How to Think About and Figure Out Whether a Lien Impairs an Exemption

Section 522(f) of the Bankruptcy Code provides a method by which a debtor may avoid two types of liens: judicial liens (with certain exceptions) and non-possessory, non-purchase money liens in described personal property. A limitation on this avoidance power is that such a lien can be avoided only to the extent that the lien impairs an exemption claimed by the debtor on Schedule C.

This monograph has three main parts. The first part is a discussion of the need for accuracy in preparing Schedules A, B, C and D, because these documents supply the values to be used in determining whether a lien is avoidable. The second part highlights the basic concepts that one must understand to do accurate calculations. The third part outlines how the calculations are done.

1. Prepare Accurate Schedules. The facts alleged in a motion to avoid a lien must be reflected in the Schedules, and the Schedules must be accurate.

- **Avoid Orphan Properties.** If a debtor claims on Schedule C an exemption in a particular item or piece of property, that property must be disclosed in Schedule A or Schedule B.

- **List All Liens on Schedule D.** Make sure that every lien creditor, including holders of judicial liens, are listed on Schedule D. When gathering information about judicial liens, find out the date on which the judgment was obtained.

- **Have the Client Value the Property.** If the value of the exempted property shown in Schedule C is "unknown," it is impossible to determine whether a lien would impair the exemption, and hence a motion to avoid a lien on unvalued property will always be denied.

- **Obtain Accurate Values and Amounts.** Obtain accurate information about both the current values of property and the amounts of secured debt. It is not uncommon for a debtor to schedule less debt than actually owed to a creditor secured by property to which a judgment lien has attached. Understating the amount of debt as of the petition date may prevent the avoidance of a judgment lien that in fact would be avoided if the correct amount of debt had been stated. Sources of information about debt include the payoff that a lender can provide and proofs of claim filed in the current or prior case.

- **Ownership and Liability.** Be careful about who actually owns the residence or other property and who the judgment is against. If the judgment is against spouse 1 only, that lien cannot attach to the property of spouse 2.

- **Ga. Code Ann. 44-13-100.** Read it occasionally. Do not list on Schedule C property not exemptible under this statute and do not claim an exemption amount greater than that permitted by this statute. Real estate (other than a grave site) not used as the primary residence by the debtor or a dependent of the debtor is NOT exemptible under O.C.G.A. § 44-13-100(a)(1).

2. Understand the Basic Concepts.

- **Analysis by Property.** Each type or perhaps even item of property must be analyzed separately. You do NOT add the values of all personal property and compare that total to the sum of all exemptions. It is property by property. This is because every consensual lien might not attach to every item or piece of property. In all likelihood, the car financier does not have a consensual lien on the house and the mortgagee does not have a consensual lien on the car.

- **Key Date.** For purposes of section 522(f), the values of properties and amounts of debts are determined as of the petition date, unless the debtor acquires post-petition a larger interest in property to which the judicial lien attached pre-petition and the debtor is in either a Chapter 13 or Chapter 11 case, in which case the applicable date is the date of acquisition of the new interest. *See In re Willett,* 544 F.3d 787 (7th Cir. 2008).

- **Debtor's Interest in Property.** The value of a debtor's interest in property is the value of the property multiplied by the debtor's percentage of ownership. If the debtor owns an undivided 50% interest, the value of his interest is one-half the total current value. Pay attention to ownership when preparing Schedules A and B.

- **Debtor's Share of Consensual Liens.** The debtor's share of the amount of consensual and statutory liens against the property in question is, generally, the aggregate amount of such liens multiplied by the debtor's percentage of ownership. (It is possible, however, for a consensual lien to attach by agreement only to a debtor's fractional interest in the property and not the co-owner's interest, in which case, that debt is chargeable entirely to the debtor.)

