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LIEN AVOIDANCE UNDER SECTION 522(f) IN THE DISTRICT OF SOUTH CAROLINA

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I. INTRODUCTION

On November 6, 1978, President Carter signed into law the Bankruptcy Reform Act of 1978 (the Bankruptcy Code).[1] One of the many changes in the new Bankruptcy Code is the addition of section 522(f).[2] This new provision reflects Congress' desire to further enhance a debtor's "fresh start" by removing certain unfair creditor practices.[3]

To achieve this improved "fresh start," section 522(f) permits a debtor to avoid certain liens on exempt property. For instance, a debtor may avoid a judicial lien on any property which could have been exempted in the absence of the lien.[4] Similarly, a debtor may avoid a lien that impairs exemptions to which the debtor is entitled under state law if the lien is created by a non-

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1. Pub. L. No. 95-598, 92 Stat. 2549 (1978)(principally codified at 11 U.S.C. (Supp. IV 1982)).

2. 11 U.S.C. § 522(f) (Supp. IV 1982) states:

> 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 judicial lien; or
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> (2) a nonpossessory, nonpurchase-money security interest in any—
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> (A) household furnishings, household goods, wearing apparel, appliances, books, animals, crops, musical instruments, or jewelry that are held primarily for the personal, family, or household use of the debtor or a dependent of the debtor;
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> (B) implements, professional books, or tools of the trade of the debtor or the trade of a dependent of the debtor; or
>
> (C) professionally prescribed health aids for the debtor or a dependent of the debtor.

3. *See* H.R. REP. No. 95-595, 95th Cong., 1st Sess. 126 (1977), *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 5963, 6087.

4. *See* 11 U.S.C. § 522(f)(1). *See also* H.R. REP. No. 95-595, 95th Cong., 1st Sess. 362 (1977), *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 5963, 6318.

possessory, nonpurchase-money security interest in various types of household goods, tools of the trade, or health aids.[5]

This Article will not attempt to provide an exhaustive analysis of section 522(f). That contribution has been made by other authors.[6] Rather, this Article will briefly survey those bankruptcy cases decided in the District of South Carolina which affect lien avoidance under section 522(f).

II. THE MECHANICS OF LIEN AVOIDANCE

In *Barker v. Household Finance*,[7] the Bankruptcy Court for the District of South Carolina considered whether a debtor could use section 522(f)(2)(A) to avoid a nonpossessory, nonpurchase-money security interest in a case filed under Chapter 13 of the Bankruptcy Code.[8] Unlike a Chapter 7 debtor who may retain only claimed exempt property, a Chapter 13 debtor is permitted to retain his property, exempt or otherwise, as provided for in the proposed repayment plan.[9] Despite this distinction, the bankruptcy court rejected the minority view[10] that lien avoidance is not available in a Chapter 13 case and instead adopted the majority view that section 103(a)[11] requires that section 522(f)(2)(A) be applied to Chapter 13 cases.[12]

In another case, *In re Hawkins*,[13] the bankruptcy court ad-

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5. *See* 11 U.S.C. § 522(f)(2). A purchase-money security interest is an interest taken by a seller in the goods sold to ensure payment of their price. S.C. CODE ANN. § 36-9-107 (1976).

6. *See, e.g.*, Vuckowich, *Debtors' Exemption Rights Under the Bankruptcy Reform Act*, 58 N.C.L. REV. 769 (1980); Note, *Protection of a Debtor's "Fresh Start" Under the New Bankruptcy Code*, 31 CATH. U.L. REV. 843 (1980); Note, *Lien Avoidance Under Section 522(f) of the Bankruptcy Code: Is Retroactive Application Constitutional?*, 49 FORDHAM L. REV. 615 (1981); Note, *Constitutionality of Retroactive Lien Avoidance Under Bankruptcy Code Section 522(f)(2)*, 94 HARV. L. REV. 1616 (1981). *See also* Lacy, *South Carolina's Statutory Exemptions and Consumer Bankruptcy*, 30 S.C.L. REV. 643 (1979).

