506(d), which provides that the lien is void to the extent that the claim is not an allowed secured claim.

The power of Congress to enact statutory provisions that avoid liens of secured lenders is grounded on well-established constitutional principles. This Court held over 70 years ago that secured creditors are entitled to protection of their lien "throughout the proceedings, to the extent of the value of the property [and that] [t]here is no constitutional claim of the creditor to more than that."[3] This fundamental principle was stated in *United States v. Ron Pair Enter., Inc.* 489 U.S. 235, 239 (1989), which held that "a claim is secured only to the extent of the value of the property on which the lien is fixed. . . ."

The reduction of secured liens to the value of the collateral is central to modern bankruptcy practice and in particular to the reorganization chapters, namely, Chapters 11, 12 and 13. This principle enables the bankruptcy courts to adjust the debts of large commercial debtors, as well as the small claims on the personal assets of Chapter 7 debtors. Thus, bankruptcy courts routinely bifurcate a secured claim

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[3] *Wright v. Union Central Life Ins. Co.,* 311 U.S. 273, 278 (1940)(citations omitted).

into a secured component, based on collateral value, and an unsecured component for the balance; the lien on the unsecured portion is then extinguished or voided. This statutory and constitutional authority to modify, extinguish or avoid secured debts, even without full payment of the face amount of the debt, is in harmony with the economic reality that a lien is only as valuable as the collateral that underlies it. Bankruptcy financial restructurings could not occur without such an indispensable legal tool.

In *Dewsnup v. Timm,* 502 U.S. 410 (1992) this Court held that in a Chapter 7 liquidation, where the lender was only partially secured, a debtor could not reduce (or void) the mortgage to the value of the collateral, stating that the "voiding of a lien [occurs only] when a claim secured by the lien itself has not been allowed." 502 U.S. at 416. That is, unless the *claim* itself was disallowed, the lien could not be voided. This Court had never previously indicated such an interpretation.

Justice Scalia dissented, joined by Justice Souter, who correctly pointed out that, under § 506(a) and (d) a valueless lien is void: "Read naturally and in accordance with the other provisions in the statute, this [language] automatically voids a lien to the extent the claim it secures is not both an 'allowed claim' and a 'secured claim' under the Code." *Dewsnup*, 502 U.S. at 420.

Even the majority in *Dewsnup* recognized a crucial limitation on the reach of *Dewsnup*, when it held that lien avoidance is valid in the "reorganization chapters," Chapters 11, 12 and 13. The Court also cautioned that Dewsnup might not apply in other contexts *or to other Code sections.* And just one year later, in *Nobelman v. American Sav. Bank,* 508 U.S.

324 (1993), the Court declined to apply the reasoning of *Dewsnup* to § 506 in a Chapter 13 case.

Bank of America has acknowledged throughout that lien avoidance is permitted in the reorganization chapters. Nevertheless, it has asserted novel interpretations of § 506 which, if accepted and then applied to the reorganization chapters would severely impair the ability of business and individual debtors to use the statutory power to restructure and avoid liens in the reorganization chapters. Because the arguments of Bank of America risk intrusion into the reorganization chapters, NACBA and AARP have submitted this Brief to urge that this Court resist such arguments. Further, NACBA and AARP contend that *Dewsnup* simply does not apply where the lender is entirely unsecured, as here. Alternatively, NACBA and AARP urge reconsideration and reversal of *Dewsnup*.

SUMMARY OF ARGUMENT

Lien avoidance is central to the overall operation of the Bankruptcy Code in all chapters, but in particular in the reorganization chapters. The reduction of liens to the value of collateral occurs in the contexts of plans, sales, exemptions, and many of the most critical aspects of bankruptcy. In *Dewsnup* this Court acknowledged that its ruling did *not apply* in the reorganization context. Bank of America acknowledges that lien avoidance is permitted in the reorganization chapters, but nevertheless both directly and indirectly, tries to limit the scope of lien avoidance in ways that would subvert the historically accepted operation of the reorganization chapters. Bank of America's argument that lien avoidance is permitted only in "narrowly cabined exceptions, principally in the reorganization cases" (Pet. Br. 31-32) inverts what is the exception and what is the rule. Lien avoidance may not be fairly characterized as any form of exception, but instead is the rule.

Second, this Court in *Dewsnup* expressly stated that it "might be inclined" to agree with the contrary position of the petitioner that a claim is secured only to the extent of the judicially determined value of the real property. 502 U.S. at 417. This position is the rule set forth in *Ron Pair*, stating that § 506 "governs the definition and treatment of secured claims." 489 U.S. at 238-239. That is, a plain language interpretation of §§ 506(a) and (d) expressly supports the avoidance of wholly unsecured liens in Chapter 7.

Bank of America has put forth other arguments to support *Dewsnup* that find no expression or basis in the decision itself. The cornerstone of its argument is that there is a difference between a claim and a lien, from which it then argues that a debtor may modify a claim, but that the associated lien remains intact, and unaffected. This interpretation is at odds with the ability to avoid, to modify and to restructure secured loans in the reorganization chapters and if adopted, would represent a major rejection of established bankruptcy law.

Lastly, Bank of America argues that *Dewsnup* should be extended because, (a) secured lenders have a "property right" that is entitled to be protected from lien avoidance and (b) secured lenders have a bankruptcy right to the future appreciation of their collateral. (Pet. Br. 22, 31-32.) These arguments are inconsistent with accepted bankruptcy theory and practice, including this Court's pronouncements on the actual scope of a secured lender's entitlements under the Fifth Amendment.

