SO ORDERED.

SIGNED this 25 day of March, 2020.

Stephani W. Humrickhouse

Stephani W. Humrickhouse
United States Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF NORTH CAROLINA
WILMINGTON DIVISION

IN RE:	**CASE NO.**
JESUS VASQUEZ, JR. and **PENNY LEIGH VASQUEZ**	**19-01841-5-SWH** **CHAPTER 7**
DEBTORS	
JESUS VASQUEZ, JR. and **PENNY LEIGH VASQUEZ** **Plaintiffs**	**ADVERSARY PROCEEDING** **NO. 19-00100-5-SWH**
v.	
JPMORGAN CHASE BANK, N.A. **Defendant.**	

ORDER ALLOWING MOTION TO DISMISS

This matter came on to be heard upon the motion to dismiss filed by JPMorgan Chase Bank, N.A. on August 21, 2019 (the "Motion to Dismiss") (Dkt. 6). A hearing was held in Wilmington, North Carolina on December 11, 2019. The issue before the court is whether a chapter 7 debtor can strip down a mortgage lien to the value of the real property. The matter turns on the interplay between sections 506(a) and 506(d) of the Bankruptcy Code, as well as the binding precedents of *Dewsnup v.*

Timm and *Bank of America, N.A. v. Caulkett*. For the reasons set forth below, the motion will be allowed.

BACKGROUND AND PROCEDURAL POSTURE

Jesus and Penny Leigh Vasquez filed a petition for relief under chapter 7 of the Bankruptcy Code on April 22, 2019. The Vasquezes own and reside at real property located at 404 Swann Point Avenue, Rocky Point, North Carolina 28457 (the "Property"). The Vasquezes purchased the Property for $268,000 in 2013 and obtained a loan from JP Morgan Chase Bank, N.A. ("JPMorgan") secured by a first priority deed of trust on the Property. The first deed of trust was recorded in the Pender County Registry on July 25, 2013, in the amount of $268,000. On the petition date, the balance owed to JPMorgan was $240,464.48. Subsequently, the Vasquezes borrowed money from the North Carolina Housing Finance Agency secured by a second deed of trust recorded in Pender County on April 23, 2015. On the petition date, the balance owed on the second deed of trust was $34,000. The debtors scheduled the value of the property in their petition as $219,705 and noted that it reflected the value of the most recent Pender County tax valuation. On the petition date, the amount owing on the first deed of trust exceeded the scheduled value of the Property; as a result, the first deed of trust was "partially underwater" and the second deed of trust was "fully underwater."

On June 21, 2019, the debtors filed the complaint initiating this adversary proceeding to determine the validity, priority, and extent of JPMorgan's lien. The debtors/plaintiffs argued that under 11 U.S.C. § 506(a), JPMorgan's claim was secured in the amount of $220,000, not $240,464.48 (petition date balance) and requested the court determine that JPMorgan's lien is void to the extent it exceeds the value of the Property. The debtors received their chapter 7 discharge on August 7, 2019. JPMorgan filed a motion to dismiss the complaint on August 21, 2019 on grounds that the relief sought in the complaint was expressly prohibited by the Bankruptcy Code and governing caselaw. A hearing on that motion was held in Wilmington, North Carolina, on December 11, 2019.

DISCUSSION

A defendant may move to dismiss a case for failure to state a claim upon which relief may be granted under Federal Rule of Civil Procedure 12(b)(6), as made applicable to adversary proceedings through Federal Rule of Bankruptcy Procedure 7012. It is well settled that "[t]he purpose of a Rule 12(b)(6) motion is to test the sufficiency of the complaint." *Edwards v. City of Goldsboro*, 178 F.3d 231, 243 (4th Cir. 1999). A complaint must contain sufficient facts that when accepted as true, "state a claim to relief that is plausible on its face." *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 570 (2007); *Ashcroft v. Iqbal*, 556 U.S. 662, 679 (2009). When ruling on a 12(b)(6) motion, a court must accept the plaintiff's factual allegations as true and draw all reasonable factual inferences in the plaintiff's favor. *Iqbal*, 556 U.S. at 678-79. However, "the tenet that a court must accept as true all of the allegations contained in a complaint is inapplicable to legal conclusions," and the court is "not bound to accept as true a legal conclusion couched as a factual allegation." *Id.* at 678 (internal quotation omitted).

