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EXPERT ANALYSIS

# Can Home Equity Lenders Finally Breathe a Sigh of Relief?

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In June 2015 the U.S. Supreme Court issued a monumental decision that protected home equity lenders from having wholly unsecured liens removed from a debtor's home. In *Bank of America v. Caulkett*, 135 S. Ct. 1995 (2015), the high court held that a debtor filing a Chapter 7 bankruptcy liquidation case may not void a junior mortgage lien even when the debt owed on a senior mortgage lien exceeds the current value of the debtor's home.

In reaching this conclusion, the Supreme Court reasoned — in substantial part — that a lender's lien rights should not be affected by a one-time judicial determination relating to something as fluid as real property market value.

The *Caulkett* decision had an immediate impact. The 11th U.S. Circuit Court of Appeals quickly reversed several of its own recent decisions that had reaffirmed a debtor's right to remove wholly unsecured liens in liquidation proceedings. In the 11th Circuit's view, the Supreme Court made it clear that wholly unsecured home equity liens cannot be stripped.

In sharp contrast, several other courts rapidly decided that *Caulkett* should be strictly limited to liquidation proceedings — and not applied to Chapter 13 bankruptcy filings where the debtor is seeking to repay creditors through a multiple-year plan.

Regardless of this difference, *Caulkett* impacted the practice of stripping home equity liens. The question, nevertheless, remains: How broadly should *Caulkett* be interpreted? Quite broadly.

## THE *CAULKETT* DECISION

The factual background of *Caulkett* presented a routine bankruptcy matter. David Caulkett had two mortgage liens on his home. Bank of America held the junior mortgage lien in connection with a home equity loan. The amount owed on Caulkett's senior mortgage was greater than the market value of his home. Thus, in an economic sense, Bank of America's junior mortgage lien was completely underwater.

Caulkett filed for a Chapter 7 bankruptcy in 2013 in the U.S. Bankruptcy Court for the Middle District of Florida. As part of his case, he filed a motion with the bankruptcy court seeking to "strip off," or void, the lien held by Bank of America. Consistent with existing practice, the bankruptcy court voided Bank of America's lien.

The U.S. District Court for the Middle District of Florida and the 11th Circuit affirmed the Bankruptcy Court's decision. These rulings were in line with other court decisions permitting the lien-stripping practice.

Bank of America appealed the removal of its lien to the U.S. Supreme Court, which faced the question of whether to allow this practice to continue.

After reviewing pertinent sections of the U.S. Bankruptcy Code and its prior decisions, the Supreme Court firmly held that "a debtor in a Chapter 7 bankruptcy proceeding may not void a junior mortgage lien ... when the debt owed on a senior mortgage lien exceeds the current value of the collateral."

In reaching this decision, the Supreme Court specifically reasoned that the treatment of a bank's claim should not depend upon whether "a court valued the collateral [a home] at one dollar more [or less] than the amount of a senior lien" in fear that a reliance upon judicial valuations of "the constantly shifting value of real property ... could lead to arbitrary results."

*We must avoid affecting a lender's rights based upon something as flimsy as a valuation yielding one dollar more or one dollar less.*

## THE IMPACT OF *CAULKETT*

As one might expect, *Caulkett* had an immediate influence on bankruptcy practice. In the four months that followed the decision, the 11th Circuit reversed four of its own rulings.

Each of those cases were similar to *Caulkett* in that a junior mortgage holder's loan was completely underwater. In one of these decisions, the 11th Circuit quite succinctly recognized that "[u]nder *Caulkett*, [the bankruptcy code] does not permit the bankruptcy court to strip off the underwater second lien." *Bank of Am. v. Vander lest,* 613 Fed. Appx. 908 (11th Cir. 2015).

By contrast, several lower courts almost immediately restricted *Caulkett* to Chapter 7 bankruptcy cases as opposed to applying the decision to Chapter 13 matters as well. In the latter circumstance debtors are seeking to repay their creditors through a repayment plan ranging in length from three to five years.

In a representative ruling, one lower court essentially decided that "[t]he recent Supreme Court decision on lien stripping, *Bank of America, N.A. v. Caulkett*, has no effect ... because *Caulkett* only applies in the Chapter 7 context." *In re Wilson*, 532 B.R. 486 (S.D.N.Y. 2015).

## *CAULKETT*'S TRUE REACH

The only question that remains after *Caulkett* is whether the Supreme Court's holding should be applied uniformly to both Chapter 7 and Chapter 13 cases. The lower courts that have limited *Caulkett* have simply ignored the Supreme Court's desire to eliminate the arbitrary impact of judicial valuations.

As the Supreme Court stated in *Caulkett*, we must avoid affecting a lender's rights based upon something as flimsy as a valuation yielding one dollar more or one dollar less. If not, debtors, relying upon the same judicial valuations that *Caulkett* seeks to avoid, will routinely be allowed to escape what can be a 15-year loan repayment obligation in three years based simply upon the filing of a different type of bankruptcy case — a Chapter 13 case.

Courts should not rewrite home equity loans by discharging a lien on real estate earlier than intended regardless of the type of bankruptcy case involved. They should simply say no to debtors who are trying to strip home equity liens.

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