No. 18-747

In The
Supreme Court of the United States

SONJA RITTER,

Petitioner,

v.

LOIS BRADY, Chapter 7 Trustee,

Respondent.

**On Petition For Writ Of Certiorari
To The United States Court Of Appeals
For The Ninth Circuit**

**MOTION FOR LEAVE TO FILE A BRIEF
AS AMICA CURIAE AND BRIEF OF
PROFESSOR MARGARET HOWARD AS
AMICA CURIAE IN SUPPORT OF PETITIONER**

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MOTION FOR LEAVE TO FILE BRIEF AMICA CURIAE

Pursuant to Supreme Court Rule 37.2(b), Professor Margaret Howard respectfully seeks leave to submit the accompanying brief as amica curiae in support of petitioner. Petitioner has consented to the filing of an amicus brief, but respondent has not.

The petition for a writ of certiorari asks this Court to overrule *Dewsnup v. Timm*, 502 U.S. 410 (1992), thereby reversing the decision of the Ninth Circuit. Amica supports the petitioner's request.

This brief presents reasons for overruling *Dewsnup* that are additional to those in petitioner's brief. Specifically, this brief analyzes the justifications advanced by the *Dewsnup* majority for its outcome, and demonstrates that none of them withstands scrutiny. First, *Dewsnup* misstated and ignored governing Supreme Court rulings then in place, including constitutional holdings. Second, *Dewsnup* asserted a dearth of legislative history supporting a contrary outcome, completely ignoring that Congress structured the 1978 Bankruptcy Code around a "priority model" of secured claims. Under that approach, secured claims are defined by the value of the collateral available for each of those claims, and the claimholder's recovery is limited to no more than the present value of that amount. Provisions across the Code are consistent with this definition, with a handful of carefully drawn statutory exceptions and with the exception of section 506(d) as (mis)interpreted by *Dewsnup*. Third, *Dewsnup* asserted that it was protecting creditors' rights to appreciation. Scrutiny reveals, however, that

preserving valueless liens is neither necessary nor appropriate to the accomplishment of that goal.

Amica is the Law Alumni Association Professor of Law Emerita at Washington and Lee University School of Law, Lexington, Virginia. She has studied and written about bankruptcy's treatment of undersecured claims for several decades, and she is well-positioned to address these issues.*

For the foregoing reasons, the Court should grant leave to file the accompanying brief.

Respectfully submitted,

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* See *The Law of Unintended Consequences*, 31 S. Ill. U. L.J. 385 (2007); *Secured Claims in Bankruptcy: An Essay on Missing the Point*, 23 CAPITAL UNIV. L. REV. 313 (1994); Dewsnup*ping the Bankruptcy Code*, 1 J. BANKR. LAW & PRACTICE 513 (1992); *Stripping Down Liens*: *Section 506(d) and the Theory of Bankruptcy*, 65 AM. BANKR. L.J. 373 (1991).

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INTEREST OF AMICA[1]

Margaret Howard is the Law Alumni Association Professor of Law Emerita at Washington and Lee University School of Law, Lexington, Virginia. She has studied secured creditors' rights in bankruptcy for nearly three decades, with specific emphasis on stripdown of liens. Her sole interest is in the appropriate interpretation and development of the bankruptcy laws of the United States. (Amica's institutional affiliation is provided for proper identification, and not to imply her institution's endorsement of these views.)

SUMMARY OF ARGUMENT

Dewsnup v. Timm, 502 U.S. 410 (1992), was wrongly decided and should be overruled. Its statutory methodology ignored both the plain meaning of the Bankruptcy Code and established principles of statutory construction. Nor is the result justified by the rationales offered by the Court.

The *Dewsnup* majority erroneously believed that liens pass through bankruptcy unaffected. They

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[1] Pursuant to Supreme Court Rule 37, *amica* notified petitioner and respondent of the intent to file this brief more than ten days before its due date. Petitioner has consented to its filing. Respondent did not consent.

No counsel for a party authored this brief in whole or in part or made a monetary contribution to its preparation or submission. Expenses were met exclusively from a grant provided by the Sydney Lewis Law Center at Washington and Lee University School of Law.

do so only if bankruptcy's substantial avoiding powers are not brought to bear.

Under this Court's constitutional precedents, secured creditors must receive the value of collateral available for their claims, but not the collateral itself. That understanding is foundational in bankruptcy.