7. 20 B.R. 11 (Bankr. D.S.C. 1982).

8. *Id.* at 12.

9. *See generally* Wickham, *Chapter 7 or Chapter 13: Guiding Consumer Debtor Choice Under The Bankruptcy Reform Act*, 58 N.C.L. REV. 815 (1980).

10. *See, e.g.*, Sands v. Blazer Fin. Serv., 15 B.R. 563 (Bankr. M.D.N.C. 1981); Aycock v. Heritage Bank, 15 B.R. 728 (Bankr. E.D.N.C. 1981).

11. 11 U.S.C. § 103(a) states: "Except as provided in section 1161 of this title, chapters 1, 3, and 5 of this title apply in a case under chapter 7, 11, or 13 of this title."

12. 20 B.R. at 11-12.

13. No. 81-00837 (Bankr. D.S.C. Jan. 24, 1983), *aff'd*, No. 83-476-3 (D.S.C. Apr. 28,

dressed numerous questions regarding the mechanics of lien avoidance. The immediate issue before the court was whether the debtors could, after a discharge was granted and the bankruptcy case closed, reopen a case pursuant to section 350(b).[14] The debtors sought to file a lien avoidance action against a creditor who had commenced a claim and delivery action in state court to obtain possession of the debtors' household goods as satisfaction for the creditor's security interest.[15]

After reviewing the conflicting lines of authority on the issue and weighing the equities involved,[16] the court ruled that the debtors could not reopen the case for the purpose of filing a lien avoidance action.[17] In denying the debtors' motion to reopen the case, the court applied a three-part test[18] and held as follows: (1) the debtor failed to provide a justifiable excuse for the nine-month delay between the execution of the order granting discharge and the debtors' motion to reopen the case; (2) by incur-

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1983), *aff'd*, No. 83-1497 (4th Cir. Feb. 7, 1984).

14. No. 81-00837, slip op. at 2. 11 U.S.C. § 350(b) states: "[A] case may be reopened in the court in which such case was closed to administer assets, to accord relief to the debtor, or for other cause."

15. No. 81-00837, slip op. at 2.

16. In weighing the equities involved to determine whether a lien avoidance action should be permitted after the discharge hearing or after the case is closed, the court followed the rationale expressed in the following cases: *In re* Coomes, 20 B.R. 290 (Bankr. W.D. Ky. 1982); *In re* Williams, 17 B.R. 204 (Bankr. W.D. Ky. 1982); Montney v. Beneficial Fin. Co., 17 B.R. 353 (Bankr. E.D. Mich. 1982); Towns v. Postal Fin. Co., 16 B.R. 949 (Bankr. N.D. Iowa 1982); Associates Fin. Serv. v. Swanson, 13 B.R. 851 (Bankr. D. Idaho 1981).

Thus, the court in *Hawkins* chose not to follow those cases which hold that a lien avoidance action may be filed at any time, even after the discharge hearing and the closing of the case, regardless of the equities involved. *See, e.g., In re* Newton, 15 B.R. 640 (Bankr. W.D.N.Y. 1981); Baskins v. Household Fin. Corp., 14 B.R. 110 (Bankr. E.D.N.C. 1981); Gortmaker v. Avco Fin. Corp., 14 B.R. 66 (Bankr. D.S.D. 1981). Nor did the court follow those cases which refuse to permit the reopening of cases for the filing of lien avoidance actions after the discharge hearing, regardless of the equities involved. *See, e.g.*, Associates Fin. Serv., Inc. v. Porter, 11 B.R. 578 (Bankr. W.D. Okla. 1981); *In re* Krahn, 10 B.R. 770 (Bankr. E.D. Wis. 1981); *In re* Adkins, 7 B.R. 325 (Bankr. S.D. Cal. 1980).

