

CONSUMER BANKRUPTCY

Avoiding Judicial Liens in Chapter 13 Cases

New decision says avoidance not dependant on discharge

By Craig D. Robins

One of the extraordinary powers a consumer debtor has is the ability to avoid (eliminate) judicial liens in a bankruptcy case provided certain conditions are met.

In a typical bankruptcy filing the debtor can discharge the personal liability on most debts – both secured and unsecured. However, *in rem* liens on real estate, including mortgages and judicial liens obtained from judgments, remain protected.

The discharge prevents lien holders from pursuing the debtor personally to collect on the underlying obligation; however, the lien holder maintains the value of its security interest as a lien against the real estate. Consumer debtors have the ability

to avoid judicial liens to the extent that the lien impairs the debtor's homestead exemption.

In this month's column I will provide a brief background on judicial liens and the process to avoid them. I will then discuss an interesting recent decision by Judge Grossman which holds that avoiding a judicial lien in a Chapter 13 case should be effective immediately, rather than years later when the debtor receives his discharge.

How do creditors obtain judicial liens?

When a creditor sues a consumer and obtains a judgment, the judgment can become a lien on real estate that the con-



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sumer owns. If the creditor obtains the judgment in Supreme Court, then it automatically becomes a lien on any real estate owned by the debtor in the county where the court is located.

If the creditor obtains the judgment in District Court, then the creditor must file a transcript of judgment with the County Clerk in order to obtain a lien on realty in that county. Judicial liens are always subordinate to any other liens of record such as existing mortgages.

When a consumer debtor files for bankruptcy relief – which is usually done under Chapter 7 or 13 – the debtor can avoid judicial liens which impair the debtor's homestead exemption as long as the formula set forth in Bankruptcy Code Section 522(f) is satisfied.

If the lien only partially impairs the homestead exemption, the debtor can avoid that part of the lien, essentially reducing it.

Procedure for avoiding judicial liens

A debtor bringing an application to avoid a judicial lien must do so by motion, as opposed to adversary proceeding. This is usually done prior to discharge.

The debtor actually has the burden of filing the motion. If the debtor fails to do so, the lien remains on the property and survives bankruptcy, although the creditor is

prevented by virtue of the automatic stay and order of discharge from pursuing the debtor personally.

Creditors can object to a motion to avoid a judicial lien. The most common ground is a dispute over the valuation of the real estate, thus creating an issue as to whether the debtor's homestead exemption is actually impaired.

If the debtor is successful, the court will grant the motion and enter an order declaring the judgment to be void as a lien of record. The debtor must then file a certified copy of the order with the County Clerk to remove the judgment lien from the judgment roll.

When should the order granting lien avoidance become effective?

In Chapter 7 cases, the order is effective immediately. However, a unique issue exists in Chapter 13 cases. This is because a great number of Chapter 13 cases eventually fail, resulting in dismissal of the case and no discharge for the debtor. An argument can be made that a debtor should not be permitted to finalize the avoidance of a judicial lien by expunging it from the public records of the County Clerk if the Chapter 13 case can be dismissed for non-payment of Chapter 13 obligations a few months later.

So here's the big question: Should a Chapter 13 debtor be able to avoid a judi-

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cial lien shortly after filing the case? Or should the effectiveness of the lien avoidance be dependant upon the debtor demonstrating 100 percent success with the bankruptcy, which means fulfilling all obligations under the Chapter 13 plan over a period that is three to five years?

In a case where there is no binding case law in the Second Circuit, Judge Robert E. Grossman, sitting in the Central Islip Bankruptcy Court, just issued a decision on October 26, 2010 in which he determined that a Chapter 13 debtor who avoids a judgment lien pursuant to Section 522(f) should not have to wait until discharge for the order to become effective. *In re: Kathleen Mulder*, no. 10-74217, (Bankr. E.D. New York 2010). In doing so, he reversed the court's policy of many years.

In the *Mulder* case, the debtor owned a home worth \$255,000 at the time of filing. There were mortgages on the property totaling \$220,000. Thus there was about \$35,000 worth of equity. The debtor was entitled to exempt up to \$50,000 worth of equity under her New York homestead exemption.

At the time of filing, there was a judg-

ment lien in the sum of \$160,000. The debtor, who was represented by my colleague, Donna M. Fiorelli of Garden City, filed a routine motion to avoid the judgment lien. The creditor filed a limited objection arguing that its rights would be severely prejudiced if the court permitted the debtor to expunge the lien prior to discharge.

The sole issue before the court was whether Section 522(f) lien avoidance is effective immediately or whether it must be conditioned upon the entry of a discharge in the case. (There was no dispute that the lien should be avoided).

The court overruled the judgment creditor's objection and permitted the debtor to immediately expunge the lien, finding nothing in the code to prohibit this. In reaching this conclusion, the court adopted the minority view in this country and essentially changed the policy of the court in Central Islip (or at least those cases before Judge Grossman).

The court pointed out that other provisions of the code protect the creditor, in particular, Section 349 which provides that when a case is dismissed; all property rights are restored to the position in which they

were found at the commencement of the case. Thus, Section 349 automatically reinstates liens avoided by Section 522(f).

However, as a practical matter, this is not automatic, and if the debtor expunges the lien and the case is later dismissed, it places a burden on the judgment creditor to immediately take steps to protect itself.

Judge Grossman pointed out that the minority view seeks to preserve the function of Section 349 if the case is dismissed. "Courts which condition lien avoidance on the entry of a discharge perceive a weakness in the code that could adversely affect judgment lien holders. . ." However, he found good cause to part from this view because the code does not explicitly provide for this.

It appears that Judge Grossman's approach here greatly differs from his approach in other cases. Here he has taken a strict constructionist approach, stating, "the court finds that the words of Section 522(f) are clear, and when reading a statute, if the meaning is clear, the analysis ends there."

He also quoted another decision stating, "Congress 'says in a statute what it means

and means in a statute what it says there.'" He concluded, "While this court shares a similar frustration with what appears to be drafting deficiencies of the code, this court is bound by the plain meaning of the statute."

Yet, most of Judge Grossman's previous decisions have been more geared towards reaching a logical outcome, as opposed to citing strict constructionist grounds, something I addressed in my March 2010 column. In any event, this decision is a win for the consumer.

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