The Code follows a "priority model" under which lienholders are assured the value of their secured claims, but not property rights in particular collateral. Numerous sections of the Code, applicable in both liquidations and reorganizations, reflect the priority model: section 361, listing ways of providing adequate protection and protecting only value, not property rights; section 364(d), overriding secured creditors' property rights by permitting liens to be demoted if necessary post-petition credit cannot otherwise be obtained; section 722, permitting debtors to redeem certain property and eliminate encumbrances by paying the collateral's value; section 506(b), allowing oversecured creditors to claim post-petition interest, but only up to the value of available collateral; and plan confirmation provisions in the reorganization chapters, requiring payment only of the present value of secured claims.

The few exceptions enacted by Congress are specific and narrowly drawn.

Dewsnup's result was not necessary to preserve creditors' rights to appreciation, whether during the case or later. Property rarely appreciates during a chapter 7 proceeding because of its short duration. If appreciation does occur, lienholders' interests are

fully protected by proper valuation as of the proper time. Proper valuations take expected appreciation into account, so the amount of the allowed secured claim already includes such compensation. Thereafter, cashed-out creditors can capture appreciation by reinvesting in a rising market. Institutional lenders may not be able to hold property for appreciation anyway, for statutory and regulatory reasons.

Dewsnup has negative inter-creditor effects, giving lienholders inappropriate leverage against both debtors and other creditors. It also fails to replicate results under state law foreclosure, thereby violating the fundamental principle that outcomes should not be different in bankruptcy than out.

For these reasons, this Court should grant the petition for a writ of certiorari and overrule *Dewsnup*.

ARGUMENT

I. *Dewsnup* ignored both the plain meaning of the Bankruptcy Code and established principles of statutory construction.

Dewsnup v. Timm, 502 U.S. 410 (1992), acknowledged that the phrase "allowed secured claim," when used in section 506(a), means the claim measured by the value of the collateral. It read that very same language appearing in subsection (d), however, "term-by-term to refer to any claim that is, first, allowed, and, second, secured." *Id.* at 415.

That this reading did violence to the most fundamental rules of statutory interpretation is widely acknowledged and hardly debatable. See, e.g., *Bank of America National Trust & Savings Association v. 203 N. LaSalle Street Partnership*, 526 U.S. 434, 461 (1999) (Thomas, J., concurring) (referring to *Dewsnup*'s mode of statutory analysis as "methodological error"); *Woolsey v. Citibank, N.A. (In re Woolsey)*, 696 F.3d 1266, 1274 (10th Cir. 2012) (noting that *Dewsnup*'s interpretive methodology "may have warped the bankruptcy code's seemingly straight path into a crooked one"); Robert M. Lawless, *Legisprudence Through a Bankruptcy Lens: A Study in the Supreme Court's Bankruptcy Cases*, 47 SYRACUSE L. REV. 1, 26, 27 (1996) (referring to *Dewsnup* as a "disaster" and its methodology as "faux textualism").

II. None of *Dewsnup*'s supporting rationales justifies its outcome.

The *Dewsnup* majority was aware that its statutory methodology was dubious. *Dewsnup*, 502 U.S. at 417 (noting its statutory reading was "not without its difficulty"). In an effort to reach the "right" result, despite statutory language pointing in a different direction, the Court justified its conclusion on three grounds: that liens passed through bankruptcy under pre-Code law; that Congress did not intend to alter pre-Code law; and that stripdown would deprive the creditor of appreciation, thereby constituting a "windfall" to the debtor.

Not one of these rationales withstands scrutiny.

A. *Dewsnup* misread pre-Code law, including this Court's constitutional precedents.

Dewsnup believed that, under pre-Code law, liens passed through bankruptcy unaffected, relying primarily[2] on the venerable decision of *Long v. Bullard*, 117 U.S. 617 (1886). *Dewsnup*, 502 U.S. at 417. In so doing, *Dewsnup* grossly mischaracterized *Long*.