This Court should affirm the decision of the Eleventh Circuit. Doing so will be consistent with a plain reading of § 506. Alternatively, if the Court does reverse the Eleventh Circuit, then it should clarify that its ruling has no applicability to Chapters 11, 12 or 13 of the Code.

ARGUMENT

I. *DEWSNUP* SHOULD NOT BE EXTENDED: THIS COURT CORRECTLY DECLINED TO EXTEND THE RATIONALE OF *DEWSNUP*.

One of the central tenets of modern bankruptcy law concerning secured lenders is that the "allowed secured claim" is measured by the value of the collateral that secures the claim. *See, e.g., United Sav. Ass'n of Texas v. Timbers of Inwood Forest Associates, Ltd.*, 484 U.S. 365, 371-372 (1988). ("The phrase "value of such creditor's interest" in § 506(a) means "the value of the collateral.") *Ron Pair* held the same. 489 U.S. at 238 n.2. *See also, Associates Commercial Corporation v. Rash,* 520 U.S. 953, 957 (1997)("The value of the allowed secured claim is governed by § 506(a) of the Code.").

Despite these prior rulings, Bank of America argues that in *Dewsnup,* "this Court soundly rejected" the reading of § 506 which holds that a claim is only a secured claim "to the extent" that a lien has value. (Pet. Br. 13.) There was however, no such "sound" rejection. The majority of this Court strongly indicated that *Dewsnup* is to be strictly limited. Other members of this Court have expressed grave reservations about the ruling in *Dewsnup*.[4] Indeed, if anything, reconsideration of *Dewsnup* is warranted.

A. This Court expressly limited *Dewsnup* and declined to extend the ruling to the reorganization provisions of Chapters 11, 12 and 13.

Bank of America argues that § 506 only voids a lien where the underlying claim itself is not enforceable. (Pet. Br. 3.) In its view, the value of the collateral has no role. As noted, it claims that this Court soundly rejected the plain meaning interpretation of § 506, which forms the basis for, and is more consistent with, *Ron Pair*.

In truth, this Court expressed serious and meaningful reservations about *Dewsnup* in that decision itself, and certainly about any broader application. Significantly, this Court stated that "were we writing on a clean slate" we "might be inclined" to adopt the contrary rule urged by petitioner. 502 U.S. 417. The contrary rule is the view expressed in *Ron Pair* that § 506 has a plain meaning, and that an allowed secured claim is measured and defined by the value of the collateral.[5]

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[4] Justice Thomas implored the Court not to repeat the "methodological error committed by this Court in Dewsnup." *Bank of America Nat. Trust and Sav. Ass'n v. 203 North LaSalle Street Partnership*, 526 U.S. 434, 461 (1999). (Thomas, J., concurring in the judgment).

[5] As Justice Scalia noted in *Dewsnup*, "Almost point for point, today's opinion is the methodological antithesis of *Ron Pair*—and I have the greatest sympathy for the Courts of Appeals who must predict which manner of statutory construction we shall use for the next Bankruptcy Code case." 502 U.S. at 435.

This Court's decision in *Ron Pair* presents the correct starting point for understanding the historical development and meaning of § 506, much of which is at odds with the views argued by Bank of America. The question presented in *Ron Pair* was whether an oversecured lender was entitled to post petition interest. 489 U.S. at 237. This Court acknowledged that "Section 506, enacted as part of the extensive 1978 revision of the bankruptcy laws, governs the *definition and treatment* of secured claims, *i.e.*, claims by creditors against the estate that are secured by a lien on property in which the estate has an interest." *Id.* at 238-239 (emphasis added). And, importantly, this Court stated that "Subsection (a) of § 506 provides that a claim is secured only to the extent of the value of the property on which the lien is fixed; the remainder of the lien is considered unsecured." *Id.* at 239.[6]

While Bank of America argues that Congress gave no sense that it intended for § 506 to effectuate any changes in pre-Code law, (Pet. Br. 13), this Court said the opposite in *Ron Pair*. The *Ron Pair* decision essentially found that § 506 *was* part of a major revision to pre-Code law, was not ambiguous and thus, reliance on pre-Code law was not appropriate:

> Initially, it is worth recalling that Congress worked on the formulation of the Code for a

[6] This Court provided a key example: "Thus, a $100,000 claim secured by a lien on property of a value of $60,000, is considered to be a secured claim to the extent of $60,000, and to be an unsecured claim for $40,000. See 3 Collier on Bankruptcy, ¶ 506.04, p. 506-15 (15th ed. 1988). ("[S]ection 506(a) requires a bifurcation of a 'partially secured' or 'undersecured' claim into separate and independent secured claim and unsecured claim components."). 489 U.S. at 239 n.3.

> decade. It was intended to modernize the bankruptcy laws. . . and as a result made significant changes in both the substantive and procedural laws of bankruptcy. . . In particular, Congress intended 'significant changes from current law in. . . the treatment of secured creditors and secured claims. . . . In such a substantial overhaul of the system, it is not appropriate or realistic to expect Congress to have explained with particularity each step it took. (citations omitted). [7]

Further, and critically, this Court in *Dewsnup* noted that its views on lien avoidance were "apart from [the] reorganization proceedings," where lien avoidance is permitted. 502 U.S. at 418. This Court specifically declined to predict that its ruling would apply to other "fact situations" nor that it would it be applied in the same way to other Code provisions. *Id*. at 416. "[W]e express no opinion as to whether the words 'allowed secured claim' have different meaning in other provisions of the Bankruptcy Code." *Id*. at 417 n.3.