17. No. 81-00837, slip op. at 10.

18. The three-part test is as follows:

> To deny relief to the debtor, the record should show (1) a failure by the debtor to act promptly in asserting his rights under § 522(f) without good cause therefore; (2) reliance by the creditor on the debtor's failure to assert his rights and on assertion by the creditor of his rights against the property based on such reliance; and (3) a creditor who is acting and has acted in good faith.

Towns v. Postal Fin. Co., 16 B.R. 949, 955 (Bankr. N.D. Iowa 1982).

ring expenses to commence the claim and delivery action, the creditor had detrimentally relied on the debtors' delay in filing the lien avoidance action; and (3) the creditor had not acted in bad faith.[19]

The court in *Hawkins* also discussed the substantive effect and procedural ramifications of the debtors' failure to avoid the creditor's security interest. The court stated that even though section 524(a)(2)[20] shields a debtor from personal liability on a discharged debt, section 506(d)[21] provides that a valid, unavoided, prefiled lien remains enforceable in rem to the extent that an allowed secured claim exists.[22] The court then examined section 522(c)(2)[23] and held that valid liens may be enforced against exempt property.[24]

In light of *Hawkins*, a debtor's attorney should file any nec-

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19. No. 81-00837, slip op. at 10.

20.

> A discharge in a case under this title—
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> * * *
>
> (2) operates as an injunction against the commencement of an action, the employment of process, or any act, to collect, recover or offset any such debt as a personal liability of the debtor, or from property of the debtor whether or not discharge of such debt is waived; . . . .

11 U.S.C. § 524(a)(2).

21.

> To the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void, unless—
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> (1) a party in interest has not requested that the court determine and allow or disallow such claim under section 502 of this title; or
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> (2) such claim was disallowed only under section 502(e) of this title.

11 U.S.C. § 506(d).

22. No. 81-00837, slip op. at 3-4.

23.

> Unless the case is dismissed, property exempted under this section is not liable during or after the case for any debt of the debtor that arose, or that is determined under section 502 of this title as if such claim had arisen before the commencement of the case, except—
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> * * *
>
> (2) a lien that is—
>
> (A) not avoided under section 544, 545, 547, 548, 549, or 724(a) of this title;
>
> (B) not voided under section 506(d) of this title; or
>
> (C)(i) a tax lien, notice of which is properly filed; and
>
> (ii) avoided under section 545(2) of this title.

11 U.S.C. § 522(c)(2).

24. No. 81-00837, slip op. at 4-5.

essary lien avoidance motion[25] as soon as possible after filing the petition for relief. Failure to file a lien avoidance motion promptly may cause a debtor to lose property which was subject to an otherwise avoidable lien.

III. The Retroactive Application of § 522(f)

The issue of whether section 522(f) could be applied retroactively to avoid judicial liens or security interests obtained prior to the Code's enactment or effective date without violating the fifth amendment has been the subject of much litigation. Thus, any discussion of lien avoidance must examine whether section 522(f) can be applied constitutionally to judicial liens or security interests created prior to either November 6, 1978, the enactment of the Code, or October 1, 1979, its effective date.[26]

A. The Retroactive Avoidance of Judicial Liens

In *Hinson v. Lexington State Bank*,[27] the bankruptcy court considered whether the retroactive application of section 522(f)(1) to avoid judicial liens[28] obtained prior to the Code's enactment violated the due process clause of the fifth amendment.[29] The debtors in *Hinson* sought to avoid four judgment liens which encumbered their residence.[30] Two of the liens were recorded prior to the Code's enactment.

To decide whether the retroactive application of section 522(f)(1) violated the due process clause, the bankruptcy court examined South Carolina law to determine whether the avoid-

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25. As of August 1, 1983, Bankruptcy Rules 4003(d) and 9014 require the filing of a motion to commence a lien avoidance action. Thus, a complaint to avoid a lien is no longer necessary or advised.

26. Section 402(a), Pub. L. No. 95-598, 92 Stat. 2682 (1978). The time between the enactment date and the effective date is known as the "gap period."