In *Long*, a mortgage holder who had not participated in bankruptcy sought to enforce his lien against the debtor's exempt residence after the case closed. The issue in *Long* was whether discharge in bankruptcy eliminates only a creditor's recourse against the debtor or recourse against the collateral as well. *Long* held that discharge only affects a debtor's personal liability and does "not relieve the property from the operation of liens created by contract before the bankruptcy." 117 U.S. at 620. *Long* addressed the effect of discharge, and its holding remains valid—discharge only affects a debtor's personal liability. See § 522(c) (providing that exempt property remains liable for debts secured by unavoided liens); § 524(a)(1) (providing that discharge affects only "the personal liability of the debtor").

Long dealt with the scope of discharge; it did not present a question of lien avoidance. Rather, *Long*

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[2] *Dewsnup* also cited *Farrey v. Sanderfoot*, 500 U.S. 291 (1991), and *Johnson v. Home State Bank*, 501 U.S. 78 (1991), each of which cited *Long*.

presumed the validity of the lien at issue. To cite *Long* for the proposition that "liens pass through bankruptcy" is to perpetuate a deeply misleading half-truth. Accurately stated, *Long* stands for the proposition—unremarkable today—that *valid* liens are enforceable post-bankruptcy. *Long* says absolutely nothing about bankruptcy's power to avoid liens.

Under pre-Code law, *valid* liens were unaffected by bankruptcy. Section 67(d) of the 1898 Bankruptcy Act said so expressly until amended by the Chandler Act in 1938. Pub. L. No. 55-541, 30 Stat. 544, *amended by* Pub. L. No. 75-696, 52 Stat. 840 (1938) (repealed 1978). Thereafter, courts understood that no change in the law was intended. See *Oppenheimer v. Oldham*, 178 F.2d 386, 389 (2d Cir. 1949) ("It has always been a fundamental principle of the bankruptcy law that the property rights and interests designated as liens and pledges, *when valid in bankruptcy*, shall not be impaired in the administration of a bankrupt estate. The Chandler Act manifests no intent to deviate from that principle." (emphasis added)).

The Court's earlier constitutional holdings fared no better in *Dewsnup* than did *Long*. *Dewsnup* cited *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555 (1935), to suggest that stripping a lien down to its supporting value raises constitutional concerns. By citing only *Radford* and failing to note subsequent cases, *Dewsnup* misstated this Court's holdings regarding bankruptcy's treatment of secured claims. *Dewsnup* also mischaracterized *Radford* as a

lien-stripping case when, in fact, that case presented a takings question.

Radford interpreted the Frazier-Lemke Act, Pub. L. No. 73-486, 48 Stat. 1289 (1934), which was designed to provide relief to farmers—a group especially hurt by the Great Depression. *Dewsnup* correctly noted that the Act's "avowed object is to take from the mortgagee rights in the specific property held as security; and to that end 'to scale down the indebtedness' to the present value of the property." *Dewsnup*, 502 U.S. at 419 (quoting *Radford*, 295 U.S. at 594). That was only a partial statement of the Act's effects, however. It allowed the debtor to purchase property, free of liens predating the Act, at appraised value—*i.e.*, an amount less than the debt—by making payments over time, without interest. This, according to *Radford*, amounted to a retroactive taking of the mortgagee's property without just compensation.

Congress amended the Frazier-Lemke Act immediately after *Radford*. Pub. L. No. 74-384, 49 Stat. 942 (1936). In a series of cases, this Court found the revised Act to pass constitutional muster: *Wright v. Vinton Branch Bank*, 300 U.S. 440 (1937) (*Wright I*); *Wright v. Union Central Life Ins. Co.*, 304 U.S. 502 (1938) (*Wright II*); and *Wright v. Union Central Life Ins. Co.*, 311 U.S. 273 (1940) (*Wright III*). These cases unquestionably limited *Radford*.

In *Wright I*, the Court identified retroactivity as the constitutional infirmity of the original Frazier-Lemke Act. See *Wright I*, 300 U.S. at 456-57 (stating that *Radford* rested "solely" on retroactivity). And in *Wright III*, the Court held that a bankruptcy statute

permitting the debtor to purchase encumbered property by paying its current value did not violate constitutionally-protected rights of the mortgagee: "Safeguards were provided to protect 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." 311 U.S. at 278.

Radford, taken alone, fails to capture this Court's constitutional holdings regarding secured claims. Under those holdings, a secured creditor, paid the present value of its collateral, has no sustainable constitutional complaint, notwithstanding *Dewsnup*'s intimations to the contrary.

