

Lien Avoidance: Questions, Answers & Conundrums

Long before consumer bankruptcy became embroiled in issues surrounding stripping consensual liens from property, the Bankruptcy Code provided for avoiding liens on the property of the debtor that impaired an exemption which would otherwise be available to the debtor.

Lien avoidance under §522 is available in any chapter to a debtor who can claim exemptions and is counterweight to the bromide that “liens pass through bankruptcy unaffected”.

Section 522(f) empowers the debtor to avoid judicial liens and nonpossessory, nonpurchase-money security interests in delineated personal property.

(1) Notwithstanding any waiver of exemptions but subject to paragraph (3), the debtor may avoid the fixing of a lien on an interest of the debtor in property to the extent that such lien impairs an exemption to which the debtor would have been entitled under subsection (b) of this section, if such lien is—

(A) a judicial lien, other than a judicial lien that secures a debt of a kind that is specified in section 523(a)(5); or

(B) a nonpossessory, nonpurchase-money security interest in any—

(i) household furnishings, household goods, wearing apparel, appliances, books, animals, crops, musical instruments, or jewelry that are held primarily for the personal, family, or household use of the debtor or a dependent of the debtor;

(ii) implements, professional books, or tools, of the trade of the debtor or the trade of a dependent of the debtor; or

(iii) professionally prescribed health aids for the debtor or a dependent of the debtor.

(2) (A) For the purposes of this subsection, a lien shall be considered to impair an exemption to the extent that the sum of—

(i) the lien;

(ii) all other liens on the property; and

(iii) the amount of the exemption that the debtor could claim if there were no liens on the property; exceeds the value that the debtor’s interest in the property would have in the absence of any liens.

(B) In the case of a property subject to more than one lien, a lien that has been avoided shall not be considered in making the calculation under subparagraph (A) with respect to other liens.

(C) This paragraph shall not apply with respect to a judgment arising out of a mortgage foreclosure.

The amendments to the Bankruptcy Code in 2005 added provisions to limit the household goods which could be liberated from non possessory, nonpurchase money security interests and a cumulative value of those goods. *See* 522(f)(3) and(f)(4).

Like any useful tool in our tool box, the more you know about the tool, the better use you can make of it.

20 Questions

1. **Is it the debtor's property?**

The liens to be avoided are only those that attach to the debtor's interest in property.

Joint tenancy: Avoidance available only as to debtor's share of property. *Pagnini*, 433 B.R. 455 (1st Cir. BAP 2010).

Community property: All of the community property comes into the estate, even if only one spouse files. §541(a)(2). *Schmiedel*, 236 B.R. 393 (Bankr. E.D. Wis. 1999).

Tenancy by entireties: debtor's interest in property is the entire property. *Levinson*, 395 B.R. 554 (D.E.D. NY 2008); but *Raskin*, 505 B.R. 684 (Bankr. D. Md. 2014) only one half of the property subject to lien avoidance.

2. **Did the debtor's interest exist before the lien fixed?**

Statutory language that avoids the fixing of a lien on an interest of the debtor in property prevents stripping liens that fix simultaneously with the debtor's acquisition of that interest in property.

Farrey v. Sanderfoot, 500 U.S. 291 (1991)

Weeks v. Pederson, 230 B.R. 158 (9th Cir. BAP 1999)

3. **Is the lien one that can be avoided?**

Only judicial liens can be avoided under §522(f).

Tax liens are statutory and not avoidable as impairing an exemption: *Frengel*, 115 B.R. 569 (Bankr. N.D. Ohio 1989).

DSO not avoidable: *Nevette*, 227 B.R. 724 (Bankr. E.D. Mo. 1998).

Attorneys charging lien is statutory: *Washington*, 242 F.3d 1320 (11th Cir. 2001).

Purchase money: refinancing purchase money lien makes new lien nonpurchase money.

Freeman, 956 F.2d 252 (11th Cir. 1992); contra: *Billings*, 838 F.2d 405 (10th Cir. 1988).

4. **Which exemptions apply?**

Federal bankruptcy exemptions are available unless state law provides otherwise. §522(b)(2). Section 522(b)(3) looks to the debtor's domicile in the 730 days before the commencement of the case to determine which state law applies.

If the state whose laws apply is not the debtor's current domicile, you must then determine whether the exemptions of the state providing the exemption law are available to individuals who are not current domiciliaries. Put another way, you need to determine if the exemptions in question are extra-territorial. For this exercise, nothing beats John Bates' comprehensive, state by state analysis of exemptions found at ExemptionsExpress.com.

If no state's exemptions are available to the debtor, the debtor may claim the bankruptcy exemptions of §522(d).

The right to avoid a judicial lien preempts state exemption law to the contrary. *Henderson*, 18 F.3d 1305 (5th Cir. 1994).

5. **Do you need to claim everything exempt?**

Property that is not property of the estate need not be exempted; *Sewell*, 180 F.3d 707 (5th Cir. 2001); it follows that judicial liens on such property cannot be avoided.

6. **Must the debtor have actually claimed an exemption?**

Well...

Yes: *Wallace*, 453 B.R. 78 (Bankr. W.D. NY 2011).

No: *Bodkin* 650 F.3d 396 (4th Cir. 2011).

7. **Can you amend exemptions in order to avoid lien?**

Does the policy of freely amending exemptions extend beyond case closing where the debtor seeks to avoid a lien?