This Court's reservations were well grounded. The extension of *Dewsnup* based on Bank of America's arguments is unwarranted and only risks further confusion. Instead this Court should limit *Dewsnup* and harmonize its interpretation with *Ron Pair* and *Nobelman,* so as to recognize the centrality of lien avoidance, especially in the reorganization chapters.

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[7] *Ron Pair,* 489 U.S. at 240.

B. The extension of *Dewsnup* should not be permitted based on the argument that a lien and a claim are separate and distinct.

Because Bank of America must recognize that this Court has shown a firm disinclination to extend the reasoning of *Dewsnup,* Bank of America has offered a rationale that is not found in the text of the decision. Bank of America argues that there is a distinction for bankruptcy purposes between a creditor's claim and its lien, and that this is a key feature of the architecture of the Code and is "critical to this case." (Pet. Br. 6.) It argues that this distinction exists "[b]oth outside and inside bankruptcy." (Pet. Br. 5.)

This alleged distinction between the permitted Code treatment of a lien and a claim is a wholly novel and incorrect interpretation that would undercut the fundamental workings of the reorganization chapters. It would do so by severely limiting the right of debtors to restructure and void undersecured liens. In a word, Bank of America argues that the authority given to debtors to modify debt (e.g., to "treat" the debt) somehow speaks only to the "claim" but not to the lien: "Put differently, the value of the collateral securing a debt affects only the *treatment* of the creditor's claim against the chapter 7 estate. It does not affect the validity of the creditor's lien." (Pet. Br. 13.) (emphasis altered).

Bank of America's self-defined "critical argument" represents an unprecedented change in the historical treatment of secured lenders under the Code. It seems to ignore this Court's long standing holding that a secured lender is entitled to protection of its lien only "to the extent of the value of the property" to which the lien attaches. *Wright,* 311 U.S. at 278. That is, *all* of the "rights" of a secured lender as such (whether those rights are said to spring from the claim or the associated lien) are *only* protected to the extent of the value of the collateral. If Bank of America's argument were to become law, then the ability to modify liens could be lost, despite plain statutory and judicial authority to the contrary. In other words, despite acknowledging that this Court stated specifically that *Dewsnup* does *not apply* to the reorganization chapters, Bank of America makes an argument that could be readily transported, in a future case, to the reorganization chapters. This Court should reject this unprecedented distinction between the power to modify and the power to modify a secured claim.

First, a lien and a claim, for bankruptcy law purposes, are largely co-extensive for purposes of understanding the Code's treatment of such. Bank of America's argument that a lien and claim are different was contradicted by this Court just one year prior to *Dewsnup,* in *Johnson v. Home State Bank,* 501 U.S. 78 (1991) which held the opposite. Instead, this Court stated "we have no trouble concluding that a mortgage interest that survives the discharge of a debtor's personal liability is a 'claim' within the terms of § 101(5)." 501 U.S at 84. This is because, in part, there remained a right to payment in the form of proceeds from the sale of the debtor's property. Further, the Court in *Johnson* said that "but for the codification of the rule of *Long v. Bullard,* there can be little question that a 'discharge' under Chapter 7 would have the effect of extinguishing the *in rem* component as well as the *in personam* component of any claim against the debtor. And because only claims are discharged under the Code, the very need to codify *Long v. Bullard* presupposes that a mortgage interest is otherwise a claim." 501 U.S. at 84 (citation omitted). In short, it said "a surviving mortgage interest is a 'claim' under § 101(5). . . ." *Id*. at 85.

Second, as a statutory matter, the statement that the Code treats a claim and a lien as distinct is not accurate. Section 102(2) states plainly that a "claim against the debtor" includes a claim against property of the debtor. A lien is a claim against property of the debtor.

Third, the notion that an allowed secured claim and a lien are largely co-extensive is consistent with this Court's ruling in *Ron Pair.* While Bank of America argues that the value of the collateral only affects the treatment of the claim and not the lien, this Court said that the value of the collateral determines the extent of the secured claim. "[A] claim is secured only to the extent of the value of the property on which the lien is fixed." *Ron Pair* 489 U.S. at 239. In this formulation, claim and lien are linked by value. They are inseparable. *Nobelman* said the same thing, as did *Rash.* This effort by Bank of America to separate the claim from the lien, and to inhibit the power to modify the claim only would effectively reverse an entire body of this Court's case law.

The lien-claim distinction finds no basis in *Dewsnup* and provides no basis to revive or extend *Dewsnup.* It is entirely at odds with the basic workings of the Code and should be soundly rejected by this Court. It's potential harm to the reorganization cases (discussed below) is far too significant to permit any embrace of such a notion. Just as the "plain meaning" of § 506 will not support extension of *Dewsnup,* neither will this "critical" argument by Bank of America.

II. LIEN AVOIDANCE IS CENTRAL TO MODERN BANKRUPTCY ADMINISTRATION AND PRACTICE IN ALL OF THE REORGANIZATION CHAPTERS.

Bank of America acknowledges that lien avoidance is permitted in the reorganization chapters, including Chapter 11 (Pet. Br. 20, 22-23, 31-32, 38, 39 n. 20)[8] and that it was permitted under pre-Code practice. (Pet. Br. 13.)[9] Indeed, it relies heavily on the express power to modify secured claims in the reorganization chapters as further support for its argument that § 506(d) is not sufficient by itself to do the same.

Yet, despite this acknowledgement, it argues that *Dewsnup* should be extended in this case because lien avoidance is an exception to the basic operation of the Code, and that the survival of liens is the basic statutory outcome of bankruptcy law. Bank of America argues that the Code shows no clear intention to deny lienholders of their basic state-law property rights, and that the Code is carefully designed to preserve those rights, with certain "narrowly cabined exceptions, principally in the reorganization cases." (Pet. Br. 31-32.) Later, it argues that lien avoidance is permitted "only in specific and limited circumstances." (Pet. Br. 35.)