B. *Dewsnup* misunderstood the intent of Congress and structure of the Bankruptcy Code.

Plain text must control, unless "demonstrably at odds" with legislative intent. *U.S. v. Ron Pair Enterps. Inc.*, 489 U.S. 235, 241 (1989). The legislative history relevant to these cases, however, reveals that Congress meant exactly what the statute plainly says.

1. Congress adopted a "priority model" of secured creditors' rights in bankruptcy.

The Code provides that a lienholder, upon valuation of the collateral in accordance with bifurcation under section 506(a), is entitled either to its collateral or to the value of that collateral (again, with

interest, if necessary). Congress, in effect, adopted a "priority model" of the rights of secured creditors. This model requires that the holder of a secured claim receive the value of supporting collateral; it does not entitle creditors to assert rights to specific property.[3]

Congress codified the priority model consciously and intentionally:

> 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, [the bill] 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 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

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[3] Mary Josephine Newborn, *Undersecured Creditors in Bankruptcy:* Dewsnup*,* Nobelman *and the Decline of Priority*, 25 ARIZ. ST. L.J. 547, 556 n.26 (1993) ("Under a 'priority' notion of security, 'security' means a right not to a specific piece of collateral, but simply a right to be paid first to the extent of the value of the collateral."); Lawrence Ponoroff & F. Stephen Knippenberg, *The Immovable Object Versus the Irresistible Force: Rethinking the Relationship Between Secured Credit and Bankruptcy Policy*, 95 MICH. L. REV. 2234, 2272-73 (1997) (noting that the Code adopted "the principle that the secured creditor's rights were limited to the value of its collateral rather than to a possessory interest in the collateral itself." (footnotes omitted)).

> creditor. By addressing the problem in terms of claims, the bill makes clear that an unsecured [*sic*: 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. 595, 95th Cong., 1st Sess. 180-81 (1977) [hereinafter "H.R. REP. NO. 95-595"]. Commentators, then and later, understood that the Code had adopted a priority model in dealing with the rights of secured creditors in bankruptcy.[4]

Congress read the *Radford-Wright* line of cases to require that a secured creditor receive every penny of the value available to support its claim, but no more. This constitutional mandate became bankruptcy's touchstone. Never in the process of revision, however, did Congress even hint that liens are sacrosanct. Quite the opposite.

The Code's legislative history supports three interrelated propositions: first, the secured creditor is entitled to the value of its collateral as a matter of

[4] See, e.g., Charles A. Shanor, *A New Deal For Secured Creditors in Bankruptcy,* 28 EMORY L.J. 587, 595 n.39 (1979) ("The Code's focus on the value of the secured party's claim rather than on the security itself is a substantial change from both the Act and the U.C.C."); Theodore Eisenberg, *The Undersecured Creditor in Reorganizations and the Nature of Security*, 38 VAND. L. REV. 931, 952 (1985) ("This view translates secured status into a priority claim equal to the value of the creditor's collateral, which alone is the measure of the value of the creditor's secured status in bankruptcy.").

constitutional right;[5] second, this value is to be protected from erosion during the case; and third, points one and two are what Congress meant by "the benefit of the bargain."

The legislative history also refutes another of *Dewnup*'s claims—namely, that pre-Code law permitted stripdown only in reorganization cases, and that "Congress must have enacted the Code with a full understanding of this practice." *Dewsnup*, 502 U.S. at 419. That is true, but Congress's "full understanding" cut entirely the other way. Congress intended to make "significant changes from current law in . . . the treatment of secured creditors and secured claims," H.R. REP. NO. 95-595, at 180. Reliance on pre-Code law is particularly perilous given the wholesale rewriting of bankruptcy law in 1978.

Additionally, Congress intended the Code to repair the inefficacy with which pre-Code law handled consumer cases: "The current Bankruptcy Act, last revised in any major way in 1938, was not designed to provide adequate relief to the consumer debtor. The primary thrust of the 1938 revision was toward business bankruptcies, because consumer bankruptcy was not a significant factor in the 1930's." H.R. REP. NO. 95-595, at 116-17. Congress did not address these deficiencies by distinguishing between business and consumer cases, however. The bill made "no such

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[5] The legislative history cited both *Radford* and *Wright III*: H.R. REP. NO. 95-595, at 339 ("The concept [of adequate protection] is derived from the fifth amendment protection of property interests as enunciated by the Supreme Court. See *Wright v. Union Central Life Ins. Co.*, 311 U.S. 273 (1940); *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555 (1935).").

distinction." *Id.* at 6. Instead, "provisions of chapter 7 . . . apply equally to business and consumer cases" and "provisions in the generally applicable chapters, 1, 3, and 5, are not divided along consumer/business lines." *Id.* When rules need to apply differently in consumer and business cases—or in liquidations and reorganizations—the Code says so expressly.[6] Otherwise, generally applicable provisions, such as sections 506(a) and (d), apply to the universe of bankruptcy cases.

