



# THE ENFORCER

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## Can a Lien Created by a Judgment of Divorce be Avoided in Bankruptcy?

It is becoming common for one or both parties to a divorce to file for bankruptcy in an attempt to discharge marital debt. Bankruptcy filings are often times jointly planned and not intended to cause harm to the other party. However, frequently there is joint property that was divided in the divorce. What affect, if any, can a post-divorce bankruptcy filing have on divided joint property?

The focus of this article will be on the marital home (the "Property") which is usually the big ticket item in a divorce. Often though the parties' joint tenancy in the Property is extinguished, parties retain some type of interest in it. The Judgment of Divorce will grant one spouse (hereinafter referred to as "Wife") fee simple title to, and the right to possession of, the Property. The other spouse (hereinafter referred to as "Husband") then receives a money judgment ("Money Judgment") and a lien (the "Lien") on the Property to secure that obligation. If Wife, as fee simple owner, decides to file for bankruptcy protection post-divorce, it becomes part of the bankruptcy estate<sup>i</sup> and is subject to the provisions of the Bankruptcy Code.

Pursuant to 11 U.S.C. 522(f)(1), a judicial lien may be avoided by the debtor in bankruptcy if the lien impairs an exemption to which that debtor would have been entitled in absence of the lien.<sup>ii</sup> The Bankruptcy Code defines "judicial lien" as a "lien obtained by judgment, levy, sequestration, or other legal or equitable process or proceeding."<sup>iii</sup> By this definition, Husband's Lien, created by the Judgment of Divorce, is a "judicial lien." The pertinent language of 11 U.S.C. 522(f) provides:

Notwithstanding any waiver of exemptions . . . 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-

(1) (A) a judicial lien, other than a judicial lien that secures a debt of a kind specified in section

523(a)(5); or

\* \* \*

(2)(A) For 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.

Under §522(d)(1), a Debtor is entitled to a \$21,625 exemption which the debtor uses for a residence. If the judicial lien reduces the Debtor's exempted equity<sup>1</sup>, it is considered "impaired".

Before it can be determined whether Husband's Lien can be avoided though Wife's bankruptcy, the creation of the Lien must be examined in greater detail. This is because the inquiry can be cut short depending on the purpose for the award of the Money Judgment and the Lien.

In our hypothetical, the purpose of the award of money was to buy out Husband's interest in the Property. Wife is permitted to remain in the Property but the Lien secures the Husband's Money Judgment. The creation of the parties' new interests in the Property, i.e the , grant of the Lien and the award of the Property in fee to Wife, are both accomplished through the provisions of the Judgment of Divorce.<sup>iv</sup> Rather than a property equalization, if the underlying Money Judgment had been granted for the support of Husband, the Lien would have been created to secure a domestic support obligation ("DSO").<sup>v</sup> Section 522(f)(1)(A) explicitly provides that it is not applicable to a DSO and the analysis is ended.<sup>vi</sup>



However in our hypothetical, section 522(f)(1) appears to be quite a cause for concern to Husband. It is possible Wife will attempt to use the Bankruptcy Code as a means to rid her newly acquired fee simple interest in the Property of any encumbrances. Can Wife really use this section of the Bankruptcy Code to eradicate Husband's security for the obligation<sup>vii</sup> owed to him?

This question was answered in a United States Supreme Court decision, *Farrey v. Sanderfoot*, 500 US 291 (1991). In *Farrey*, when the parties divorced, a Wisconsin court awarded each one-half of their marital estate.<sup>viii</sup> Among other things, the divorce decree awarded Farrey's interest in the marital home and real estate to Sanderfoot and ordered Sanderfoot to make payments to Farrey to equalize their net marital assets.<sup>ix</sup> To secure the award, the court granted Farrey a lien against Sanderfoot's real property.<sup>x</sup> Sanderfoot did not pay Farrey and subsequently filed for bankruptcy, listing the marital home and real estate as exempt homestead property.<sup>xi</sup> Sanderfoot proceeded to file a motion to avoid Farrey's lien under 11 U.S.C. 522(f)(1).<sup>xii</sup>

The bankruptcy court denied the motion finding that the lien could not be avoided because it protected Farrey's pre-existing interest in the marital property.<sup>xiii</sup> The District Court reversed, concluding that the lien was avoidable because it "is fixed on an interest of the debtor in the property."<sup>xiv</sup> The Court of Appeals affirmed the District Court's reversal.