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[8] Amicus curiae, the Loan Syndication and Trading Association, ("LSTA") acknowledges the same. (LSTA Br. 20, 21.)

[9] "Apart from reorganization proceedings. . . no provision of the pre-Code statute permitted involuntary reduction of the amount of a creditor's lien for any reason other than payment on the debt." citing *Dewsnup,* 502 U.S. at 418-419. The LSTA acknowledges that the Chandler Act permitted modification of a secured creditor's lien but only in a "plan." (LSTA Br. 20.)

This portrayal inverts the true relationship between what is central in bankruptcy and what is a narrow exception. The modern 1978 Code uses lien modification and avoidance as one of the fundamental tools to enable reorganization as well as the fresh start for Chapter 7 debtors. As stated by this Court, the protection of secured lenders in bankruptcy is "to the extent of the value of the property" and that "there is no constitutional claim of the creditor to more than that."[10] Unless Congress specifically states that a lien cannot be modified, the normal operation of the Code permits modification of secured debt, including lien avoidance. This is hardly a narrow cabin. The arguments advanced by Bank of America would work an historic shift in bankruptcy jurisprudence and should be rejected.

A. Lien avoidance is central to the operation of Chapter 11.

Courts generally agree that *Dewsnup* does not apply in the reorganization chapters. "A great majority of the courts that have considered the issue in reorganization cases have concluded that the holding in *Dewsnup* should be limited to Chapter 7 cases and should not prevent lien avoidance in reorganization cases."[11] Given the critical role of Chapters 11, 12 and 13 in restructuring debt, it could hardly be otherwise. Lien modification and reduction is central to Chapter 11 and indeed goes to the very core of how modern bankruptcy works.

The Third Circuit recently stated that *Dewsnup* cannot apply in Chapter 11 without injuring its

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[10] *See Wright v. Union, supra.,* 311 U.S. at 278.

[11] *In re Johnson*, 386 B.R. 171, 175 (Bankr. W.D. Pa. 2008) *aff'd sub nom. I.R.S. v. Johnson* 415 B.R. 159 (W.D. Pa. 2009).

central functions. "[T]he process of lien stripping is ingrained in the reorganization provisions of the Bankruptcy Code. . .[A]ny attempt to extend the holding in *Dewsnup* to Chapter 11 cases would require that numerous provisions of the statute be ignored or construed in a very convoluted manner." *In re Heritage Highgate, Inc.,* 679 F.3d 132, 144 (3d Cir. 2012).

The basic power to modify liens in Chapter 11 is set forth in § 1123(b)(5), which empowers a court to approve a plan that permanently modifies "the rights" of a secured lender:

> (b) Subject to subsection (a) of this section, a plan may—
>
> * * * *
>
> (5) modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence . . . .

This power to "modify the rights" speaks directly to the power to modify all rights, regardless of whether they spring from the note or claim, or the mortgage instrument. There is no claim-lien distinction on the power to modify. "Rights" means all rights, including those that are lien based. Thus, while § 506 provides for lien avoidance, § 1123 gives courts the additional power to modify even rights springing from state law. Indeed, this was the very conclusion reached by this Court in *Nobelman,* decided just one year after *Dewsnup* (see discussion below).

Further, the effect of confirmation is to extinguish all claims and *interests* that existed pre-petition and to provide instead, that the claim holders shall have only what they receive under a confirmed plan. Thus

§ 1141(c) states expressly that the property dealt with in a plan (including a lender's collateral) is "free and clear of all claims and interests."

> (a) Except as provided in subsections (d)(2) and (d)(3) of this section, the provisions of a confirmed plan bind the debtor. . . and any creditor. . .
>
> * * * *
>
> (c) Except as provided in subsections (d)(2) and (d)(3) of this section and except as otherwise provided in the plan or in the order confirming the plan, after confirmation of a plan, the property dealt with by the plan is free and clear of all claims and interests of creditors. . . .

At the very core of how modern Chapter 11 works is the notion of "cram down" found in § 1129(b)(2) which permits a business debtor to reduce a secured claim to the judicially determined value of the collateral. Here the Code is explicit that the lien is retained *only* to the extent of the value of the collateral. This section states:

> (A) With respect to a class of secured claims, the plan provides—
>
> (i)(I) that the holders of such claims retain the liens securing such claims . . . to the extent of the allowed amount of such claims; and
>
> (II) that each holder of a claim of such class receive on account of such claim deferred cash payments totaling at least the allowed amount of such claim, of a value, as of the

> effective date of the plan, of at least the value of such holder's interest in the estate's interest in such property;

An instructive example of how lien avoidance operates in the normal Chapter 11 case was set forth by this Court in the landmark decision of *Bank of Am. Nat'l Trust & Sav. Ass'n v. 203 North LaSalle St. P'ship* 526 U.S. 434 (1999). In *203 North LaSalle* the owners proposed a plan of reorganization that bifurcated a $93 million mortgage loan into secured and unsecured portions, based on the judicial valuation. *Id.* at 438-439. Under the plan, the debtor proposed to provide Bank of America with a secured claim of $54.5 million based on § 506(a) and the value of the collateral. *Id.* at 440. Then, as to the unsecured portion, the debtor proposed a permanent lien avoidance by paying only 16% of the allowed unsecured claim. *Id.* The pre petition lien of $38.5 was to be voided. *Id*.