Dewsnup rests ultimately on a belief that the fundamental rights of secured creditors are different, depending upon whether the debtor is in a liquidation or reorganization proceeding. Thus, *Dewsnup* completely misread the purposes of Congress, as expressed in the statute and its legislative history. Unless the Code says otherwise, it protects a secured creditor's interest only to the extent of the value of available collateral, and it draws no distinction between rules generally applicable to liquidations and those applicable to reorganizations. Legislative history expressly indicates Congress's intent to bring undersecured creditors within bankruptcy's reach to a significant degree.[7]

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[6] As is explained below, the Code's reorganization provisions clearly permit the stripdown of valueless liens, and courts have held *Dewsnup* inapplicable in reorganization cases. See *infra*, p. 16. That leaves *Dewsnup* to chapter 7, but as a practical matter it applies only in consumer cases. When corporations liquidate, no legal entity remains; thus, there is no surviving debtor who might want to retain encumbered property.

[7] Commentators so understood at the time the Code was enacted. See, e.g., Frank R. Kennedy, *Secured Creditors Under the Bankruptcy Reform Act*, 15 IND. L. REV. 477, 486-87 (1982) ("The

2. The Code's provisions are consistent with a priority understanding of secured creditors' rights.

Multiple sections of the Code are consistent with the priority view of secured creditors' rights.

The first of these is section 506(a) itself. Bifurcation became necessary when Congress chose to protect only the value of a secured claim. *Dewsnup* failed to realize that section 506(a) defines the meaning of "secured claim" throughout the Code, for all purposes: "*Throughout the bill,* references to secured claims are only to the claim determined to be secured under this subsection [section 506(a)], and not to the full amount of the creditor's claim." H.R. REP. NO. 95-595, at 356 (emphasis added). Thus, wherever the phrase "secured claim" appears in the Code, it carries this post-bifurcation meaning (with a handful of statutory exceptions and the exception of section 506(d) as interpreted by *Dewsnup*).

Adherence to the mandate of the *Radford-Wright* line of cases also necessitated that such claims be protected from erosion during the case. This function is served by section 361, which sets out a nonexclusive list of ways an otherwise-deteriorating secured claim can be maintained. Section 361 clearly protects the creditor's right to the value of its collateral, but not any right to the property itself. Nowhere is a secured creditor given a right to insist

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Bankruptcy Reform Act is more explicit in regard to the rights of secured creditors than any previous bankruptcy legislation.").

upon *in rem* realization against its pre-bankruptcy collateral. Instead, such an entity is assured of receiving the value of its collateral, without reduction by post-petition depreciation,[8] and nothing more. The House Report was quite specific on this point:

> The section [361], and the concept of adequate protection, is based as much on policy grounds as on constitutional grounds. Secured creditors should not be deprived of the benefit of their bargain. There may be situations in bankruptcy where giving a secured creditor an absolute right to his bargain may be impossible or seriously detrimental to the bankruptcy laws. Thus, this section recognizes the availability of alternate means of protecting a secured creditor's interest. Though the creditor might not receive his bargain in kind, the purpose of the section is to insure that the secured creditor receives in value essentially what he bargained for.

H.R. REP. NO. 95-595, at 339.

Section 361 and its legislative history also establish that Congress intended no protection for a valueless lien. Since section 361 protects the creditor's "interest" against a decline in value, adequate protection is not required when a lien is already valueless. This Court recognized decades ago, in a

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[8] Charles J. Tabb, BANKRUPTCY 294 (3d ed. 2014) [hereinafter TABB] (stating that section 361 protects creditors from a decrease in value of their interests "caused by the imposition of the bankruptcy case, during the pendency of the case").

case involving similar statutory provisions, that valueless liens have no position to protect. In *In re 620 Church Street Building Corp.*, 299 U.S. 24 (1936), holders of valueless liens (citing *Radford*) protested the plan's failure to provide them a distribution:

> Petitioners insist that . . . their claims should have been accorded "adequate protection." But the adequate protection to which the statute refers is "for the realization of the value of the interests, claims or liens" affected. Here the controlling finding is not only that there was no equity in the property above the first mortgage but that petitioners' claims were appraised by the court as having "no value." There was no value to be protected.

