Nos. 13-1421 & 14-163

IN THE

Supreme Court of the United States

BANK OF AMERICA N.A., *PETITIONER*,
v.
DAVID B. CAULKETT, *RESPONDENT.*

BANK OF AMERICA N.A., *PETITIONER*,
v.
EDELMIRO TOLEDO-CARDONA, *RESPONDENT.*

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

BRIEF OF OCCUPY THE SEC AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENTS

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STATEMENT OF INTEREST

Occupy the SEC ("OSEC") is a nonprofit advocacy group within the New York-based Occupy Wall Street movement.[1] OSEC's mission is to advocate for specific improvements to legislations and regulations governing the financial services industry. We seek to ensure that the nation's laws serve the public interest, and not that of Wall Street and its lobbyists. Our group has previously filed *amicus curiae* briefs in court cases that raise significant issues of concern for financial activists, including the recent Supreme Court cases *Gabelli v. SEC*, 133 S. Ct. 1216 (2013) and *Chadbourne & Parke LLP v. Troice*, 134 S. Ct. 1058 (2014).

OSEC submits this brief in support of Respondents and the holdings of the Eleventh Circuit in the decisions below, which were premised on *McNeal v. GMAC Mortgage, LLC*, 735 F.3d 1263 (11th Cir. 2012) and *In re Folendore*, 862 F.2d 1537 (11th Cir. 1989). The instant case centers on a key provision of the Bankruptcy Code, § 506. The Respondents propound the correct interpretation of the phrase "allowed secured" in § 506(d), which plainly permits the strip-off of a wholly underwater lien during Chapter 7 liquidation.

Misconduct in the mortgage industry played a pernicious role in bringing about the recent financial crisis of 2008. That crisis destabilized the global economy and devastated the economic position of millions of home-

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[1] The parties have consented to the filing of this brief. No counsel for a party authored this brief in whole or in part, and no person, other than amicus curiae or its members made a monetary contribution to the preparation or submission of this brief.

owners, forcing many to pursue bankruptcy protection from the demands of creditors.

OSEC files this amicus brief to advocate for the interests of economically vulnerable debtor-homeowners, whose access to justice would be severely limited if the Court were swayed by the Petitioner's flawed interpretation of the phrase "allowed secured" in § 506(d).

Chapter 7 victims are placed in a vulnerable position after losing essentially everything they have. The Court has long acknowledged that debtors who are undergoing liquidation should be afforded a fresh start after bankruptcy. Our governmental system must protect our rights,[2] and we ask the Court to serve the best interests of the people by interpreting § 506(a) and § 506(d) together so as to allow strip-off of wholly underwater liens. This outcome is essential because it would protect liquidation debtors from unjust foreclosure and collection on liens that have no present value.

SUMMARY OF ARGUMENT

The Court should read § 506(a) and § 506(d) of the Bankruptcy Code together in order to arrive at the correct interpretation of the term "allowed secured" in § 506(d). Under the plain language of these provisions, a completely underwater junior lien must be voided as part of the Chapter 7 bankruptcy process. Even subsection (d) alone expresses a clear intention to void liens "to the extent" that they are not secured in collateral value.

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[2] *See* Occupy Wall Street, Declaration of the Occupation of New York City (2011), *available at* http://www.nycga.net/resources/declaration/.

While the Petitioner cites *Dewsnup v. Timm*, 502 U.S. 410 (1992) to support its reasoning, the Court in that case carefully (and repeatedly) limited its decision's precedential impact to the specific fact pattern presented in that case. Thus, *Dewsnup* is inapposite to the case at bar.

The Petitioner recognizes that the phrase "allowed secured" in § 506(d) establishes two separate requirements for a lien to survive voidance: first, the associated claim must be "allowed" under § 502, and second, the claim must be "secured." Despite this recognition, the Petitioner glosses over the second requirement, making the simplistic argument that a lien's status *as such* is sufficient to satisfy the securedness requirement. The *Dewnsup* decision followed similarly erroneous reasoning.

The legislative history behind the enactment of § 506 reveals that subsections (a) and (d) were meant to be read collectively, with securedness corresponding to collateral value. This is demonstrated in various passages in the House and Senate reports accompanying the passage of the Bankruptcy Code in 1978. Therefore, any ambiguities in interpreting § 506(d) can be solved by reading it in conjunction with § 506(a).

Moreover, numerous policy considerations militate in favor of strip-off of wholly underwater liens. The Bankruptcy Code was passed with the intention of reorienting the bankruptcy regime to be more protective of debtors and their right to an unencumbered fresh start. Thus, while a debtor's property could conceivably appreciate in value after a liquidation and discharge, such post-petition appreciation rightly belongs to the debtor under fresh start principles. Allowing an unsecured lienholder to partake in postpetition appreciation would mean granting it a windfall, especially because other unsecured creditors would be denied that opportunity. Moreover, it is far from certain that a debtor's property value would ever increase enough to resuscitate an unsecured lienholder's otherwise-valueless lien.