No mention is made in the *203 North LaSalle* decision of an argument about a lien-claim distinction. This Court analyzed the case on the basis that lien avoidance was permitted and occurred as part of the normal operation § 506. The reported decision shows that neither this Court nor Bank of America remotely questioned the power of the lower court to bifurcate the lien and to extinguish the unsecured portion of the lien.

Nor does the *203 North LaSalle* reflect that any argument was made that lien avoidance violates the notion that a lender must always be paid in full as a condition to release of its lien. The notion put forth by both Bank of America and its amicus, that a lender is entitled to retain its lien unless and until paid in full is without any basis, if asserted as some kind of overarching bankruptcy principle. The very opposite is more accurate. This Court criticized the Solicitor's General's office for its "starchy" view that owners cannot retain any interest "if creditors are not paid in full." *See id.* at 451-452. Bank of America essentially makes the same "starchy" argument in this case.

Lien avoidance is thus at the core of Chapter 11. One court stated that to bar lien avoidance would "gut the sum and substance of the reorganization and rehabilitation of debt concept" in its entirety:

> [Without lien avoidance] the Debtor would propose a plan for repayment of creditors to the extent of the value of the property securing the creditor's claim, but would still owe the unsecured portion of the claim, post-confirmation, in order to obtain a release of the lien on said property. This would require all plans filed under Chapters 11, 12 and 13 to pay all creditors one hundred percent of their claims in order for the debtor to emerge from bankruptcy with a true "fresh start." Clearly, this has never been the purpose contemplated for Section 506 (d).

In re Johnson, 386 B.R. at 177 quoting *In re Butler,* 139 B.R. 258, 259 (Bankr. E.D. Okl. 1992).

Bank of America has put forth an argument that it did not make when a form of lien avoidance was last before this Court in a Chapter 11 case. It should not now be the basis for extending *Dewsnup* to wholly unsecured loans and especially not to the reorganization chapters.

B Section 506 complements the avoidance powers found in Chapter 11.

Bank of America argues that if § 506(d) itself permitted lien avoidance then the reorganization sections, discussed above, would be superfluous. (Pet. Br. 32, 39.) Yet, the very opposite is true. Section 1129(b)(2) works in tandem with § 506's avoidance power. As the first step, § 506 provides that the secured creditor will retain its lien "to the extent of the allowed amount of such claims," and then receive under the plan (almost always in the form of a new note or debt instrument) a new loan obligation that has a face amount at least equal to the value of the collateral on the effective date of the plan. § 1129(b)(2)(A)(i). Because the payments will be made over time, the present value of the payments must also be equal to the value of the collateral.

In the second step, § 506(d) complements this process by voiding the remainder of the lien. Then, § 1129(b)(2)(B) provides for the "treatment" of the resulting deficiency claim which is now classified as an unsecured claim and is equal to the excess over the value of the collateral. Section 506 is thus not superfluous, because once the lien avoidance occurs, the Code must still provide for the correct "treatment" of the bifurcated claims.

C. Lien avoidance is central to the operation of Chapter 13.

It is undisputed that Congress has expressly provided for lien avoidance in Chapter 13 as a general matter; Bank of America acknowledges this. ("[C]hapter 13 permits a plan to strip down an undersecured creditor's lien to the value of the collateral in certain circumstances.")(Pet. Br. 38.)

Judge Gorsuch, writing for the Tenth Circuit noted that "every federal court of appeals to consider the question has already refused to extend *Dewsnup's* definition of the term 'secured claim' to other statutory provisions using that term in Chapter 13 . . . ." *Woolsey v. Citibank, N.A. (In re Woolsey),* 696 F.3d 1266, 1276 (10th Cir. 2012).[12] *See also In re Enewally,* 368 F.3d 1165, 1170 (9th Cir. 2004), where the court stated:

> The rationales advanced in the *Dewsnup* opinion for prohibiting lien stripping in Chapter 7 bankruptcies, however, have little relevance in the context of rehabilitative bankruptcy proceedings under Chapters 11, 12, and 13 where lien stripping is expressly and broadly permitted, subject only to very minor qualifications. The legislative history of the Code makes clear that lien stripping is permitted in the reorganization chapters.

This Court has consistently held that lien avoidance is permitted in Chapter 13, and that the lien is avoided based on the value of the collateral. In *Till v. SCS Credit Corp.,* 541 U.S. 465 (2004), this Court stated as follows:

> At the time of the filing, respondent's outstanding claim amounted to $4,894.89,

[12] "This same pattern—of circuits distancing themselves from *Dewsnup*—recurs in Chapter 11 and Chapter 12 reorganization cases. Most notably, the Supreme Court itself has declined to extend *Dewsnup*'s understanding of the term "secured claims" when it appears in Chapter 13 . . . . So it is that *Dewsnup* has lost every away game it has played: its definition of "secured claim" has been rejected time after time elsewhere in the code and seems to hold sway only in § 506(d)." *Id.* at 1276.

> but the parties agreed that the truck securing the claim was worth only $4,000. App. 16-17. In accordance with the Bankruptcy Code, therefore, respondent's secured claim was limited to $4,000, and the $894.89 balance was unsecured.

Id. at 470. [13]

The statutory power to avoid liens in Chapter 13 is found in part in § 1322(b)(2) which expressly empowers a court to approve a plan that modifies the rights of a secured creditor, with one limited exception. This section states as follows:

> (b) Subject to subsections (a) and (c) of this section, the plan may—
>
> (2) modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence . . . .

The permitted "modification" includes a permanent reduction in the loan. Thus, a plan of reorganization in Chapter 13 may do what a plan may do in Chapter 11, namely, "modify" and hence restructure, a debt secured by a lien.[14] If a Chapter 13 debtor owns a car or a boat, then the lien of the secured lender is subject

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[13] *See also*, *Associates Commercial Corp. v. Rash,* 520 U.S. 953, 960 (1997): "In such a 'cram down' case we hold, the value of the property (*and thus the amount of the secured claim* under § 506(a) is the price a willing buyer . . . would pay to obtain like property from a willing seller." (Emphasis added.)

[14] "Thus, in cases like this involving secured interests in personal property, the court's authority to modify the number, timing, or amount of the installment payments from those set forth in the debtor's original contract is perfectly clear." *Till*, 541 U.S. 465, 475.

to various forms of modification including loan *and* lien reduction. This reduction is permanent and constitutes lien avoidance.

The effect of confirmation in Chapter 13 is also to effectuate the permanent avoidance of any lien or claim dealt with in the plan. Liens do not remain in place after confirmation, except as provided in a plan. Thus § 1327(c) states as follows:

> (c) Except as otherwise provided in the plan or the order confirming the plan, the property vesting in the debtor under subsection (b) of this section is free and clear of any claim or interest of any creditor provided for by the plan.

An example of how lien avoidance operates in Chapter 13 is found in *Nobelman v. American Savings Bank*, 508 U.S. 324 (1993). In *Nobelman,* the question presented was whether a debtor could avoid a partially unsecured mortgage lien. *See id.* at 325-326. The Nobelmans had purchased a home with a loan from American Savings Bank for $68,250. At the time of their proposed Chapter 13 plan, the uncontroverted valuation of the home was $23,500. Petitioners sought to make payments based on this value, and to avoid the remaining balance in excess of the $23,500. *Id.* at 326.

Nobelman also illustrates the proper relationship between § 506 and the specific provisions that permit treatment of claims after the bifurcation occurs in § 506. The Court stated that after conducting a valuation under § 506(a), a partially secured claim will be bifurcated into its secured and unsecured portion, with that portion having no value being treated as an unsecured claim:

> Petitioners were correct in looking to § 506(a) for a judicial valuation of the collateral to determine the status of the bank's secured claim. It was permissible for petitioners to seek a valuation in proposing their Chapter 13 plan, since § 506(a) states that '[s]uch value shall be determined . . .in conjunction with any hearing . . . on a plan affecting such creditor's interest."

Id. at 328-329.[15]

Nobelman also acknowledged that valuation of collateral is central to the determination of which portions of a lender's claim are secured, and which are unsecured; the opposite of what Bank of America argues here: "The portion of the bank's claim that exceeds $23,500 [the judicial valuation of the home] is an 'unsecured claim componen[t]' under § 506(a)," citing *Ron Pair* 489 U.S. 235, 239, n. 3.

This Court made no distinction between a lien and a claim. Further, implicit in the *Nobelman* decision is the corollary principle that if the lien has no economic value based on the underlying collateral, it is totally unsecured, and is not a secured claim for purposes of the Code.

The *only reason* this Court declined to permit the lien avoidance in *Nobelman* was because § 1322 states

[15] Justice Scalia, in his dissent in *Dewsnup* observed that "in light of § 506(a)," the prohibition on the power to modify a mortgagee's rights exists "only with respect to the portion of his claim that is deemed secured under the Code." 502 U.S. at 429. (citations omitted).

that a plan cannot "modify the rights" of a creditor secured only by a security interest in real property that is a debtor's principal residence. The dispositive term was "rights." Because of this language the Court looked to state law only, and did not adopt the *Dewsnup* definition of allowed secured claim. *Id.* at 329. Because mortgage lenders have a state law right, *outside of bankruptcy law*, to retain a lien until foreclosure, the Court held that such right could not be modified.

Significantly, this ruling means that the statutory power to modify the "rights" of secured lenders embraces *all rights under state law* and thus makes no distinction between lien and claim. In a word, *Nobelman* directly contradicts the lien-claim argument of Bank of America, which it describes as its critical argument.

III. SECURED LENDERS DO NOT HAVE AN ENTITLEMENT TO FUTURE APPRECIATION OF THE COLLATERAL NOR A PROTECTED PROPERTY RIGHT THAT PREVENTS LIEN AVOIDANCE.

A. Lien avoidance does not deprive lenders' of any so-called entitlement to future appreciation.

Bank of America argues that lien avoidance should be prohibited in Chapter 7, because secured lenders are entitled to the future appreciation of their collateral. (Pet. Br. 4, 22.) It argues that its "bargain" included the possibility of future appreciation at the time of foreclosure. (Pet. Br. 26.) Bank of America acknowledges, however, as a factual matter, that the right to foreclose *now* would be of no value. "[I]f the house were sold today, Bank of America would obtain no recovery." (Pet. Br. 26.) The record contains no evidence on likely future appreciation.

These assertions are incorrect and run contrary to well-established principles of bankruptcy law. First, as to any supposed "bargain" (which is also absent from the record) bankruptcy law is premised on the constitutional notion that state contract rights (the "bargain") may in fact be modified and even abrogated. This power resides in the Bankruptcy Clause (U.S. CONST. art. I, § 8, cl. 4). "The Bankruptcy Clause necessarily authorizes Congress to make laws that would impair contracts. It long has been understood that bankruptcy law entails impairment of contracts." *In re City of Detroit, Mich.*, 504 B.R. 97, 137-38 (Bankr. E.D. Mich. 2013) (internal citations omitted)"[16]

Nor does the Fifth Amendment create a right to future appreciation. The controlling principle is that a secured lender's "rights" are the preservation of the value of its lien "throughout the proceedings."[17] There is no constitutional right to any value accrual after the bankruptcy proceedings are complete.