Whether a claim is secured, and in what amount, is determined through application of § 506(a)(1) of the Code, which provides in relevant part:

> An allowed claim of a creditor secured by a lien on property in which the estate has an interest . . . is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property . . . and is an unsecured claim to the extent that the value of such creditor's interest . . . is less than the amount of such allowed claim.

11 U.S.C. § 506(a)(1). Disallowance of claims is determined through application of § 506(d), which provides in relevant part that "[t]o the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void," subject to certain exceptions. 11 U.S.C. § 506(d).

The larger issue here is the proper interpretation of the Supreme Court's rulings in *Dewsnup v. Timm*, 502 U.S. 410 (1992), and *Bank of America, N.A. v. Caulkett*, 575 U.S. 790 (2015). In *Dewsnup*, a chapter 7 debtor filed an adversary proceeding to void a mortgage lien under § 506(d) of the Code. 502 U.S. at 413. The Supreme Court denied the relief sought by the debtor and held that a chapter 7

debtor could not use § 506(d) to partially void or strip down a mortgage lien that was both secured by real property and allowed under § 502. *Id.* at 417. Citing respondents' argument that "the words 'allowed secured claim' in § 506(d) need not be read as an indivisible term of art defined by reference to 506(a)," the Court agreed that § 506(d) "should be read term-by-term to refer to any claim that is, first, allowed, and second, secured." *Id.* at 415. The *Dewsnup* two-step analysis can best be understood in the following way: First, is the claim allowed under § 502? Second, is the claim secured under § 506(a)? If the answer to both questions is yes, then the claim *cannot* be *disallowed* by § 506(d).

The Court additionally based its holding on what it found to be pre-Code bankruptcy practice of preserving liens on real property. The Court noted that if it were "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)." *Id.* at 417. However, the Court concluded, there was nothing in the legislative history to indicate that Congress intended to change the law: "This Court has been reluctant to accept arguments that would interpret the Code, however vague the particular language under consideration might be, to effect a major change in pre-Code practice that is not the subject of at least some discussion in the legislative history." *Id.* at 419. Thus, the Court declined to read into the Code's ambiguity a "broad new remedy." *Id.* at 420. Instead, the Court concluded that "given the ambiguity in the text, [it was] not convinced that Congress intended to depart from the pre-Code rule that liens pass through bankruptcy unaffected," and thus declined to partially void the undersecured mortgage. *Id.* at 417.

The Court expanded the holding of *Dewsnup* in *Bank of America, N.A. v. Caulkett*, 575 U.S. 790, 135 S. Ct. 1995 (2015). In *Caulkett*, a chapter 7 debtor sought, unsuccessfully, to "strip off" a junior mortgage lien that was "wholly underwater." 135 S. Ct. at 1998. The Court declined to limit *Dewsnup* to partially underwater liens, reasoning that *Dewsnup*'s definition did not depend on such a distinction, and that not extending *Dewsnup*'s holding could lead to "arbitrary results":

"Under the debtors' approach, if a court valued the collateral at one dollar more than the amount of a senior lien, the debtor could not strip down a junior lien under *Dewsnup*, but if it valued the property at one dollar less, the debtor could strip off the entire junior lien." *Id.* at 2001. The Court reaffirmed that "*Dewsnup* defined the term 'secured claim' in § 506(d) to mean a claim supported by a security interest in property, regardless of whether the value of that property would be sufficient to cover the claim." *Id.* at 1999.

Returning to the facts of this case, the court concludes that *Dewsnup* is controlling here. Like the underlying claim in *Dewsnup*, there is no dispute that JPMorgan's claim is an "allowed" claim under § 502, and that it is secured by a first priority lien with recourse to the underlying collateral. Since it is both allowed and secured under § 506(a), it cannot be avoided under § 506(d). Under *Dewsnup*, the debtors cannot use § 506(d) to strip down JPMorgan's lien.