Economic analysis reviewing the impact of *Dewsnup* and other lien-stripping cases on the mortgage market reveals that debtors would benefit from strip-off of wholly underwater second liens, while lenders would be no worse off (if not better off). Furthermore, the Court should take cognizance of the role that lenders played in producing the dismal economic conditions that have forced millions of people into bankruptcy and foreclosure in recent years.

ARGUMENT

I. THE PLAIN LANGUAGE OF SECTION 506 SUPPORTS AFFIRMANCE

Under a plain reading of 11 U.S.C. § 506 of the Bankruptcy Code, a completely underwater junior lien is voided in a Chapter 7 liquidation. The explicit language of a statute controls over secondary considerations like legislative history and public policy. *See United States v. Ron Pair Enters. Inc.*, 489 U.S. 235, 241 (1989).

Section 506(d) states that a lien is void if it "secures a claim against the debtor that is not an allowed secured claim." The instant case turns on the exact meaning of the phrase "allowed secured" in § 506(d). The Petitioner, citing *Dewsnup*, 502 U.S. at 415, concedes that these two "words should be read term-by-term to refer to any claim that is, first, allowed, and, second, secured." Pet. Br. 22. That is, a lien will be void under § 506(d) to the extent that it secures a claim that is *either* disallowed *or* not secured. There is no dispute that § 502 dictates whether a claim is "allowed." Pet. Br. 32. Thus, the only real question is what constitutes a "secured" claim under § 506(d).

The Court need look no further for an answer than three subsections earlier in the same statute, § 506(a). That subsection of § 506 clarifies that a lienholder has a "secured" claim for the amount of the lien up to the value of the collateral (and an unsecured claim for the remainder). Thus, a claim that corresponds to zero value in the collateral cannot be "secured," and the lien attached to that claim must be voided under § 506(a).

A. *Dewsnup* is Inapposite on its Own Terms

Citing *Dewsnup*, the Petitioner champions a strained reading of § 506 that would have this Court completely ignore § 506(a) in construing § 506(d). Pet. Br. 22. The Petitioner's reliance on *Dewsnup* is inapposite, as that case dealt with a secured claim corresponding to collateral with diminished value, whereas the instant matter deals with a claim that is not secured by any collateral value whatsoever. *See McNeal*, 735 F.3d at 1265 (noting that *Dewsnup* has precedential value in lien "strip-down" cases, not "strip-off" ones).

Importantly, *Dewsnup* by its *own terms* did not seek to apply its interpretation of § 506(d) to "all possible fact situations," leaving such "other facts to await their legal resolution on another day." 502 U.S. at 416-17. Indeed, *Dewsnup* (while paradoxically holding to the contrary) admitted that the better view was for "allowed secured" to take the same meaning in § 506(d) as in § 506(a). 502 U.S. at 417. ("Were we writing on a clean slate, we might be inclined to agree . . . that the words 'allowed secured claim' must take the same meaning in § 506(d) as in § 506(a)."). Thus, the Petitioner's exhortations regarding the *stare decisis* effect of *Dewsnup*, Pet. Br. 30, 40, are misplaced. *See Hoover v. Wise*, 91 U.S. 308, 313-14 (1875) (recognizing the simple axiom that cases "in which the point before [the Court] was not raised or brought to the notice of the court. . . . are not authority on the point.").

B. A Lien Must be Tied to a Claim that is Both Allowed and Secured to Escape Voidance Under Section 506(d)

The Petitioner correctly acknowledges that the phrase "allowed secured" in § 506(d) establishes two requirements for a lien to survive voidance: first, the underlying claim must be "allowed" under § 502, and second, the claim must be "secured." Pet. Br. 22. However, the Petitioner's subsequent reasoning gives short shrift to the second requirement. Bank of America takes the absurd view that a lienholder with an allowed claim *always* has a "secured" claim for purposes of § 506(d), irrespective of whether any collateral is available to actually secure that claim. *See* Pet. Br. 22. This interpretation reduces the word "secured" in "allowed secured" into a nullity and a superfluity.

Under the Petitioner's reasoning, the effect of § 506(d) would be no different whether that statute referred to "an allowed secured claim" or "an allowed claim." Either way, a lien could only be voided under § 506(d) if the underlying claim were disallowed under §

502. The Court must not assume that Congress included the term "secured" in § 506(d) out of mere verbosity. *See Market Co. v. Hoffman*, 101 U.S. 112, 115 (1879) ("As early as in Bacon's Abridgment, sect. 2, it was said that 'a statute ought, upon the whole, to be so construed that, if it can be prevented, no clause, sentence, or word shall be superfluous, void, or insignificant'").