Justice Scalia recognized in *Dewsnup* that there is no entitlement to future appreciation under bankruptcy law. "There, no more than under Chapter 7, can [secured lenders] demand the benefit of

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[16] Judge Rhodes cited *Sturges v. Crowninshield,* 17 U.S. 122, 191 (1819). *Id*. at 138. Contractual bargains in loan agreements are often impaired as part of the normal operation of bankruptcy. Section 1123(b) expressly provides that a plan of reorganization may "impair . .any class of claims, secured or unsecured . . . ." Impairment means to alter the legal, equitable or contractual rights to which a creditor might otherwise be entitled to under state law. *See* § 1124.

[17] *See Wright,* 311 U.S. at 278, discussed at Kenneth N. Klee, BANKRUPTCY AND THE SUPREME COURT, 147 (2008).

postevaluation increases in the value of property given as security." 502 U.S. at 430.

The circuit courts have also recognized this principle. As the Third Circuit correctly stated, "a secured lender's expectation of benefiting from the eventual appreciation of collateral (the so-called "upside" of the collateral) is not an entitlement when the property is part of a bankruptcy estate." *In re Philadelphia Newspapers, LLC.,* 599 F.3d 298, 316 (3d Cir. 2010).[18] The Third Circuit added that "asserting an absolute right to [the upside in collateral] is plainly contrary to other provisions of the Code . . . ." *Id*.

> The Bankruptcy Code. . . does not protect a secured creditor's upside potential; it protects the "allowed secured claim." If a creditor were over-secured, it could not demand to keep its collateral rather than be paid in full simply to protect the "upside potential."
>
> *Id*. (citing *In re Pacific Lumber,* 584 F.3d 229, 247 (5th Cir. 2009)).

The notion that a lender has a statutory entitlement to future appreciation of its collateral is belied by the provisions dealing with "adequate protection" under § 361. The Code provides that a secured lender is entitled to have its collateral protected against only a "decrease" in value during the course of the case. *See* §§ 361(1) and (2). The courts have uniformly held that absent any provable decrease in value, a secured lender is not entitled to any further protection during the course of the case. *United Savings Ass'n v. Timbers of Inwood Forest Assoc.,* 484 U.S. 365, 370

[18] *But see, RadLAX Gateway Hotel LLC v. Amalgamated Bank,* 132 S.Ct.2065 (2012)(disagreement on other issues).

(1988) (noting that a creditor's interest "is not adequately protected *if* the security is depreciating during the term of the stay") (emphasis added).

Further, efforts by lenders to obtain adequate protection during the bankruptcy case for any excess in value over the collateral's current value (the "equity cushion") have likewise been rebuffed by the courts. *See, e.g., Orix Credit Alliance, Inc., v. Delta Resources, Inc., (In re Delta Resources, Inc.),* 54 F.3d 722, 728 (11th Cir. 1995).

Nor is a secured lender entitled to future appreciation of the collateral at the end of the bankruptcy case. In a Chapter 11 case, where the debtor retains the asset, the lender is given a new note based on the present value of the income stream. § 1129(b)(2)(A). Thus, a bankruptcy court is only "require[d] . . . to ensure that the property to be distributed to a particular secured creditor over the life of a bankruptcy plan has a total 'value' as of the effective date of the plan, that equals or exceeds the value of the creditor's allowed secured claim . . ." *Till,* 541 U.S. at 474. The judicial determination is made "as of the effective date of the plan." *Id.* The principle is that the judicial valuation on the effective date governs and determines the rights of the lender. The risk of future depreciation or the gain from future growth are with the debtor, not the lender. [19]

If a lender seeks to share in the potential appreciation of collateral at some point after the bankruptcy proceedings, the Code provides two avenues for doing so—but certainly contains no

[19] "The Supreme Court's opinion in *Dewsnup* does not establish a general principle for allocating post-petition appreciation." *In re Marsh,* 929 F. Supp. 2d 852, 856 (N.D. Ill. 2013).

expression of an automatic "entitlement." First, a lender may request that the trustee or debtor sell the property free and clear under § 363(f). The undersecured lender can credit bid, and acquire the property, subject to the rights of any senior lien holder. *See* § 363(k). This is the same right it would have under state law—namely to bid in at a state foreclosure sale, pay off any first lien, and then, and only then, hold the property for any future appreciation. Otherwise, under state law, the undersecured junior lien is extinguished on the sale by the senior. This is the true "bargain" that Bank of America made here—a risk that it would have its lien extinguished at a foreclosure sale, unless it was willing to purchase the property. [20]

While the Code generally does not provide for a secured lender to protect itself against loss of future appreciation, it does do so in one limited case, but then, only by a specific provision. In a Chapter 11 case, a lender may protect itself against loss of future appreciation of its collateral by operation of § 1111(b). Because the normal operation of the Code is that lenders may have their liens extinguished based on the judicial valuation as of the effective date, the 1978 Code included gave lenders an "election" right to retain their liens up to the face amount of the debt,

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[20] Bank of America did not originate the loans in this case, but acquired the loan portfolio of Country Wide. Brief in Opposition to Petition for Writ of Cert, No. 13-1421, *Bank of America v. Caulkett*, p. 5. The sale was reported to have closed on July 1, 2008. *See* "The Deal that Cost Bank of America $50 Billion-and Counting," Charlotte Observer, August 16, 2014, available at www.charlotte.observer.com. In 2008 Bank of America should have anticipated that the mortgages in the Eleventh Circuit would be subject to lien avoidance, which was then the prevailing law in that circuit. None of this was before the courts below.

even if the value of the collateral was determined to be less than the debt. This was accomplished pursuant to § 1111(b), which provides for such an election.[21] A lender who makes the election, however, does not have an unsecured claim, and in a Chapter 11 case, this can be significant as the lender will not have a large, controlling vote among the unsecured creditor class.

