

## BANKRUPTCY LAW

# Taking Advantage of the Bankruptcy Fresh Start: Avoiding Judicial Liens

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One of the most powerful tools for achieving a truly fresh start through bankruptcy is the debtor's power to avoid (nullify) certain liens on his or her assets. The power to avoid liens modifies the general bankruptcy rule that liens pass through a bankruptcy unaffected. Specifically, unless liens are avoided, the discharge only eliminates the personal liability of the debtor, not the liability of the property that is subject to a pre-petition lien.

### Lien Avoidance Under 11 U.S.C. §522(F)

There is a common misconception that a bankruptcy discharge automatically results in the removal of judgment liens. Lien avoidance is not automatic. The debtor has the burden to file a lien avoidance action under 11 U.S.C. §522(f). If such an action is not filed all liens on the debtor's property, even if exempt, generally survive the bankruptcy. Both the bankruptcy courts and New Jersey state courts have the power and authority to remove liens upon proper application.

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The Bankruptcy Code recognizes three types of pre-petition liens: judicial, statutory and consensual. Section 522(f)(1)(A) gives the debtor the unqualified right to avoid any judicial lien that impairs an exemption to which the debtor would have been entitled under §522(b), subject only to an exception for domestic support obligation debts. This article will focus only on the avoidance of judicial liens.

The Bankruptcy Code defines judicial liens to mean any lien "obtained by judgment, levy, sequestration, or other legal or equitable process or proceeding." 11 U.S.C. §101(36). The exemptions giving rise to the right to avoid judgment liens are contained in 11 U.S.C. §522(d). The exemptions most commonly used to avoid judgment liens are the real estate exemption, currently \$23,675 per debtor, and the wild card exemption, which can be applied to any asset.

"Where a judgment has not become a lien on any of the debtor's property at the filing of the bankruptcy petition, Section 522(f) cannot apply." *In re Hamilton*, 286 B.R. 291, 293 (Bankr. D.N.J. 2002). Similarly, there can be no lien avoidance if the debtor has transferred or otherwise divested his or her interest in the property prior to the time the lien is sought to be avoided. *In re Vitullo*, 60 B.R. 822 (D.N.J. 1986).

Among the most common liens avoided utilizing 11 U.S.C. §522(f)(1)(A) are judicial liens on real estate. In New Jersey, a judgment becomes a



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lien on all of a debtor's real property located in the state when it is recorded on the docket of the Clerk of the Superior Court. N.J.S.A. §§2A:16-1 and 2A:17-17.

Section 522(f) provides a mathematical calculation to determine when a lien should be considered as impairing the debtor's exemption and can therefore be avoided. That section provides:

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.

11 U.S.C. §522(f)(2)(A).

If the debtor is seeking to avoid more than one judicial lien on a particu-

lar property, as each lien is avoided, the avoided lien is no longer considered in the calculation to remove the remaining judicial liens. 11 U.S.C. §522(f)(2)(B); *In re Yampell*, 2013 Bankr. LEXIS 2231, \*7 (Bankr. D.N.J. May 31, 2013). For purposes of judgment lien avoidance, property exemptions and property valuation are determined as of the petition date. 11 U.S.C. §522(a)(2); *In re Steck*, 298 B.R. 244, 250 (Bankr. D.N.J. 2003).

The following hypothetical illustrates how lien avoidance works. The value of the debtor's real property is \$200,000.

(i) The judgment lien sought to be avoided is \$15,000.

(ii) The other liens are a first mortgage of \$170,000 and a real estate tax lien with a balance of \$20,000.

(iii) The debtor claimed a real estate exemption of \$15,000 in her bankruptcy petition.

The sum of (i), (ii) and (iii) equals \$205,000. This sum exceeds the value of the real property (\$200,000). The entire lien is therefore impaired because it is greater than the value of the property, and is subject to avoidance.

A lien can also partially impair an exemption. Using the above example, if the value of the real estate is \$210,000, the value of the real property now exceeds the liens and exemption by \$5,000. Due to the partial impairment, the judgment lien can be fixed in the amount of \$5,000. A judgment in that amount will survive the bankruptcy.