The Petitioner's reasoning attempts to "strip-off" any real meaning from the word "secured" in § 506(d)[3] – a meaning that is readily supplied by § 506(a). The Petitioner's *reductio ad absurdum* cannot be countenanced under long-standing principles of statutory interpretation. *See Montclair v. Ramsdell*, 107 U.S. 147, 152 (1883) (holding that an unnatural meaning should be disfavored at any time, but particularly when it produces a redundancy).

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[3] The Petitioner's reasoning mirrors that of *Dewsnup*, which similarly attempted to efface the iteration of "secured" in § 506(d) out of existence. *Dewsnup*'s express adoption of a two-step analysis of "allowed secured" actually undermined its own holding. *Dewsnup* might have been logically consistent if it had reduced the phrase "allowed secured" into "allowed," but the decision actually took pains to establish a two-step process whereby each term in the phrase would be considered separately. *Dewsnup*, 502 U.S. at 415. After doing so, the decision summarily disregarded the second step in that process, deferring instead to questionable policy concerns. *See id.* There is no wonder then that *Dewsnup*'s reasoning has been subject to intense criticism in the Chapter 7 context, *see, e.g.*, Margaret Howard, *Dewsnupping the Bankruptcy Code*, 1 J. Bankr. L. & Pract. 513 (1992), and has "lost every game it has played" outside of the liquidation arena. *In re Woolsey*, 696 F.3d 1266, 1276 (10th Cir. 2012).

C. Voidness in Section 506(d) is a Matter of Degree

The surrounding context of the phrase "allowed secured" in § 506(d) also sheds light on the proper meaning of those words. Section 506(d) states that a lien is void "to the extent" that it secures a claim that is not an allowed secured claim. The fact that the statute uses the modifier "to the extent" instead of "if" suggests that voidness is a matter of degree. *See Dewsnup*, 502 U.S. at 424 (Scalia, J., dissenting) ("[A] lien only 'secures' the claim in question *up to the value* of the security that is the object of the lien—and only *up to that value* is the lien subject to avoidance under § 506(d)." (emphasis added)). The "extent" of voidness corresponds to the "extent" of securedness. Thus, where a claim underlying a lien is mostly secured, there is little voiding effect. And where a leinholder's claim is not secured by any value, the lien is fully voided. Under the Petitioner's view, the options for lien voidance under § 506(d) are binary. Pet. Br. 25. Either a claim underlying a lien is allowed, or it is not—voidness follows suit. However, this simplistic either-or approach is at odds with the graduated approach adopted by Congress in choosing the words "to the extent."

II. CONGRESS INTENDED FOR SECTIONS 506(A) AND 506(D) TO BE READ TOGETHER

The Petitioner echoes *Dewsnup* in claiming that the word "secured" in § 506(d) means something different than in § 506(a). *See* Pet. Br. 21-22 (citing U.S. 520 at

415). However, that claim is undermined by a review of the legislative history behind the passage of § 506, which reveals that subsections (a) and (d) were meant to be read together. Both the Senate and the House reports state that "*[t]hroughout the bill*, references to secured claims are only to the claim determined to be secured under this subsection, and not to the full amount of the creditor's claim." S. Rep. No. 95-989, 95th Cong., 2d Sess. 68 (1978) (emphasis added); H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 356 (1978) (emphasis added). Thus, the term "secured" in subsection (d) was meant to have the same definition as in subsection (a).[4]

The Petitioner notes that Congress has not amended § 506 of the Bankruptcy Code in the twenty years since the *Dewsnup* holding, and claims that that fact evidences Congress's implicit acquiescence to *Dewsnup*'s reading of § 506(d). Pet. Br. 40. However, mere non-action does not equal acquiescence or outright approval. This Court has long-ago observed that "it is at best treacherous to find in congressional silence alone the adoption of a controlling rule of law." *Girouard v. United States*, 328 U.S. 61, 69 (1946). "It is 'impossible to assert with any degree of assurance that congressional failure to act represents' affirmative congressional approval of the Court's statutory interpretation." *Patterson v. McLean Credit Union*, 491 U.S. 164,

[4] This point is further corroborated by the House Report's discussion of a separate provision, § 502(b)(7), which relates to voidance of a landlord's security interest: "By virtue of proposed 11 U.S.C. **506(a) and 506(d)**, the claim will be divided into a secured portion and an unsecured portion in those cases in which the deposit the landlord holds is less than his damages." H.R. Rep. No. 95-595, at 354 (emphasis added).

175 n.1 (1989) (quoting *Johnson v. Transportation Agency, Santa Clara Cty.*, 480 U.S. 616, 672 (1987) (Scalia, J., dissenting))).

Indeed, one can just as easily use similar reasoning to reach the opposite conclusion. Despite passing amendments to the Bankruptcy Code in 1986, 1994 and 2005, Elizabeth Warren & Jay Lawrence Westbrook, *The Law of Debtors & Creditors* 104-06 (6th ed. 2009), Congress has never found it necessary to clarify the ostensible ambiguity in § 506. That non-action calls into question whether any ambiguity ever existed in the first place. Furthermore, as explained above, under the Petitioner's view, § 506(d) would have the same legal effect regardless of whether it predicated immunity from lien voidance on the underlying claim's status as an "allowed secured claim" *or* an "allowed claim." *See* Pet. Br. 25-26. Yet, in the near forty years since the institution of § 506(d), Congress has never once ratified that view by removing the assertedly-superfluous word "secured" from the phrase "allowed secured claim."