However, the election right does not exist where the lien has no value. The election may only be made where the lien is not of "inconsequential value." Professor Klee states, "If the lien securing the claims is worthless or of inconsequential value, then the class is ineligible to make the election." Klee, "All You Ever Wanted to Know," *supra* at 153.

Thus, the normal operation of Chapter 11 is that lenders' claims are subject to judicial valuation, and then to lien avoidance where the value is less than the debt. Absent the purchase of the collateral, or an election under § 1111(b), any future appreciation is not preserved for the lender. As Justice Scalia observed, even if there is some tension with a lender's view of what is "fair," "Congress. . . expressly chose to create that alleged tension." *Dewsnup,* 502 U.S. at 435.

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[21] *See e.g. Matter of Tampa Bay Associates, Ltd*., 864 F.2d 47, 50 (5th Cir. 1989) (discussing Congress' reaction to *Great Nat'l Life Ins. Co. v. Pine Gate Associates, Ltd*., 2 Bankr. Ct. Dec. 1478 (Bankr. N.D. Ga. 1976), which recognized that under § 506 a lender could be compelled to accept a monetary payment equal to the value of the collateral and have its lien avoided.

B. Lien avoidance does not contravene the Takings Clause of the Fifth Amendment.

Bank of America has also argued that liens are property interests with a "constitutional dimension." (Pet. Br. 23.) It cites *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555 (1886). This argument also appears to cut across all of the reorganization chapters.

The precise constitutional dimension however is limited and reliance on *Radford* for extending *Dewsnup* would be seriously misplaced. As one leading commentator stated, "If Radford is not a dead letter, it is of limited vitality. Thus, secured creditors cannot rely on the Takings Clause to limit the modification of their property rights in bankruptcy cases." Klee, BANKRUPTCY AND THE SUPREME COURT, *supra* note 17 at 141-142

Radford has been recognized as having very limited applicability, and certainly as not preventing Congress from adopting § 506 for the purpose of permitting lien avoidance or altering the contractual bargain of a secured lender. "In the final analysis, however, the Due Process Clause, not the Takings Clause, provides secured creditors with the baseline protection of property rights in bankruptcy. Property rights do not gain any absolute inviolability in the bankruptcy court because created and protected by state law." [22]

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[22] *See* Klee, BANKRUPTCY AND THE SUPREME COURT, supra at 141-142 citing *Wright v. Union Cent. Life Ins. Co.,* 304 U.S. 502, 518 (1938).

The constitutional framework relates directly to the issue in this case over the meaning of § 506. The Bankruptcy Code "protects the rights of secured creditors, throughout the proceedings, *to the extent of the value of the property*. There is no constitutional claim of the creditor to more than that."[23] The arguments by Bank of America for an extension of *Dewsnup* cannot be based on the Fifth Amendment.

IV. *DEWSNUP* SHOULD BE REVERSED; LIEN AVOIDANCE IS PERMITTED IN CHAPTER 7.

Bank of America argues that Chapter 7 stands alone, and that the interpretation of § 506(d) in *Dewsnup* is correct because "liens pass through bankruptcy unaffected." (Pet. Br. 13.) This argument too fails.

The categorical statement that liens pass through Chapter 7 unaffected is overbroad and inaccurate. While the discharge *itself* does not effectuate a lien avoidance, other provisions do provide for such. "Chapter 7 indubitably permits liens to be removed in many situations." *Woolsey v. Citibank (In re Woolsey),* 696 F.3d 1266,1274 (10th Cir. 2012). The Eighth Circuit agreed:

> At this point, we think it wise to address the conventional wisdom that liens pass through bankruptcy unaffected. As Judge Posner recently demonstrated in *In re Penrod,* 50 F.3d 459, 461–62 (7th Cir. 1995), this "old saw" is actually far too broad, for there are many ways in which liens may be affected by bankruptcy proceedings. To name just a few,

[23] *Wright*, supra, 311 U.S. at 278. *See also,* Klee, *id.* at 147.

> a lien may be removed from collateral and replaced by adequate protection if the trustee obtains permission to sell property free and clear of liens, *see* 11 U.S.C. § 363(e)-(f) (1994), or voided if the related claim is disallowed, *see* 11 U.S.C. § 506(d) (1994), or avoided to the extent it impairs an exemption of the debtor, *see* 11 U.S.C. § 522(f) (1994), or avoided if it is the result of a preference or a fraudulent transfer, *see* 11 U.S.C. §§ 547–548 (1994). Because all of these provisions are applicable in Chapter 7, it is not even accurate to say that liens pass through Chapter 7 unaffected.

Harmon v. U.S. Through Farmers Home Admin., 101 F.3d 574, 581 (8th Cir. 1996).

Lien avoidance is central to the proper operation of bankruptcy. While NACBA and AARP have primarily urged that this Court reject any argument by Bank of America that could endanger the historic operation of the reorganization Chapters, they further urge that this Court reconsider *Dewsnup,* give full recognition to the power to avoid liens even in Chapter 7, and affirm the decision of the Eleventh Circuit.

CONCLUSION

For all of the foregoing reasons, NACBA and AARP respectfully request that the decision of the Eleventh Circuit be affirmed.

Respectfully submitted,

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