Generally, non-dischargeability of an underlying debt is no defense to an otherwise proper action to avoid a judgment lien that impairs an exemption. *Walters v. U.S. Nat'l Bank*, 879 F.2d 95 (3d Cir. 1989).

## Procedure for Use of Avoiding Power

### • *Avoiding Liens in Bankruptcy Court.*

The preferred method to avoid a judicial lien is by filing a motion during the course of the bankruptcy case. The

Federal Rules of Bankruptcy Procedure prescribe the lien avoidance procedure that the debtor must follow. Rule 4003(d) provides that lien avoidance under 11 U.S.C. §522(f) shall be by motion in accordance with Bankruptcy Rule 9014. In Chapter 7 and 11 cases, a motion is filed on notice to affected creditors. In Chapter 13 cases, while a separate motion may be filed, the local Chapter 13 Plan contains a motion to avoid judicial liens. The Plan containing the motion must be served on affected creditors.

A creditor may object to a motion filed under 11 U.S.C. §522(f) by challenging the validity of the exemption asserted to be impaired by the lien even if the time has otherwise run to challenge the exemption. Fed. R. Bank. P. 4003(d). The Bankruptcy Rules providing for debtor lien avoidance set no time limits. Therefore, the lien avoidance motion may be filed at any time during the pendency of the bankruptcy case, after the discharge has been entered and even after the case is closed. However, if the case has been closed a motion must be made to reopen the case under 11 U.S.C. §350(b). See *In re Vitullo*, 60 B.R. at 824.

### • *Avoiding Liens in State Court.*

New Jersey law provides an alternate remedy for the avoidance of judgment liens after the bankruptcy case has been completed. N.J.S.A. §2A:16-49.1 "permits a debtor, whose debts have been discharged in bankruptcy, to apply to the state court that has entered a judgment against the debtor, or has docketed the judgment, for an order directing the judgment to be canceled and discharged." *Gaskill v. Citi Mortg*, 221 N.J. 501, 503 (2015).

N.J.S.A. §2A:16-49.1 "requires the debtor to wait at least a year following his or her bankruptcy discharge before seeking the cancellation and discharge of the judgment lien." *Gaskill*, 221 N.J. at 503. "[T]he controlling issue is whether or not the lien was 'subject to be discharged or released' under the provisions of the Bankruptcy Code[.]" *Chemical*

*Bank v. James*, 354 N.J. Super. 1, 9 (App. Div. 2002) (quotations omitted). See *New Century Fin. Servs. v. Staples*, 379 N.J. Super. 489, 496-98 (App. Div. 2005).

To utilize the state statute, a motion must be filed in the court in which the judgment was entered. Notice must be given to the judgment holder and counsel that obtained the judgment on its behalf.

The use of N.J.S.A. §2A:16-49.1 is more expansive than 11 U.S.C. §522(f). For instance, if a judgment lien still appears of record after the bankruptcy is completed, even if there is no property to which the judgment lien attaches, a debtor can utilize N.J.S.A. §2A:16-49.1 to return to the court that entered the judgment and have it cancelled. *In re Hamilton*, 286 B.R. at 293.

As a practical matter, if there are numerous judgment liens to be avoided, it may be more cost effective to reopen the bankruptcy case and file one motion to avoid all of the liens, which requires one filing fee, rather than several motions and filing fees in the state court. Another practical consideration is timing. The longer a debtor waits to avoid a judgment lien, the harder it becomes to locate either counsel for the judgment holder or the judgment holder itself. The ideal time to seek lien avoidance is by bringing a motion early on in the bankruptcy case.

Regardless of which court enters the order, it is important to make sure that the order is recorded with the Judgment Section of the Superior Court of New Jersey.

## Conclusion

Lien avoidance issues can often become complicated. This article is intended to only provide a very basic understanding of judicial lien avoidance both during and after bankruptcy proceedings. There are many bankruptcy and state court cases addressing these issues. It is important that the practitioner be well versed in both the statutes and the case law before bringing these lien avoidance actions. ■