The Petitioner also claims that the original version of § 506(d) "made clear that a lien was not voided unless a party in interest had objected to the claim and the court had affirmatively disallowed it." Pet. Br. 33. The originally introduced § 506(d) stated:

> To the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void, unless (1) a party in interest has not **requested that the court determine and allow or disallow such claim** under section 502 of this title;

> or (2) such claim was disallowed only under section 502(e) of this title.

Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, § 506(d), 92 Stat. 2549, 2583 (emphasis added).

Contrary to the Petitioner's claim, the above passage actually states that a lien can only be voided if the claim has undergone the allowance determination process under § 502. Under a simple reading of this original language, either an allowed *or* disallowed claim could be voided. The current version of the statute is not materially different.[5]

Both the Petitioner and the *Dewsnup* majority focused a significant part of their arguments on the proposition that all liens pass through Chapter 7 liquidation unaffected. Pet. Br. 34 ("At least in liquidation proceedings like those here, 'liens pass through bankruptcy unaffected.'" (citing *Dewsnup*, 502 U.S. at 417)). This proposition is predicated upon a misconstrued single line in the House Report, which states that "[s]ubsection (d) permits liens to pass through the bankruptcy case unaffected." H.R. Rep. No. 95-595, at 357.

While liens do enjoy special treatment in bankruptcy, the simple fact is that all liens do *not* pass through liquidation unaffected. Both the Petitioner and *Dewsnup* have implicitly acknowledged this fact (and have thereby contradicted themselves) given their recognition that liens attached to disallowed claims are

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[5] *See* 11 U.S.C. § 506(d) (voiding a lien securing a claim under certain circumstances, unless "such claim is not an allowed secured claim due only to the failure of any entity to file a proof of such claim under section 501").

voided under § 506(d).[6] There is no disagreement among the parties that *at least some* liens do not survive the liquidation process, pre-Code practice notwithstanding. Indeed, numerous other provisions under Chapter 7 of the Code allow for lien voidance.[7]

One such provision is § 506, the plain text of which mandates the voidance of liens that are attached to claims that are not secured by collateral value. The Petitioner argues that the term "secured" in § 506(d) is "ambiguous in isolation," because it could mean secured in the sense of corresponding to collateral value, or secured in the sense of having an attached lien. Pet. Br. 30 (citing *United Sav. Ass'n of Tex. v. Timbers of Inwood Forest Assocs.*, 484 U.S. 365, 371 (1988)). Even assuming such ambiguity exists, the very case cited by the Petitioner instructs that such ambiguity can be satisfactorily resolved if "the same terminology is used elsewhere in a context that makes its meaning clear." *Timbers*, 484 U.S. at 371. Here, the term "secured" is

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[6] *See* Pet. Br. 33 ("§506(d) addresses what happens if a secured creditor's claim is disallowed: In that event, because the underlying debt has been determined to be invalid, the lien securing the debt is voided as well."); *Dewsnup*, 502 U.S. at 417; *see also id.* at 434 (Scalia, J., dissenting) ("[N]o matter how deeply one admires and venerates 'pre-Code law,' it is impossible to interpret § 506(d) in a manner that entirely preserves it—and the Court itself, for all its protestation of fealty, does not do so. No provision of the former Bankruptcy Act, nor any pre-Code doctrine, purported to invalidate—across the board—liens securing claims disallowed in bankruptcy[.]").

[7] *See, e.g.*, 11 U.S.C. §522(f) (extending the rights of debtors to avoid liens against exempt property); *id.* §544(a) (avoiding unperfected security interests).

used nearby, in § 506(a), in a context that clarifies any ambiguity over the meaning of "secured" in § 506(d).

Even if pre-Code practice had contained a blanket prohibition on lien-stripping, that historical practice would still remain unavailing to the Petitioner because prior policy cannot trump a more recent statutory mandate. Generalizations about legislative history are inadequate to "overcome the plain textual indication" of statutory language. *Timbers*, 484 U.S. at 380. Indeed, as Justice Scalia noted in his *Dewsnup* dissent, the Court has never held pre-Code practice to be determinative in the face of contradictory statutory text. *Dewsnup*, 502 U.S. at 433 (Scalia, J., dissenting).