Id. at 27. The Bankruptcy Code, following pre-Code law, provides no protection for valueless liens.

Other provisions, found across the Code, consistently use "secured claim" to mean the post-bifurcation amount, as determined under section 506(a). These provisions are also consistent with the priority view, replacing a secured creditor's rights against collateral with assurance that the creditor will receive the value of those rights: section 364(d) (authorizing bankruptcy court to trump existing secured claim by imposing new lien having equal or even senior priority, when necessary to obtain post-petition credit, and leaving demoted creditor to adequate protection under § 361); section 722 (permitting individual debtor to redeem consumer personalty "by paying the amount of the allowed secured claim . . . in full, at the time of redemption,"

and denying creditor's state law right to retain lien until debt is satisfied); section 506(b) (giving oversecured creditor rights to post-petition interest only up to value of collateral, and barring additional interest once that value is consumed).

In addition, plan confirmation provisions under the reorganization chapters require payment of no more than the present value of the secured claim.[9] All three of the reorganization chapters provide that the nonconsenting holder of an "allowed secured claim" retain its lien and receive a stream of payments with a face amount and a present value of "the allowed amount of such claim." § 1129(b)(2)(A); § 1225-(a)(5)(B); § 1325(a)(5)(B)(ii). That ensures an undersecured creditor the value of the collateral, with interest when necessary.[10]

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[9] Because the reorganization provisions expressly permit stripdown, courts agree that *Dewsnup* is inapplicable in reorganization cases, even though it interpreted a provision—section 506—applicable across the Code. See, e.g., *In re Heritage Highgate, Inc.*, 679 F.3d 132 (3d Cir. 2012) (holding *Dewsnup* inapplicable in chapter 11); *Woolsey v. Citibank, N.A. (In re Woolsey)*, 696 F.3d 1266 (10th Cir. 2012) (holding *Dewsnup* inapplicable in Chapter 13).

[10] Chapter 11 is more complicated, because it allows an undersecured creditor to elect to have a secured claim in the amount of its debt, rather than the value of the collateral, thus treating it as fully secured. § 1111(b). Despite being at its creditor-protective best in section 1111(b), Congress did not mandate that undersecured creditors receive more than the economic value of their interest in collateral: first, even creditors making that election are not absolutely entitled to receive more than the value of their collateral, because, if stretched over a long enough period, payments totaling the amount of the debt may have a present value equal to no more than the value of the

In all of these provisions, the Bankruptcy Code is consistent with a priority view of secured creditors' rights, entitling them to the *value* of the collateral supporting their liens, no more and no less.

This is not to say that Congress intended no exceptions. When exceptions appear, however, they are clearly drawn. They also cut both ways, sometimes allowing elimination of liens fully supported by value and occasionally providing more generous treatment to an undersecured creditor.

Exceptions in the former category permit the avoidance of liens with economic value—that is, "secured claims," as defined by section 506(a): section 547 (permitting avoidance of liens arising shortly before bankruptcy, when given to secure pre-existing debts); section 548 (allowing avoidance of certain transfers and obligations on grounds of constructive fraud, if made or incurred for less than reasonably equivalent value within two years before bankruptcy); section 545 (permitting avoidance of designated statutory liens); and section 522(f)(1) (enabling debtor to avoid judicial liens and nonpossessory, nonpurchase money security interests in specified categories of property, if those encumbrances impair debtor's exemptions). In these instances, bankruptcy voids liens *with* supporting value, and does so with no constitutional taint whatsoever.[11]

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collateral; and second, the election is unavailable when the claim "is of inconsequential value." § 1111(b)(1)(B)(i).