Yes: *Goswami*, 304 B.R. 386 (9th Cir. BAP 2003); *Dickson* (Bankr. ND Ill. 2014).

No: *Bartlett*, 326 B.R. 436 (Bankr. N.D. Ind. 2005).

8. **What if the lien supports a nondischargeable debt?**

Lien for nondischargeable judgment avoidable: *Vaughan*, 311 B.R. 573 (10th Cir. BAP 2004).

9. **Can a lien creditor challenge validity of exemption in avoidance motion if it was earlier allowed?**

Yes: *Morgan*, 149 B.R. 147 (9th Cir. BAP 1993); *Maylin*, 155 B.R. 605 (Bankr. Maine 1993).

No: *United States v. Williams*, 156 B.R. 77 (Bankr. S.D. Ala 1993). But see FRBP 4003(d) “notwithstanding the provision of subdivision (b), a creditor may object to a motion filed under §522(f) by challenging the validity of the exemption asserted to be impaired by the lien.

10. **Does the lien impair an exemption?**

The statute provides a formula that subtracts the lien in question, other unavoidable liens on the debtor’s interest and the debtor’s exemption from the value of the debtor’s interest. If the result is zero or a negative number, the lien impairs the exemption. If it is a positive number, the value of the asset is sufficient such that the exemption is not impaired.

Junior-most liens are avoided first. *Hanger*, 217 B.R. 592 (9th Cir. B.A.P. 1997) , aff’d, 196 F.3d 1292 (9th Cir. 1999) ; *Heaney*, 453 B.R. 42 (Bankr. E.D.N.Y. 2011).

11. **How do you count senior liens where others have an interest in the property?**

Total of liens deducted from debtor’s one half of property value to determine impairment: *Cozad*, 208 B.R. 495 (10th Cir. BAP 1997).

OR

Total of liens senior to lien to be avoided deducted from total value of co owned property to calculate value of debtor’s interest. *Lehman*, 205 F.3d 1255 (11th Cir. 2000).

12. **Who has burden of proof on motion to avoid?**

Debtor bears the burden on all elements of lien avoidance. *Soost*, 262 B.R. 68 (8th Cir. BAP 2001). But what if the issue is whether the exemption is allowable? The debtor bears burden of showing that an exemption was claimed; any contest as to whether the exemption was proper shifts to the objecting creditor. *Thompson*, 263 B.R. 134. (Bankr. WD Okla 2001).

13. **Is avoidance dependent on equity in the property?**

The 1994 amendments to 522(f) attempted to provide a formula for calculating “impairment” that made clear that the debtor did not have to have equity in the property in order to avoid a lien. See *Thigpen*, 374 B.R. 374 (Bankr. S.D. GA 2007). *Freeman*, 259 B.R. 104 (Bankr. D.S.C. 2001). Some arguments persist that equity is a requirement of a state law exemption that then bars debtor from avoiding lien.

14. **Can you bring avoidance motion after case closes?**

You bet.

After case closing: *Green*, 2013 WL 4055846 (BAP 9th Cir. 2013).

After sale of lien property: *Chiu*, 304 F.3d 905 (9th Cir. 2002).

After payment of lien: *Wilding*, 475 F.3d 428 (1st Cir. 2007).

Abandonment does not cut off jurisdiction: *Ramos*, 498 BR 1 (BAP 1st Cir. 2013).

15. **Can you wait too long to avoid the lien?**

Yes, principles of equity, including a detrimental change of position, may defeat a long delayed motion to avoid lien. *Bianucci*, 4 F.3d 526 (7th Cir. 2004)

16. **What is the proper date for valuation?**

Asset is valued as of the filing of the petition. *Rehbein*, 49 B.R. 250, (Bankr. D. Mass 1985). Unless, the case is converted from 13 to 7, at which point the date of conversion is the relevant date. *Salamone*, 46 B.R. 19 (Bankr. E.D. N.Y. 1984). And the debtor as owner is competent to value the property. *Saucier*, 353 B.R. 383 (Bankr. D. Conn. 2006)

17. **Do costs of sale matter?**

No, costs of sale are not part of the statutory formula for measuring impairment. *Wolmer*, 494 B.R. 783 (Bankr. D. Conn. 2013). The relevant measure of value is what a willing buyer would give a willing seller, not a forced-sale value. *James*, 75 B.R. 124 (Bankr. S.D. Ohio 1987)

18. **How much of the lien is avoided?**

Lien is avoided only to the extent that it impairs the exemption. Therefore, some part of the lien may survive.

Nelson v. Scala, 192 F.3d 32 (1st Cir. 1999); *Falvo*, 227 B.R. 662 (BAP 6th Cir. 1998)

19. **Did you forget 522(h)?**

Subsection h allows the debtor to avoid a transfer and claim exempt property involuntarily transferred to a creditor when the trustee elects not to avoid the transfer. *McCarthy*, 501 B.R. 89 (BAP 8th Cir. 2013)

Defenses that are good against trustee are good against debtor *Sandoval*, 470 B.R. 195 (Bankr. D.N.M. 2012); *Maus*, 282 B.R. 836 (Bankr. N.D. Ohio 2002); *Pierce*, 504 B.R. 506 (BAP 8th Cir. 2014)

20. **Does lien avoidance depend on getting a discharge?**

Who knows? With the building consensus that mortgage lien stripping in Chapter 20 cases is permissible, one must ask what the role the discharge plays in §522 lien avoidance.