Pre-Code practice is also irrelevant given the historical fact that the Bankruptcy Code was enacted in 1978 with an express intention to reduce the rights of lienholders vis-à-vis debtors. *See* Howard, *Dewsnupping the Bankruptcy Code*, at 527 n.74 ("The Code was understood at the time of its enactment not to be as solicitous of secured creditors as pre-Code law had been[.]"). This reorientation is manifested in Section 506(a), which dilutes a lienholder's interest into secured claims and unsecured ones. This framework protects lienholders only to the extent of collateral value,[8]

[8] The House Report contains the following illuminative passage:

> One of the more significant changes from current law in proposed Title 11 is the treatment of secured creditors and secured claims. Unlike current law, H.R. 8200 distinguishes between secured and unsecured claims, rather than between secured and unsecured creditors. The distinction becomes important in the handling of creditors with a lien on property that is worth less than the amount of their claim, that is, those creditors that are undersecured. Current law is ambiguous and

without over-privileging their mere status as holders of liens "with recourse to the underlying collateral." Pet. Br. 20.

Thus, a more accurate restatement of the treatment of liens would be that they pass through liquidation unaffected, *provided* that some provision of the Bankruptcy Code does not void them. *See* Howard, *Dewsnupping the Bankruptcy Code*, at 526 n.71.

Furthermore, a close reading of the House Report for the Bankruptcy Code undermines the Petitioner's contention that Congress intended to circumscribe § 506(d) voidance to liens tied to disallowed claims. The Report states that "if a party in interest requests the court to determine and allow or disallow the claim secured by the lien under section 502 and the claim is not allowed, then the lien is void to the extent that the claim is not allowed." Pet. Br. 34 (citing H.R. Rep. No. 95-595, at 357); *see also* S. Rep. No. 95-989, at 68 ("Subsection (d) provides that to the extent a secured claim is not allowed, its lien is void[.]"). This passage stands for the unremarkable proposition that a lien tied to a disallowed claim is voided under § 506(d). That passage does not address (and thereby logically permits) the possibility that *allowed* claims could *also* be voided

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> vague, especially under Chapter XIII, on whether an undersecured creditor is to be treated as a secured creditor, or as a partially secured and partially unsecured creditor. By addressing the problem in terms of claims, the bill makes clear that an undersecured creditor is to be treated as having a secured claim to the extent of the value of the collateral and an unsecured claim for the balance of his claim against the debtor.

H.R. Rep. No. 95-595, at 180-81 (emphasis added).

under certain circumstances, such as for failing to be secured in collateral. Instead, the passage is focused solely upon the first component of the pivotal phrase "allowed secured," which both *Dewsnup* and the Petitioner recognize as a single phrase composed of two legally distinct words. *See* Pet. Br. 22; *Dewsnup*, 502 U.S. at 415 ("[T]he words should be read term-by-term to refer to any claim that is, first, allowed, and, second, secured."). The contours of the second word in the phrase "allowed secured" are amply delineated earlier in the same House Report, which explains that "*[t]hroughout the bill*, references to secured claims are only to the claim determined to be secured under this subsection, and not to the full amount of the creditor's claim." H.R. Rep. No. 95-595, at 356. This statement demonstrates Congress's intention to void certain liens where their associated claims are not "secured" in collateral.

III. POLICY CONSIDERATIONS FAVOR AFFIRMANCE

A. Fresh Start Principles Support Strip-off of Underwater Second Liens

For well over a century, the Court has recognized the fundamental principle that debtors undergoing liquidation should be afforded a fresh start after bankruptcy.

> The federal system of bankruptcy is designed not only to distribute the property of the debtor, not by law exempted, fairly and equally among his creditors, but as a main purpose of the act, intends to aid the

> unfortunate debtor by giving him a fresh start in life, free from debts, except of a certain character, after the property which he owned at the time of bankruptcy has been administered for the benefit of creditors. Our decisions lay great stress upon this feature of the law — as one not only of private but of great public interest in that it secures to the unfortunate debtor, who surrenders his property for distribution, a new opportunity in life."

Stellwagen v. Clum, 245 U.S. 605, 617 (1918).

To be sure, it is clear that liens are not voided by the mere initiation of a liquidation proceeding. *Johnson v. Home State Bank*, 501 U.S. 78, 84 (1991). However, this Court is now presented with the less obvious question of whether to allow strip-off of completely underwater second mortgages under § 506(d). As noted by the Petitioner, millions of homeowners are saddled with partially or wholly underwater junior mortgages, Pet. Br. 16-17, and a sizeable portion of that number may be facing the prospect of bankruptcy. The financial difficulties of this population mirror those of the broader economy, which has suffered a catastrophic downturn propelled in large part by eroding housing and mortgage markets. *See generally* The Financial Crisis Inquiry Report: Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States (2011) ("FCIC Report"). The stripping off of economically worthless junior mortgages would grant the "unfortunate debtor" a truly unfettered "new opportunity in life," *Stellwagen*, 245 U.S. at 617, which is a timely and laudable policy objective given the recent history of financial turbulence. The public interest would not be served by an adoption of the Petitioner's view, which would unconscionably permit a junior mortgagee to dun a debtor with the specter of foreclosure even when the present value of the mortgagee's interest is essentially zero.