- **Section 522(f).** Read it occasionally. The only avoidable consensual liens are non-possessory, non-purchase money security interests attaching to the following property: (I) household furnishings, household goods, wearing apparel, appliances, books, animals, crops, musical instruments, or jewelry 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. 11 U.S.C. § 522(f)(1)(B). Consensual liens on vehicles are not avoidable because vehicles are not listed in section 522(f)(1)(B). Tax liens, mechanics liens and other statutory liens are not avoidable, and if a judgment has been obtained on a statutory lien, it is not avoidable because it is still, practically speaking, a statutory lien. Otherwise, a judicial lien against an individual is potentially avoidable, even if the debt evidenced by that judgment is not dischargeable.

- **No-Brainers.** If the exemption amount is greater than or equal to the value of debtor's interest in a type or item of property, the judgment lien is always avoidable. For example, if the value of the household goods stated on Schedule B is $1,000 and the amount of the exemption claimed for household goods is $1,000, any avoidable lien will impair the exemption. Similarly, if the debtor exempts a primary residence, and the value of the debtor's interest in the residence is less than or equal to the amount of unavoidable consensual and statutory liens against the debtor's interest in that residence, the judicial lien is always avoidable. The result is the same if the sum of the maximum exemption and the debtor's share of unavoidable liens equals or exceeds the value of the debtor's interest in the residence.

- **The "Value of the Exemption."** Schedule C refers not to the amount of an exemption but to the "value of the exemption." This term does not appear in section 522 or the Bankruptcy Rules. As a practical matter, this entry has often been treated as the claim of the amount of the exemption. But some read the term "value of the exemption" as the value the exemption would have if the property were sold, and list the value as zero if the amount of the consensual debt secured by the property in question is greater than the current value of the property. This position, while defensible, can lead to problems, not the least of which is the argument, itself not necessarily frivolous, that the debtor intended to exempt nothing. It might be safer to at least exempt one dollar.

- **Legal Conclusions Not Admitted by Default.** Always state in the motion the amounts of consensual and statutory liens, the amount of the judgment liens to be avoided and the values of properties to which such liens attach. Don't just state the legal conclusion that a lien impairs the exemption. By not responding to the motion, the creditor admits only well-pleaded facts and not legal conclusions. Show that the lien impairs the exemption by stating the relevant facts – or be prepared to prove it.

- **No Need for Separate Motions.** Make it easy on yourself and the Court. Name all judgment lien holders as respondents in one motion. If any one of the judgment liens may not be avoided in its entirety, it is essential to state the dates on which the judgment liens were obtained.

3. The Arithmetic of Lien Avoidance Under Section 522(f).

A. First, a simple way of thinking about the problem.

A simple way to think about the process is to imagine a sale of property to which a judgment lien has attached and then imagine how the sales proceeds would be distributed. The property would be presumed to be sold for its current value. From the debtor's share of the sale proceeds, the debtor's share of the total amount of all unavoidable liens (mortgage liens, tax liens, other statutory liens) would be paid first. If there is nothing left over, all judgment liens are completely avoidable.

If there is something left over, imagine that the next distribution is the amount of statutory exemption under O.C.G.A. § 44-13-100. If there is nothing left over after allocating the remaining sales proceeds to the exemption, all judgment liens are completely avoidable.

If there is a balance left over after reserving or paying the amount of the exemption, that balance is allocated to the judgment liens in their order of priority, i.e., oldest first. All liens or portions of liens that cannot be paid from the balance are avoidable. Liens that would be satisfied in whole or in part with the funds remaining after the amount of the exemption has been set aside from the sale proceeds are not avoidable.

The Basic Formula

Current value of Debtor's Interest in Property **minus** Debtor's Share of Nonavoidable liens **minus** Exemption Amount **equals** Amount Available to Pay Judgment Liens.

If there is no amount available to pay judgment liens, all such liens are avoidable.

If there is an amount available to pay judgment liens, allocate that amount to the judgment liens in order of priority; any fully covered senior judicial lien is NOT avoidable. Liens that could be partially paid are not avoidable to that extent- the amount that would pay part of the judgment; the balance of the judgment is avoidable. Liens that are completely out of the money are avoidable in their entirety.