The plaintiffs acknowledge, of course, that this court must fully comply with *Dewsnup*, but are earnest in their desire to be heard. "While this [c]ourt cannot undo the travesty that is *Dewsnup*," they argue, "it is the hope of Plaintiffs that this [c]ourt will emphasize to the courts above how erroneous the reasoning in *Dewsnup* is and how much it complicates bankruptcy practice at this level." Pls.' Resp. to Def.'s Mot. Dismiss 5 (Dkt. 11) ("Plaintiffs' Response"). Even though *Dewsnup* controls the outcome here, the court recognizes that there are compelling arguments for why it should be overruled, some of which have been put forward by the plaintiffs, and reviews those arguments below.

First, plaintiffs point to wide and consistent criticism leveled at the Supreme Court's decision in *Dewsnup* since it was decided. This began on day one with Justice Scalia's dissent, in which he argued that the majority's decision to treat "allowed secured claim" differently in sections 506(a) and 506(d) "replace[ed] what Congress said with what it thinks Congress ought to have said – and in the process disregard[ed], and hence impair[ed] for future use, well-established principles of statutory construction." *Dewsnup*, 502 U.S. at 420 (Scalia, J., dissenting). To Justice Scalia, the natural reading of

the Code allowed for lien stripping: "When § 506(d) refers to an 'allowed secured claim,' it can only be referring to that allowed 'secured claim' so carefully described two brief subsections earlier." *Id.* at 421 (Scalia, J., dissenting). Citing the well-established rule of statutory interpretation that "identical words used in different parts of the same act are intended to have the same meaning," Justice Scalia noted that the rule "must surely apply, *a fortiori*, to use of identical words *in the same section of the same enactment*." *Id.* at 422 (internal quotations omitted) (Scalia, J., dissenting).

Although not specifically highlighted by the plaintiffs, the court offers some additional observations. The majority opinion in *Dewsnup* is a mere four pages long. Fundamentally, it parts ways with Justice Scalia's analysis by determining that § 506 is ambiguous and thus amenable to interpretation guided by legislative history, or, as here, the lack thereof. *See id.* at 419-20. In contrast, Justice Scalia comfortably concludes that the plain language of the statute is unambiguous and easily interpreted. *Id.* at 420. The majority opinion is reluctant and almost apologetic in tone, noting that the position espoused by the respondents, and adopted by the Court, is "not without its difficulty." *Id.* at 417. And at the outset, the Court recognizes the limited application of its opinion by stating that the Court will "therefore focus upon the case before us and allow other facts to await their legal resolution for another day." *Id.* at 416-17.

Plaintiffs note that circuit and bankruptcy courts also have criticized *Dewsnup*. *See, e.g,*. *In re Woolsey*, 696 F.3d 1266, 1274 (10th Cir. 2012) ("Right or wrong, the Dewsnuppian departure from the statute's plain language is the law. It may have warped the bankruptcy code's seemingly straight path into a crooked one. It may not be infallible. But until and unless the Court chooses to revisit it, it *is* final."); *In re Dever*, 164 B.R. 132, 138 (Bankr. C.D. Cal. 1994) ("The basic premises of the *Dewsnup* opinion are faulty."). So, too, have many legal scholars. *See, e.g.*, 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, 2307 (1997)

("Despite its interference with the Code's fresh-start policy, *Dewsnup* has proved tenacious. In large measure, we believe that it has been difficult to eradicate because it hangs on a false conception of bankruptcy and, in particular, an appealing but ultimately inaccurate conception of the nature of security in bankruptcy."); Mary Josephine Newborn, *Undersecured Creditors in Bankruptcy: Dewsnup, Nobelman, and the Decline of Priority*, 25 Ariz. St. L.J. 547, 557 (1993) (criticizing Dewsnup's "atavistic" *in rem* approach to security). Several of these scholarly criticisms turn on *Dewsnup*'s principle of liens passing through bankruptcy unaffected, which reflects an *in rem* system where a secured creditor seizes a specific piece of collateral in order to satisfy debt and the lien stays attached until the full debt is paid regardless of the collateral's value. Additionally they note that *Dewsnup* is based on a flawed concept of lien preservation: Not only is it untrue that liens always pass through bankruptcy unaffected, much of the Code operates on a priority system that focuses more simply on the rights of certain secured creditors to be paid first and often only to the extent of the *value* of the underlying collateral.