The Supreme Court reversed the court of appeals' decision. It held that 11 U.S.C. 522(f)(1) requires a debtor to have possessed an interest to which a lien attached, before it attached, to avoid the fixing of a lien on that interest.<sup>xv</sup> The Court noted that section 522(f)(1) does not permit avoidance of any lien on a property, but instead expressly permits avoidance of "the fixing of a lien on an interest of the debtor."<sup>xvi</sup> A fixing of a lien that takes place before the debtor acquires an interest, by definition, is not on the debtor's interest.<sup>xvii</sup>

The Court determined that its reading fully comported with section 522(f)'s purpose, which is to protect the debtor's exempt property. It further comported with section 522(f)'s legislative history, which suggests that Congress primarily intended it as a device to thwart creditors who, sensing an impending bankruptcy, rush to court to obtain a judgment to defeat the debtor's exemptions. To permit lien avoidance in a situation where the debtor at no point possessed the interest without the judicial lien would allow judicial lienholders to be defrauded through the conveyance of an encumbered interest to a prospective debtor.<sup>xviii</sup>

With this reasoning, it followed that Farrey's lien could not be avoided under section 522(f)(1). Under state law, the divorce decree extinguished the parties' joint tenancy, in which each had an undivided one-half interest, and created new interests in place of the old. Thus, Farrey's lien fixed not on Sanderfoot's pre-existing interest, but rather on the

fee simple interest that he was awarded in the decree that simultaneously granted Farrey her lien.<sup>xix</sup> The Court found the result was the same even if the decree merely reordered the couple's pre-existing interests. This was because the lien would have fastened only to what had been Farrey's pre-existing interest, an interest that Sanderfoot would never have possessed without the lien already having fixed.<sup>xx</sup> To permit Sanderfoot to use the Bankruptcy Code to deprive Farrey of protection for her own pre-existing homestead interest would neither follow the statute's language nor serve its main goal.<sup>xxi</sup>

Accordingly, due to a fair application of the Farrey reasoning to our hypothetical, Wife will not be able to avoid Husband's Lien in her bankruptcy. Instead, Husband's Lien, being created at the same time as, and by the same judicial instrument which granted, Wife's fee simple interest in the Property, will survive the bankruptcy proceeding.

1. The sum of the property's fair market value less mortgages and bankruptcy exemption(s).
- i. See 11 U.S.C. 541.
- ii. 11 U.S.C. 522(d)(1) permits a debtor to exempt up to \$21,625.00 in real or personal property that the debtor uses as a residence.
- iii. 11 U.S.C. 101(36)
- iv. See *Walworth v. Wimmer*, 200 Mich. App 562, 504 NW2d 708 (1993).
- v. See 11 U.S.C. 523(a)(5). Note that the determination as to whether an obligation is the nature of support (and therefore a DSO) is based on bankruptcy law and not traditional state law notions of support. See 11 U.S.C. 101(14)(A).
- vi. See 11 U.S.C. 522(f)(1)(A).
- vii. The underlying money judgment will not be discharged as it is a non-dischargeable debt under 11 U.S.C. 523(a)(15).
- viii. *Farrey v. Sanderfoot*, 500 US 291,293
- ix. *Id.*
- x. *Id.*
- xi. *Id.*
- xii. *Id* at 294.
- xiii. *Id.*
- xiv. *Id* (citations omitted).
- xv. *Id* at 301 (emphasis added).
- xvi. *Id* at 296 (emphasis added).
- xvii. *Id.*
- xviii. *Id* at 297-298.
- xix. *Id* at 299-300.
- xx. *Id* at 300-301.
- xxi. *Id* at 301.

