

UNDERWRITING BULLETIN

Bulletin No.: 13-006 THE EFFECT OF BANKRUPTCY ON ABSTRACTS OF JUDGEMENT

Frequently it occurs that we issue a preliminary title report showing an abstract of judgment against the seller as a lien on the property. We are informed that the seller declared bankruptcy, the debt was listed, a discharge of debtor was issued, and the case was closed. Why are we showing this judgment as a lien on the property?

At the moment of recording, an abstract of judgment becomes a lien on any property that the debtor owns, and on any property that the debtor may acquire. If the lien has been established prior to the bankruptcy filing, it is a secured lien on the debtor's property. Secured liens are handled differently than unsecured liens in the bankruptcy process.

Unfortunately, many people who file bankruptcy do not know (or don't remember) that the judgment has been recorded, and don't inform their attorney of that fact. Most of the time, the debt underlying the judgment is listed in the bankruptcy schedules as an unsecured debt, and that debt is ultimately discharged. If the debt is not listed in the schedules, it is in full force and effect.

A clear distinction needs to be made between the debt and the lien. A discharge in bankruptcy relieves the debtor from personal liability for the discharged debt.

The lien of the abstract of judgment, however, was established on the property that the debtor owned at the moment the abstract recorded.

In order to remove the lien, an additional action must be taken in the bankruptcy proceeding.

If the property is the seller's residence, most often this additional action is under Section 522(f) of the Bankruptcy Code. Essentially, the bankruptcy court determines that the lien impairs the homestead exemption of the debtor, and removes the lien from the property. This requires a petition to the court; and a subsequent court order avoiding the lien.

If the property was not the residence of the debtor, and was abandoned by the bankruptcy trustee as a non-asset, it may be difficult, or impossible, to remove the lien through the bankruptcy. In that case, the owner may want to negotiate with the lien holder for a partial payment to remove the lien from this property.

In either case, legal advice needs to be sought. If the seller retained an attorney for the bankruptcy proceeding, the owner may be best served by returning to that attorney for the additional action that needs to be taken.

The situation is entirely different for a buyer or for property acquired after the bankruptcy was closed. If there was an abstract recorded, and a subsequent bankruptcy filed discharging that debt, the lien does not attach to new property that the buyer acquires. The bankruptcy proceeding must have run its course and been closed. It may occur that the examiner will report out such a lien. If that happens, ask the party to supply details on their bankruptcy, and if the timing is right, the lien may safely be eliminated.

Intentional disregard of the matters contained in this Bulletin may cause any loss sustained under the terms of a policy to be allocated entirely to the Agent