In *Dewsnup*, this Court observed that the fresh start policy does not extend to *in rem* claims against property but rather is limited to discharge of personal liability. 502 U.S. at 418 (citing *Johnson*, 501 U.S. at 84). However, *Dewsnup* and *Johnson* dealt with senior liens, whereas the present case focuses solely upon junior liens. Many junior liens essentially serve as home equity loans intended to facilitate *personal* spending. *See In re Bartee*, 212 F.3d 277, 293 (5th Cir. 2000) ("[S]econdary lending is targeted primarily at personal spending"). Therefore, the policy of preserving *in rem* liability should serve as less of a restriction on the Court's due consideration of the fresh start policy in deciding this case.

B. Postpetition Appreciation in Collateral Value Belongs to the Debtor

A key policy issue in this case is which party — lienholder or debtor — is entitled to increases in collateral value after bankruptcy ("postpetition appreciation"). In the normal case, where a lien is tied to an allowed and secured claim, the lien stays with the real property until the foreclosure or payment in full, and any appreciation in the property's value accrues to the benefit of the lienholder in the event of foreclosure. Pet. Br. 22 (citing *Dewsnup*, 502 U.S. at 417 ("Any increase over the judicially determined valuation during bankruptcy rightly accrues to the benefit of the creditor[.]")). As the Petitioner notes, "that is what it means to have a lien." *Id.* at 4. However, the lienholder's right to postpetition appreciation evaporates where a lien is rightfully stripped during the liquidation process for having no corresponding collateral value. That is what it means for a lien to be voided under the plain language of § 506. It would be unfair to both debtors and the broader class of unsecured creditors for lienholders to enjoy postpetition appreciation, at least in cases where the lienholder's claim is completely underwater.

As noted above, a fundamental objective of the Bankruptcy Code is to "aid the unfortunate debtor by giving him a fresh start in life." *Stellwagen*, 245 U.S. at 617. This hallowed fresh start policy militates in favor of speedy and expeditious disposition of debts. *See In re Dittmar,* 618 F.3d 1199, 1212 (10th Cir. 2010) (recognizing the overriding policy "that bankruptcy cases be handled in a speedy and expeditious manner") (internal citation omitted). Thus, a Chapter 7 debtor is entitled to have his debts resolved to the maximum extent possible during a single liquidation proceeding. Truly secured property rights must be firmly and finally winnowed from unsecured ones. The Bankruptcy Code was not written for the purpose of preserving essentially dead liens based upon the purely hypothetical possibility of postpetition appreciation.

Rather, the intent of Congress in formulating the country's bankruptcy regime has been "to leave the bankrupt free after the date of his petition to accumulate new wealth in the future," and thus "make an unencumbered fresh start." *Segal v. Rochelle,* 382 U.S. 375, 380 (1966). Allowing lienholders to retain valueless liens flies in the face of this policy, and hampers debtors' ability to accumulate new wealth in the form of increased home equity after having passed through Chapter 7 liquidation.

The Petitioner suggests that the housing market has improved since the nadir of 2008, and that as a result, underwater liens are regaining equity. Pet. Br. 16. While that may be true, the issue before this Court is whether § 506 renders a lien voidable for being *presently* unsecured. The language of Section 506 countenances no consideration of the possibility that an offending lien might somehow become secured *in the future*. If a lienholder's claim is not "secured" during a Chapter 7 proceeding, the associated lien is voided then and there.

If a mortgagee's completely underwater lien were preserved in the liquidation process, that mortgagee would unfairly be allowed to "have its cake and eat it too." First, the mortgagee could share in the proceeds of the distribution *in pari passu* with other unsecured creditors under § 506(a). Second, the mortgagee could benefit from any postpetition appreciation in the collateral pursuant to a foreclosure. This result would run afoul of the basic bankruptcy tenet that creditors of equal priority should receive equal pro rata distributions. *Begier v. IRS*, 496 U.S. 53, 58 (1990); *Union Bank v. Wolas,* 502 U.S. 151, 161 (1991) (recognizing that equality of distribution among creditors is "prime bankruptcy policy"). A completely underwater mortgagee, *as an unsecured creditor*, must receive distributions on par with other unsecured creditors even if those other unsecured creditors "had nothing to do with the mortgagor-mortgagee bargain." *Dewsnup*, 502 U.S. at 417.[9]

In any case, it is far from certain that collateral will appreciate in value after bankruptcy. And even if there were a postpetition increase in collateral value, the senior lienholder would have priority over a wholly unsecured junior lienholder to collect that increase. Consider, for example, a debtor like the one in *Dewsnup* who owes $119,000 to a senior lienholder, and owns collateral with a present value of $39,000. Assume a junior lienholder holds a junior claim for $20,000. In this example, the senior lienholder is undersecured by $80,000, which means that the property would need to appreciate by more than that amount after bankruptcy — a tall order — for the junior lienholder to enjoy any benefit whatsoever from its unvoided lien. Thus, it is quite likely that a bank holding a wholly unsecured junior lien would be no worse off from a stripoff of that lien, *even if* the collateral were to later appreciate in value. Liens of this type are "empty legal rights" that are not worthy of vindication. *See In re Tanner*, 14 B.R. 933, 938 (Bankr. W.D. Penn. 1981).