[11] Cf. James Steven Rogers, *The Impairment of Secured Creditors' Rights in Reorganization: A Study of the Relationship Between the Fifth Amendment and the Bankruptcy Clause*, 96

Exceptions in the latter category use targeted language to extend additional rights and protections to holders of particular secured claims. Other than section 1111(b), discussed *supra* n.10, examples include: section 1322(b)(2) (interpreted in *Nobelman v. American Savings Bank*, 508 U.S. 324 (1993), to prevent stripdown of underwater lien against debtor's residence[12]); section 1325(a)(*) (protecting certain interests in automobiles and liens taken within a year prepetition); and section 1325(a)(5)(B)(i)(I) (requiring that lien remain in place until full repayment or debtor's discharge, thereby enabling undersecured creditor to retain its lien until full repayment when debtor is ineligible for discharge[13]).

In the absence of these carefully drawn exceptions, the Bankruptcy Code follows a priority model of secured creditors' rights, entitling them to the value of their collateral, period.

C. *Dewsnup*'s result was not necessary in order to protect undersecured creditors' rights to appreciation.

The *Dewsnup* Court was primarily concerned that stripdown would give bankruptcy debtors a

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HARV. L. REV. 973, 1031 (1983) ("The only significant constitutional restraint on the substance of purely prospective bankruptcy legislation is the bankruptcy clause itself.").

[12] Section 1322(b)(2), however, does not protect liens devoid of any supporting value. See *Tanner v. FirstPlus Financial, Inc.*, 217 F.3d 1357 (11th Cir. 2000).

[13] See *Colbourne v. Ocwen (In re Colbourne)*, 550 Fed. Appx. 687 (11th Cir. 2013).

"windfall" by cutting off undersecured creditors' access to future appreciation. See *Dewsnup*, 502 U.S. at 417.

This supposed "windfall" is a complete mirage in most cases. In other instances, when appreciation is conceivable, the Bankruptcy Code provides ready protection for undersecured creditor's legitimate concerns.

The average chapter 7 case is of relatively short duration.[14] Valuation determined as of filing is unlikely to differ in any significant amount from the value of the creditor's interest as of the date of stripdown. If the facts are otherwise, because the case is unusually prolonged or because of galloping appreciation, then undersecured creditors' concerns are fully addressed if the property is valued as of the time of lien avoidance, rather than the time of filing. Section 506(a)(1) provides ample authority for a court, exercising appropriate discretion, to time valuation as necessary to protect creditors' legitimate interests: "Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property."

This approach provides complete compensation to the creditor for appreciation occurring up to the moment its secured claim is valued and paid, as well

[14] Administrative Office of the United States Courts, *2017 Report of Statistics Required by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*, Table 3 (2017) ("From filing to closing, chapter 7 consumer cases terminated in 2017 had a mean time interval of 199 days and a median time interval of 114 days.").

as for future appreciation. Under established principles governing appraisals and valuation, the likelihood of appreciation is accounted for in proper valuation of any type of property:

> [P]roper valuation subsumes all projections of future movements in the market. Such a valuation contemplates the possibility of an upside and a downside in future property values. If the property goes up in value, the secured party has already been compensated in the original valuation and therefore does not deserve the newly found surplus.

David Gray Carlson, *Bifurcation of Undersecured Claims in Bankruptcy*, 70 AM. BANKR. L.J. 1, 17 (1996). See also Int'l Valuation Standards Council, INT'L VALUATION STANDARDS 2013: FRAMEWORK AND REQUIREMENTS ¶ 103 (requiring, in valuing real property for purposes of secured lending, consideration of factors suggesting future increases in value: "anticipated future demand for the type of property and location," "potential . . . alternative uses that . . . can be anticipated," and "impact of any events foreseeable at the valuation date on the probable future value").

Thus, payment of the value of the secured claim, determined as of the appropriate moment, fully compensates the claimholder for future appreciation. Furthermore, the cashed-out creditor has complete control over the actual capture of additional future appreciation because that creditor can simply reinvest the proceeds in the rising market.

Even creditors who foreclose may be unable to hold property and await appreciation, because statutes and regulations restrict the ability of many real estate lenders to speculate on future appreciation by bidding in the amount of their debts and holding property. See, e.g., 7 C.F.R. § 1955.102 (2018) (providing, upon foreclosure of FHA loans secured by real estate, that "[s]ales efforts will be initiated as soon as property is acquired in order to effect sale at the earliest practicable time"); 38 C.F.R. § 36.4283(f) (2018) (providing, upon foreclosure of loans guaranteed by VA, that the holder "shall resell the property within a reasonable time").

