

## BANKING LAW ALERT

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June 2015 Issue

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### U. S. SUPREME COURT OFFERS AID TO "UNDERWATER" MORTGAGE HOLDER

On June 1, 2015, the United States Supreme Court issued its opinion in the matter of Bank of America, N. A. vs. Caulkett in which it answered the question as to whether a wholly "underwater" second mortgage could be voided by a debtor in a Chapter 7 bankruptcy proceeding. The case before the Court presented the common factual scenario where the value of the debtors' home, when they filed Chapter 7 bankruptcy, was less than the amount owed on their first mortgage, leaving no equity for the second mortgage.

The debtors argued that the second mortgage holder's claims were not secured because Section 506(a)(1) of the Bankruptcy Code provides that "an 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."

The Court was called to reevaluate a prior ruling where it had held that the Bankruptcy Code does not allow courts to reduce the value of a second mortgage lien to the property's market value in a situation where the second mortgage is only "partially underwater." Citing the constantly shifting value of real property, the Supreme Court concluded that the debtors' position was untenable. If the Court determined that the value of the property was \$1.00 more than the amount of the first mortgage, then the second mortgage could not be voided, but the second mortgage could be voided if the property was valued at a \$1.00 less than the first mortgage. In order to avoid statutory interpretation that could lead to "arbitrary results," the Supreme Court held that a debtor in Chapter 7 bankruptcy may not void a junior mortgage under Section 506(d) where the debt owed on a senior mortgage exceeds the current value of the collateral.

Effectively, this Supreme Court ruling offers second mortgage holders protection of their lien from discharge in a chapter 7 bankruptcy case, even when the value of the property is less than the first mortgage. To the extent that the debtor, after bankruptcy, is able to service the first mortgage and create post-petition equity in the collateral, the junior lienholder may benefit from the subsequent increase in the value of the retained property and the creation of this equity which would be subject to its junior lien. Of course, even where the junior lien survives bankruptcy, it would be subject to discharge by foreclosure on the part of the first mortgage holder.



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