The Petitioner and their amici express concern that the decision below abrogates state-law property rights. *See* Pet. Br. 31; Loan Syndications and Trading Association et al. Am. Br. 9. Yet even these parties must concede the rudimentary point that federal law preempts state law. Section 506 of the Bankruptcy Code, and not state law, determines whether a lien may be voided for failing to be secured. This Court has recog-

[9] Indeed, most unsecured creditors have nothing to do with each other's bargains.

nized that bankruptcy law should only respect the allocation of property rights under state law so long as no "federal interest requires a different result." *Butner v. United States*, 440 U.S. 48, 55 (1979). Here, the hallmark principles of creditor equality and a debtor's right to a fresh start are those superseding federal interests. *Stellwagen*, 245 U.S. at 617; *see also Union Bank*, 502 U.S. at 161.

C. Strip-off of Underwater Liens Would Benefit the Economy

A wholly underwater second lien has virtually no present economic value, and is little more than the naked right to foreclose. The stripping off of such liens under § 506(d) would not only improve the financial position of bankruptcy debtors, but would also have salutary effects on local economies ravaged by foreclosures in the recent housing crisis.

Current estimates indicate that there are approximately 2.1 million underwater borrowers holding both first and second liens.[10] The average mortgage balance for this group of borrowers is $299,000 and the average underwater amount is $78,000. Of these millions of borrowers, a significant number may be at risk of imminent default and possible foreclosure.

While foreclosure at a certain level may be the natural consequence of normal housing market conditions, excessive foreclosures produce negative externalities

[10] CoreLogic, *CoreLogic Reports 273,000 Residential Properties Regained Equity in Q3 2014* (Jan. 8, 2015), *available at* http://www.corelogic.com/about-us/news/corelogic-reports-273,000-residential-properties-regained-equity-in-q3-2014.aspx.

that depress local economies.[11] Foreclosed homes can produce urban blight that reduces the property value of adjacent homes. That can set off a perverse domino effect whereby even more homeowners sink underwater and face the risk of foreclosure. Reduced property values also cause local governments to lose property tax revenue and force cuts to spending on local public goods. It is no wonder then, that Congress has passed anti-foreclosure legislation with the express purpose of improving the economy and allowing the country to push past the recent recession. *See, e.g.*, American Housing Rescue and Foreclosure Prevention Act of 2008, Pub. L. No. 110-289, 122 Stat. 2654 (2008).

The Court need not speculate about the real-world impact that affirmance of the decisions below would have on the mortgage industry. That analysis has essentially been conducted already by a team of economists led by the Federal Reserve's Wenli Li. Covering a period between the late 1980s and the early 1990s, Li et al. analyzed every court decision concerning mortgage strip-down in the Chapter 7 or Chapter 13 context, at all jurisdictional levels (bankruptcy, district, circuit and Supreme Court).[12] Their aim was to

[11] *See* Wenli Li, et al., *Using Bankruptcy to Reduce Foreclosures: Does Strip-Down Mortgages Affect the Supply of Mortgage Credit?* (Nov. 24, 2014) 2-3, *available at* http://faculty.som.yale.edu/ishanitewari/documents/LTW_Nov24_2014.pdf.

[12] While Li et al.'s analysis was focused on strip-down and not strip-off, that is a distinction without a difference in this case, as the policy implications of their findings are the same under either scenario. Li et al., at 20 ("Although our results are for mortgages generally rather than second mortgages in particular, they suggest that allowing strip-off of totally underwater second

assess the impact that each decision had on the mortgage market within the geographic jurisdiction covered by that decision. Utilizing sophisticated statistical regression methods, they concluded that the ratification of mortgage strip-down under Chapter 7 "would *not* have strong adverse effects on mortgage loan terms and could be a useful new policy tool to reduce foreclosures" during times of housing market stress.[13] Lien stripping would be advantageous to the millions of homeowners with underwater mortgages because it would reduce their risk of facing default and foreclosure.

Importantly, the economists also found that the benefits of lien stripping do not accrue solely to debtors but can also apply to lenders. Their data analysis revealed that "mortgage strip-down under Chapter 7 did not reduce lenders' profits." Li et al., at 14. Lenders would not be harmed because lien stripping would yield them approximately the same revenue as an immediate foreclosure would. At the time same, lenders would benefit from avoiding the costs and delays associated with the foreclosure process. These findings indicate

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mortgages would not substantially harm future mortgage applicants.").