27. 20 B.R. 753 (Bankr. D.S.C. 1982). For another discussion of *Hinson*, see *infra* notes 62-70 and accompanying text.

28. A "judicial lien" is a lien "obtained by judgment, levy, sequestration, or other legal or equitable process or proceeding." 11 U.S.C. § 101(27).

29. 20 B.R. at 757. U.S. Const. amend. V states, in pertinent part: "No person shall be . . . deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation. . . ."

30. 20 B.R. at 755. Pursuant to S.C. Code Ann. § 15-35-810 (1976), a judgment becomes a lien on any real estate the judgment debtor owns in the county where the judgment is recorded. *See infra* notes 51-53 and accompanying text.

ance of judicial liens improperly interfered with a property interest "worthy of constitutional protection."[31] The court first noted a distinction between the property interests of judgment creditors and the property interests of holders of secured interests:[32] a judgment lien does not grant a judgment creditor a property interest in specific property, nor does it transfer any estate in the debtor's real property to the judgment creditor.[33] Because of this distinction, the court held that "the retroactive application of [section] 522(f)(1) does not constitute a taking of property in violation of the Fifth Amendment."[34] The court then allowed the debtor to avoid the judicial liens to the extent they impaired the debtor's homestead exemptions.[35]

After *Hinson*, the current law, at least in South Carolina, is that a debtor may use section 522(f)(1) to avoid judicial liens, created at any time, to the extent those liens impair the debtor's exemptions.[36]

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31. 20 B.R. at 757.

32. In discussing the nature of a judicial lien holder's interest, the court stated:

> The interest held by a judgment creditor is different from that held by a mortgagee or security interest holder. While a mortgage or a security interest is a specific lien on a specific item of property, a judgment lien is a general lien upon all of the debtor's real estate. *See Weatherly v. Medlin*, 141 S.C. 290, 139 S.E. 633 (1927). Thus, a judicial lien holder does not have a property interest in a specific parcel of real estate. Unlike a mortgagee or a security interest holder, a judicial lien holder does not look to a specific piece of property from which to satisfy his debt. Instead, a judgment creditor looks to any and all property owned by the debtor at the time his judgment becomes a lien. "Hence the creditor is not interested in property as property, but only in his lien."

20 B.R. at 758 (quoting *In re* Ashe, 10 B.R. 97, 99 (Bankr. M.D. Pa. 1981)).

33. 20 B.R. at 758.

34. *Id.* The court also noted that while *Hinson* was distinguishable from *Household Fin. Corp. v. Glynn*, *infra* note 40, the two cases were not inconsistent. 20 B.R. at 758.

35. 20 B.R. at 758-59.

36. After the bankruptcy court decided *Hinson*, the United States Supreme Court held in United States v. Security Indus. Bank, 103 S. Ct. 407 (1982), that Congress did not intend § 522(f)(2) to be applied retroactively to avoid security interests created prior to the enactment of the Bankruptcy Code. After deciding *Security Indus. Bank*, the Supreme Court vacated and remanded without opinion a Third Circuit Court of Appeals' decision which had held that § 522(f)(1) could be applied retroactively to avoid a judicial lien created by confession of judgment. *See In re* Ashe, 669 F.2d 105 (3d Cir. 1982), *vacated sub nom.* Commonwealth Nat'l Bank v. Ashe, 103 S. Ct. 563 (1982). Upon remand, the Third Circuit affirmed its earlier decision, finding the reasoning in *Security Indus. Bank* inapplicable to judicial liens. *In re* Ashe, 712 F.2d 864 (3d Cir. 1983), *reh'g denied*, 712 F.2d 877 (3d Cir. 1983)(en banc), *cert. denied*, 104 S. Ct. 1279 (1984).

