

BANKING ALERT

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[United States Supreme Court Upholds Validity of Undersecured Second Mortgages in Chapter 7 Bankruptcy Filings](#)

The United States Supreme Court, in [Bank of America, N.A. v. Caulkett](#), 135 S. Ct. 1995 (Jun. 1, 2015), held that a debtor could not seek to cancel a second mortgage on his home, even if the value of the home was insufficient to cover the amounts due and owing under the second mortgage.

The Supreme Court's decision arises out of two cases that were consolidated for the purposes of appeal based on their similar facts. In both instances, the debtors filed for Chapter 7 bankruptcy protection. As part of each of their respective petitions, the debtors sought to discharge junior mortgage liens on their primary residences, arguing that the second mortgage lien should be treated as an unsecured claim under the Bankruptcy Code because the value of the home was insufficient to cover both the first and second mortgage liens. The Bankruptcy Court agreed with the debtors and granted their applications to discharge the second mortgage liens.

The Eleventh Circuit Court of Appeals affirmed this decision and seemingly rejected the definition of a "secured claim" in the Bankruptcy Code set forth by the Supreme Court in [Dewsnup v. Timm](#), 502 U.S. 510 (1992). The Eleventh Circuit held that the insufficient value of the underlying security interest rendered the junior mortgage liens unsecured.

After granting *certiorari* as to the consolidated appeals, the Supreme Court overturned the Eleventh Circuit decision and reiterated its prior construction of the term "secured claim" in the Bankruptcy Code: "In other words, [Dewsnup](#) defined the term 'secured claim' in Section 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."

The decision in *Caulkett* provides further assurance to lenders that junior mortgage liens will be treated as "secured claims" for the purposes of any bankruptcy filing by the mortgagor, irrespective of the value of the underlying collateral.

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[Office Locations](#)

[New Jersey](#)

210 Park Avenue
2nd Floor
Florham Park NJ
07932
973.302.9700

[New York](#)

805 Third Avenue
10th Floor
New York NY
10022
212.763.6464

Change in New Jersey Uniform Commercial Code Financing Statement Requirements

On May 11, 2015, the New Jersey state legislature approved Assembly Bill Number 2481. The new law updates the requirements with respect to financing statements filed on or after May 11, 2015. The revised statute states that all financing statements must contain (i) the complete legal name of the debtor, (ii) the complete legal name of the secured party and (iii) a statement that the collateral is within the scope of the New Jersey Uniform Commercial Code, pursuant to N.J.S. 12A:9-102 and 12A:9-109.

In this respect, and to be considered a “sufficient” financing statement, any collateral description attached to a UCC-1 financing statement that is submitted for filing should include the following language:

“The collateral is within the scope of the New Jersey Uniform Commercial Code, pursuant to N.J.S. 12A:9-102 and 12A:9-109.”

Furthermore, the filing office may refuse to accept and record a financing statement for the following reasons:

- (1) the record is not required or authorized to be filed;
- (2) the record is outside the scope of the statute;
- (3) the collateral described is outside the scope of the statute;
- (4) the filing office reasonably believes there is intent to harass or defraud the purported debtor; or
- (5) the filing office reasonably believes the record is materially false or fraudulent.

The revised statute makes it clear that the above changes do not require refusal by the filing office; however, filed records that meet any of the above criteria may be removed from the records upon discovery. Going forward, clients should take care to see that all financing statements comply with the amended statute in order to be properly filed and recorded.

Appellate Division Affirms That Implied Covenant Of Good Faith And Fair Dealing Cannot Alter Terms Of Commercial Loan Agreement

In Provident Bank v. Interstate Transport, Inc., the Bank brought an action to enforce a term loan and line of credit upon which defendant Interstate Transport, Inc. defaulted. 2015 WL 2401139, (N.J. App. Div. May 21, 2015). In March 2010, the Bank approved a term loan for the defendant, as well as a line of credit. Each note provided the Bank a first security lien in all of the defendant’s assets, and each loan agreement provided that any modification had to be in writing and fully executed.

In December 2010, the Bank advised the defendant that it would not be renewing the line of credit once it expired on January 1, 2011 due to the frequent overdrafts on the defendant’s account. On January 1, 2011, the defendant did not pay the outstanding principal, interest and fees upon maturity of the line of credit. The Bank notified the defendant that it was in default, but agreed to extend the maturity date until April 1, 2011 in order for the defendant to refinance the loan. The Bank further extended the maturity date until July 1, 2011 and then until October 11, 2011 for the sole purpose of affording the defendant time to secure replacement financing.

On June 23, 2011, the defendant received a letter “term sheet” from Abrams & Company, Inc. (“Abrams”), a lending institution from which the defendant sought a loan. The term sheet stated that it should be viewed as an indication of interest only and was not an offer or agreement. The term sheet stated that the defendant could borrow up to \$1.5 million, but required a first priority security interest in the defendant’s personal property. The defendant claims

that Abrams told the defendant that only \$400,000 could be borrowed upfront, but that the balance would be disbursed over the course of four or five years, and the Bank's loan had to be subordinated. The defendant sought the Bank's approval of the refinancing and provided the term sheet, but did not mention that the loan would not be paid in full.

On January 2, 2012, the Bank refused to further extend the line of credit loan and declared the defendant in default. The defendant was also in default on the term loan. The Bank filed an action to enforce the loans, and the defendant asserted counterclaims and numerous defenses. The trial court granted summary judgment in favor of the Bank. The defendant appealed, arguing that the Bank, among other things, breached the covenant of good faith and fair dealing because the Bank allegedly told the defendant that it could sign the term sheet but then refused to approve the loan from Abrams and declared the defendant in default.

The Appellate Division found that, while the implied covenant of good faith and fair dealing requires neither party do anything that will injure the right of the other party to the benefit of the contract, the covenant cannot alter the terms of a written agreement. Thus, the Court found that the covenant "may not be invoked by a commercial debtor to preclude a creditor from exercising its bargained-for rights under the loan agreement."

If you have any questions about this Alert:

Attorney Contact Information

Anthony J. Sylvester

Partner

973.302.9713

asylvester@shermanwells.com

Charles R. Berman

Partner

973.302.9692

cberman@shermanwells.com

Timothy A. Kalas

Partner

973.302.9693

tkalas@shermanwells.com

Craig L. Steinfeld

Counsel

973.302.9697

csteinfeld@shermanwells.com

Caitlin T. Shadek

Associate

973.302.9672

cshadek@shermanwells.com

Arjun Shah

Associate

973.302.9698

ashah@shermanwells.com

Anthony C. Valenziano

Associate

973.302.9696

avalenziano@shermanwells.com

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