Plaintiffs also note that this reliance upon the sanctity of the lien and actual misinterpretation of *Dewsnup* has led to "further evisceration" of § 506(d). Plaintiffs' Response at 6. The precedent set by *Dewsnup* has indeed led to inconsistent interpretation and, in fact, misapplication of both its holding and of the Bankruptcy Code. *Dewsnup* depends in large part upon its two-step analysis, wherein a claim must first be allowed under § 506(a) to withstand avoidance under § 506(d). However, plaintiffs point to two circuit court cases in which § 506(d) lien avoidance was denied for claims that were disallowed under § 502(b)(9), *i.e.* they were not timely filed. *See In re Shelton*, 735 F.3d 747, 748-49 (8th Cir. 2013), *cert. denied*, 72 U.S. 1116 (2014); *In re Hamlett*, 322 F.3d 342, 347 (4th Cir. 2003). Relying on *Dewsnup* for its dicta that liens pass through bankruptcy unaffected, both courts found that lien avoidance for untimely claims would result in an unintended departure from pre-Code practice. *Shelton*, 735 F.3d at 748-49; *Hamlett*, 322 F.3d at 349-50. Interestingly, neither case discussed

Dewsnup's core holding – the two-step analysis, which depends on an allowed claim to survive avoidance.

Both *Dewsnup*, and *Caulkett* citing *Dewsnup*, relied upon the principle that liens pass through bankruptcy unaffected. This dicta from *Dewsnup* clearly has influenced the decisions of several courts and created confusion when put up against the countervailing principle of the fresh start. *See Woolsey v. Citibank, N.A.*, 696 F.3d 1266, 1274 (10th Cir. 2012) ("Whatever pre-code practice looked like, it would seem to have (at best) limited interpretive significance today, given that Chapter 7 indubitably permits liens to be removed in many situations."). To be sure, many liens do not pass through bankruptcy unaffected. Bankruptcy's fresh start is always balanced against the rights of creditors, but that does not mean that creditors receive the full value of their liens. For example, chapter 11 allows debtors to "impair or leave unimpaired any class of claims, secured or unsecured," 11 U.S.C. § 1123(b)(1), as well as "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, or of holders of unsecured claims." 11 U.S.C. § 1123(b)(5). Chapter 11 debtors may confirm plans over the objection of creditors through "cramdown," which is often premised on the valuing down of real property. Chapter 13 and chapter 12 debtors have the same ability as chapter 11 debtors to modify the rights of the holders of secured claims. 11 U.S.C. §§ 1322(b)(2), 1222(b)(2). Additionally, chapter 7, 11, 12, and 13 debtors can specifically avoid judgment liens if they would impair an exemption. 11 U.S.C. § 522(f)(1). The Code recognizes multiple instances in which liens are not categorically protected. What the debtors seek here (and what the debtors in *Dewsnup* sought) is another exception to a rule that already has many exceptions.

Courts have been unclear as to the application of *Dewsnup* to cases under different sections of the Code and the effect has been to create a substantive difference of treatment among claims under § 506(d) – even though chapter 5 is one of general applicability to all types of bankruptcy cases. 11

U.S.C. § 103(a). The Supreme Court in *Dewsnup* acknowledged the ambiguities of § 506 and chose to limit its holding to "the case before [it] and allow other facts to await their legal resolution on another day." 502 U.S. at 417. However, faced with such ongoing ambiguities, courts have struggled with whether to limit or expand its core holding. The current system allows for the valuing down of claims under § 506 in chapter 11, chapter 12, and chapter 13, but in the latter, only wholly underwater liens that are based on mortgage loans can be valued down. In a chapter 13 case, Supreme Court precedent prohibits the valuing down of mortgage liens that are merely undersecured.[1] *Nobleman v. Am. Sav.*

[1] In *Nobleman*, chapter 13 debtors sought to bifurcate an undersecured mortgage lender's claim based upon the language of § 506(a). 508 U.S. at 326. The Supreme Court addressed the question of "whether § 1322(b)(2) prohibits a Chapter 13 debtor from relying on § 506(a) to reduce an undersecured homestead mortgage to the fair market value of the mortgaged residence," and held that it does. *Id*. Specifically, the Court found that bifurcation under § 506(a) would impermissibly modify creditor "rights that were 'bargained for by the mortgagor and the mortgagee' . . ., and are rights protected from modification by § 1322(b)(2)." *Id.* at 329 (quoting *Dewsnup*, 502 U.S. at 417). Specifically, § 1322(b)(2) allows a debtor to "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." 11 U.S.C. § 1322(b)(2). While *Nobleman* cited dicta from *Dewsnup*, it avoided having to apply *Dewsnup*'s specific holding (about the interplay between § 506(a) and § 506(d)) to the chapter 13 context by finding that the claim treatment sought by the debtors was precluded by another section of the Code. 508 U.S. at 331.