B. The Method Prescribed by Section 522(f)(2).

This section supplies the formula for determining whether a lien impairs an exemption. If there is more than one judicial lien, the computations must be repeated where there is one or more unavoidable judicial liens. Section 522(f)(2) provides:

(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 1 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.

Section 522(f) refers to four separate values:

(1) the amount of the lien sought to be avoided;
(2) the aggregate amount of all other liens on the property;
(3) the amount of the exemption claimed on the property; and
(4) the value of the debtor's interest in the property.

The computations as stated in the statute are as follows:

- **Step 1 -** Determine the amount of the lien to be avoided. Start with the most senior judgment lien- the one obtained at the earliest date. (Junior judgment liens would be dealt with later, one at a time in order of seniority, after doing the calculations for more senior liens.)

- **Step 2** - Determine the debtor's share of all consensual liens and statutory liens against the debtor's interest in the property in question. For example, if the property in question is the residence, add up all of the mortgage debt (evidenced by notes and secured by security deeds on the residence), tax debt secured by tax liens against the residence, etc. If all of those liens encumber the entire property and the debtor's interest is 50%, the debtor's share of the debt would be one half of the total. Also add in the amount of any judicial lien to the extent it is determined not to be avoidable - see Step 6.

- **Step 3 -** Determine the amount of the exemption to which the debtor would be entitled if there were no liens on the property.

- **Step 4** - Add the amount of the judicial lien at issue, the amounts of unavoidable consensual and statutory liens, the amount of any senior judicial lien to the extent it is unavoidable and the amount of the exemption.

- **Step 5 -** Determine the value of the debtor's interest in a particular property. For example, if the property is a residence, the debtor's interest is the entire value if the debtor is the sole owner and is one-half the value if the debtor owns an undivided one half interest in the property.

- **Step 6** - A judicial lien impairs the exemption to the extent that the total of liens and exemptions computed in Step 4 is greater than the value of the debtor's interest in the property in Step 5. In other words, the difference is the portion of the lien that is avoidable.

  Assume a senior judgment lien of $9,000, a mortgage debt of $151,000 and an exemption of $10,000 for a total of $170,000. Assume the value of the debtor's interest in the property is $165,000. Under these facts, the amount that is avoidable is $5,000.

  Because the amount of the judicial lien is $9,000, it is unavoidable to the extent of $4,000. The $4,000 figure would be added to the mix in Step 4 when considering the next most senior lien. In the example, the sum of the consensual lien and the exemption was $161,000, so that adding the unavoided judicial lien in the amount of $4,000 produces a total of $165,000. Any junior lien added to that amount will cause the total to exceed the property value of $165,000 and hence will be avoidable in its entirety.

Example:

Sale Hypothetical	Section 522
Property value = $250,000.00 Unavoidable Debt 1st Mtge Debt = $175,000.00 2nd Mtge Debt = 35,000.00 Tax Lien = 15,000.00 Less Total Unavoidable Debt = $225,000.00 Gross Equity = $25,000.00 Less Exemption claimed = $10,000.00 Net Equity = $15,000.00 Judgment 1 (03/03/02) Less Amount = $2,100.00 Remaining Net Equity = $12,900.00 (Judgment 1 is unavoidable) Judgment 2 (04/13/03) Less Amount = $17,500.00 Remaining Net Equity = $0.00 (negative $4,600) (Judgment 2 is unavoidable to extent of $12,900 and avoidable to extent of $4,600.)	Sum of judgment 1 ($2,100), unavoidable liens ($225,000) and exemption ($10,000) is $237,000. Because that is less than the value of the property ($250,000), judgment 1 is not avoidable. Sum of judgment 2 ($17,500), unavoidable liens ($227,100) – which includes judgment 1 because it is not avoidable - and the exemption ($10,000) is $254,600, which exceeds the property value by $4,600. $4,600 of the second judgment impairs the exemption and is avoidable, leaving the second judgment unavoidable to the extent of $12,900.