Finally, the argument that undersecured creditors deserve appreciation misses the reality that appreciation derives from more than rising markets. It is also attributable to the debtor's pay-down of the senior interest and investments in improvements. Even if an undersecured creditor were entitled to market appreciation, nothing justifies access to the value of additional increments produced by the debtor's post-petition efforts.

The stripped-down creditor suffers no more violation of its legitimate interests than does a seller who receives the price of its product in a rising market. The bankruptcy debtor enjoys no more of a "windfall" than does a buyer who pays the appropriate value of acquired property, as of the time of acquisition. Every undersecured creditor is fully protected by proper valuation, made at the appropriate time, and by the opportunity to reinvest in the rising market.

III. *Dewsnup* has the pernicious effects of failing to replicate results under state foreclosure law, and of giving junior lienholders inappropriate leverage over debtors.

Upon foreclosure under nonbankruptcy law, initiated by a senior lienholder, all liens are eliminated and the first money goes to that creditor. A junior lienholder takes the leftovers, which will be measured by the value of its position. If foreclosure is initiated by a junior lienholder, a buyer takes subject to the senior lien. Baxter Dunaway, 2 LAW OF DISTRESSED REAL ESTATE §§ 26:28–26:30 (2014), *available at* Westlaw LAWDRE. Thus, no rational buyer would pay more than the amount of any value remaining after satisfaction of the senior lien. Either way, stripdown replicates these results, putting each creditor in the same position it would occupy upon foreclosure.

By allowing a valueless lien to survive, *Dewsnup* violates a bedrock principle of bankruptcy law—namely, that outcomes in bankruptcy should, to the extent possible, mimic those outside bankruptcy. Cf. *Butner v. United States*, 440 U.S. 48, 55 (1979) ("Uniform treatment of property interests by both federal and state courts within a State serves to reduce uncertainty, to discourage forum shopping, and to prevent a party from receiving 'a windfall merely by reason of the happenstance of bankruptcy.'" (Internal citation omitted.)). *Dewsnup* inappropriately preserves liens that would not survive foreclosure under state law, thereby putting junior

creditors in a better position in bankruptcy than they would occupy outside of bankruptcy.

Retention of a valueless lien does have one possible use, however—as leverage, to extract value from the debtor as the price for releasing the lien. Debtors desperate to keep the family home or to preserve the value of their own post-petition investments, may see no alternative but to pay something on the otherwise economically valueless lien. This puts a windfall, now real, in the other pocket.

Bankruptcy policy is not advanced by enabling creditors to extract value out of economically valueless interests. In at least one other context, Congress identified the exercise of such leverage as an abuse bankruptcy should prohibit, and enacted a provision designed to do just that—section 722, discussed *supra*, pp. 15-16. Congress's intent was to counter creditors' efforts to compel repayment by threatening to repossess items with minimal value in the creditor's hands, but high replacement costs for the debtor. See H.R. REP. NO. 95–595, at 127. Valueless liens should fare no better.

As the facts of this case demonstrate, a senior creditor may refuse to refinance its loan when a junior lien exists. Nothing is served by inviting such a consequence. Legitimate business interests of a creditor with money at stake should not be affected by a valueless junior interest.

Finally, *Dewsnup* prevents bankruptcy from winding up the entire financial relationship between

a debtor and his or her creditors, and among the creditors themselves, although liquidation should do just that. See TABB at 1 ("The goals of a [liquidation] bankruptcy case are twofold: resolving the competing claims of multiple creditors, *and* freeing the debtor from its financial past. After passing through the crucible of bankruptcy, the debtor and its creditors must move on."). When liens hang on, bankruptcy fails to accomplish this most fundamental task. If financial finality can be achieved, however, then debtors and willing creditors can make an unfettered choice to resurrect or continue their financial relationships through reaffirmation or refinancing.

CONCLUSION

Dewsnup offends in a number of ways: by violating established principles of statutory interpretation; by misreading this Court's precedents, including its constitutional holdings; by failing to understand the priority model on which Congress based the Bankruptcy Code; and by introducing pernicious effects.

This case squarely presents the question of *Dewsnup*'s validity—a question that has not been presented previously. This Court should grant the petition for a writ of certiorari and should overrule *Dewsnup*.

Respectfully submitted,

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