[13] Li et al., at 4. In fact, the study found that the *Dewsnup* decision *actually produced a 1.5% reduction* in the rate of mortgage approvals in the country. *Id.* That is, history has shown that *Dewsnup* served to hamper "the flow of capital into the home lending market," even though the legislative history behind the Bankruptcy Code reveals a strong preference for facilitating home ownership. *See Nobelman v. Am. Sav. Bank*, 508 U.S. 324, 332 (1993) (Stevens, J., concurring). The Court would once again run afoul of this vital Congressional objective if it were to extend *Dewsnup*'s reasoning to completely underwater second liens.

that expanded lien voidance under § 506(d) would greatly benefit debtors and the broader economy, while concomitantly leaving lenders' profits relatively unscathed. Significantly, neither the Petitioner nor their amici have submitted any countervailing empirical analysis suggesting that affirmance in this case would have adverse impacts on the mortgage industry.

D. The Court Should Affirm In Light of the Banking Industry's Role In Producing the Mortgage Crisis

Since the housing bubble burst a few years ago, a whopping eight million families have either entered foreclosure or have fallen behind on mortgage payments. FCIC Report at 402. When all is said and done, the crisis is expected to have caused up to thirteen million foreclosures. *Id.* And over 1.4 million households declared bankruptcy in the year 2009 alone. *Id.* at 394. Lenders like the Petitioner have had more than a passing role in bringing about these terrific market conditions.

The bipartisan Financial Crisis Inquiry Commission found banks to be complicit in producing the Great Recession of 2008, a financial catastrophe that saw the extinguishment of 40% of median family wealth from 2007 to 2010. Jesse Bricker, et al., *Changes in U.S. Family Finances from 2007 to 2010: Evidence from the Survey of Consumer Finances* 17, Federal Reserve Bulletin (June 2012). Crucially, the FCIC found that [l]enders made loans *that they knew borrowers could not afford*." FCIC Report at xxii (emphasis added). During this time, "irresponsible lending, including predatory and fraudulent practices, became more prevalent." *Id.* at xxiii. Many banks relaxed eligibility standards to unreasonably low levels, often with the objective of luring disadvantaged borrowers into unsustainable subprime mortgages. *Id.* at xxii, 78. The prime objective was "churn[ing] out riskier and riskier loans" to pursue profit at any cost. *Id.* at xx.

Mortgages like the ones at issue in this case supplied the grist for the gargantuan securitization mills run by the nation's largest banks, which repackaged these mortgages into asset-backed securities and related derivatives. When the housing market crashed, the concomitant failure of these esoteric financial products produced cascading losses that reverberated throughout the global financial system. *Id.* at xxv.

One of the chief culprits in the mortgage crisis was Countrywide, which was subsumed into the Petitioner, Bank of America, in 2008:

> As early as September 2004, Countrywide executives recognized that many of the loans they were originating could result in "catastrophic consequences." Less than a year later, they noted that certain high-risk loans they were making could result not only in foreclosures but also in "financial and reputational catastrophe" for the firm. But they did not stop.

Id. at xxii. The FCIC noted similar mismanagement at Bank of America itself.[14] It borders on unseemly and

[14] *Id.* at 162 ("Similarly, in examining Bank of America in 2007, its lead bank regulator, the Office of the Comptroller of the Currency (OCC), sampled 50 mortgages and found 16 with 'quality

beyond ironic that Bank of America now seeks to paint the Respondents as unworthy recipients of a potential "windfall." Pet. Br. 22.

By filing numerous writs of certiorari on the issue before this Court, the Petitioner has demonstrated its firm commitment to ensuring that underwater debtors facing foreclosure are deprived of a truly unencumbered fresh start via Chapter 7 bankruptcy protection. The Petitioner seeks judicial preservation of its presently valueless second liens so that it may extract every last penny of speculative post-petition collateral value from Chapter 7 debtors. However, this Supreme Court has long recognized its reluctance to vindicate the legal claims of parties with unclean hands:

> [W]henever a party who, as actor, seeks to set the judicial machinery in motion and obtain some remedy, has violated conscience, or good faith, or other equitable principle, in his prior conduct, then the doors of the court will be shut against him in limine; the court will refuse to interfere on his behalf, to acknowledge his right, or to award him any remedy.

Keystone Driller Co. v. Gen. Excavator Co., 290 U.S. 240, 245 (1933) (internal citation omitted).

The Court should refuse to countenance the Petitioner's arguments given the banking industry's role in contributing to the financial difficulties of underwater debtors like the Respondents.

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assurance referrals' for suspicious activity for which no report had been filed with [the concerned oversight bureau.]").

CONCLUSION

For the foregoing reasons, OSEC, as *amicus curiae*, urges the Court to rule in favor of the Respondents and hold that the Eleventh Circuit correctly construed § 506(d) to permit a Chapter 7 debtor to strip-off a junior mortgage lien in its entirety when the outstanding debt owed to a senior lienholder exceeds the current value of the collateral.

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Respectfully submitted,

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