Lower courts also have found a way to distinguish chapter 13 cases. Despite *Nobleman*, this Court has held that chapter 13 debtors can avoid fully underwater junior mortgage liens. In *In re Kidd*, the court first found that the junior mortgage creditor's entire claim was unsecured under § 506(a) because the value of the property was less the claim of the senior mortgage holder. *In re Kidd*, 161 B.R. 769, 770 (Bankr. E.D.N.C. 1993). Then, the court found that the facts of the case were "significantly different than those in *Nobleman*," and that the limitation in § 1322(b)(2) did not apply. *Id.* Specifically, the court noted that the creditor in *Nobleman* had a partially secured claim, which allowed it to take advantage of the protection provided to mortgage lien holders under § 1322(b)(2). *Id.* at 770-71. Because no portion of the junior mortgage creditor's claim in *Kidd* was secured under § 506(a), its lien was not protected by § 1322(b)(2) and could be avoided under § 506(d). *Id.* at 771; *see also In re Bartee*, 212 F.3d 277, 295 (5th Cir. 2000) (holding that chapter 13 antimodification provisions do not apply to wholly unsecured mortgage liens); *In re McDonald*, 205 F.3d 606, 615 (3d Cir.) (holding that "a wholly unsecured mortgage is not subject to the antimodification clause in § 1322(b)(2)"), *cert. denied*, 531 U.S. 822 (2000); *In re Lam*, 211 B.R. 36, 41 (9th Cir. B.A.P. 1997) ("The extension of the protections of section 1322(b) to wholly unsecured lien holders is contrary to the provisions of the bankruptcy code allowing dischargeability of unsecured claims.").

Bank, 508 U.S. 324 (1993). Additionally, as a result of *Dewsnup* and *Caulkett*, claims in chapter 7 can never be valued down, even when they are wholly underwater.

In this proceeding, plaintiffs see an opportunity in dicta from *Caulkett*, specifically that the Supreme Court acknowledged in that case that it had not been asked to overrule *Dewsnup*. 135 S. Ct. at 2001. However, it is unclear whether the Court would consider arguments for overturning *Dewsnup*, given that the Court declined to do so as recently as February of 2019, when it denied a petition for certiorari in *Ritter v. Brady*, 139 S. Ct. 1186 (Mem.) (2019). In *Ritter*, a chapter 7 debtor sought to reopen her bankruptcy case for reconsideration after an unsuccessful attempt to avoid a junior mortgage lien. *In re Ritter*, 730 Fed. Appx. 529, 529-30 (Mem) (9th Cir. 2018). The Ninth Circuit affirmed the Bankruptcy Appellate Panel and the bankruptcy court by denying the debtor's motions to reopen and for reconsideration based on the holdings of *Dewsnup* and *Caulkett*, holding that "the lien avoidance mechanism in 11 U.S.C. § 506(d) is not available when a claim secured by a lien has been allowed under § 502." *Id.* at 530. It should be noted that the issue of whether *Dewsnup* should be overturned was not squarely before the *Ritter* court, especially considering the highly discretionary standard for reopening a bankruptcy case.

On these points, JPMorgan correctly notes that Congress has repeatedly passed on opportunities to amend the Code to supersede *Dewsnup's* interpretation of § 506(d). While BAPCPA specifically amended other parts of § 506, it did nothing to disturb *Dewsnup*. So, in this matter, although plaintiffs have put forth several compelling and legally sound reasons for why *Dewsnup* should be overturned, the court must conclude that *Dewsnup* remains well-settled albeit controversial precedent. It is up to the Supreme Court to reverse its decision.

CONCLUSION

Based on the foregoing, the motion to dismiss the complaint is hereby **GRANTED**, and the adversary proceeding is **DISMISSED**.

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