B. The Retroactive Avoidance of Security Interests

The United States Supreme Court resolved the issue of whether a debtor could use section 522(f)(2) to avoid a security interest[37] created prior to the enactment of the Bankruptcy Code in *United States v. Security Industrial Bank.*[38] The Supreme Court held that section 522(f)(2) could not be applied retroactively to security interests obtained prior to the Code's enactment.[39]

The Court did not reach the issue of whether the retroactive application of section 522(f)(2) violated the taking clause of the fifth amendment.[40] Instead, the Court avoided this constitutional issue by finding that Congress did not intend for section 522(f)(2) to affect property rights, including nonpurchase-money security interests, created prior to the Code's enactment.[41]

The Supreme Court, however, has yet to consider whether section 522(f)(2) applies to security interests created after the Code's enactment but prior to its effective date,[42] and if so, whether such application violates the taking clause.[43] The Bankruptcy Court for the District of South Carolina addressed these issues in *Singleton v. Barclays American Corp.*[44] There, the

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37. A "security interest" is a "lien created by an agreement." 11 U.S.C. § 101(37).

38. 103 S. Ct. 407 (1982).

39. *Id.* at 414.

40. The Supreme Court did note that "there is substantial doubt whether the retroactive destruction of the appellees' liens in these cases comports with the Fifth Amendment." *Id.* at 412.

Prior to the *Security Indus. Bank* decision, the Bankruptcy Court for the District of South Carolina addressed this same constitutional issue in Household Fin. Corp. v. Glynn, 13 B.R. 647 (Bankr. D.S.C. 1981). In *Glynn,* the court held that the retroactive application of § 522(f)(2) would violate the fifth amendment.

41. 103 S. Ct. at 414. Citing Holt v. Henley, 232 U.S. 637 (1914), and Auffm'ordt v. Rasin, 102 U.S. 620 (1881), the Court stated:

> No bankruptcy law shall be construed to eliminate property rights which existed before the law was enacted in the absence of an explicit command from Congress. In light of this principle, the legislative history of the 1978 Act suggests that Congress may not have intended that § 522(f) operate to destroy pre-enactment property rights.

103 S. Ct. at 414.

42. In *Security Indus. Bank,* the Supreme Court stated: "Because all of the liens at issue in this case were established before the enactment date we have no occasion to consider whether § 522(f)(2) should be applied to liens established after Congress passed the Act, but before it became effective." *Id.* n.11.

43. *See supra* note 40.

44. 14 B.R. 1007 (Bankr. D.S.C. 1981).

bankruptcy court held that section 522(f)(2) did apply to security interests created after the Code's enactment but prior to its effective date,[45] and that such an application was not unconstitutional.[46] The bankruptcy court reasoned that the retroactive application of section 522(f)(2) to avoid these security interests was not unconstitutional because, after the enactment of the Bankruptcy Code, creditors had notice that certain security interests would be avoidable.[47]

In summary, to determine the current law governing section 522(f) in the District of South Carolina, the lien in question first must be classified as either a security interest or a judicial lien. If the lien involved is a judicial lien, a debtor may use section 522(f)(1) to avoid the lien regardless of when the lien was created. If, however, the lien is a security interest created prior to

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45. *Id.*

46. In distinguishing the application of § 522(f)(2) in *Glynn* from its application in *Singleton*, the bankruptcy court stated:

> In *In re Glynn*, 13 B.R. 647 (Bkrtcy. 1981) and *In re Morris*, 13 B.R. 647 (Bkrtcy. 1981) this court held that the application of 11 U.S.C. § 522(f)(2) to avoid security interests created prior to the enactment of the Bankruptcy Reform Act on November 6, 1978 would violate the Due Process Clause of the Fifth Amendment. The holding in the *Glynn* and *Morris* cases does not support the conclusion that the application of section 522(f)(2) to avoid security interests created after the enactment of the Bankruptcy Code, but prior to its effective date, would violate the Fifth Amendment. Rather, the court concludes that after the enactment of the Bankruptcy Code creditors were on notice that non-possessory nonpurchase-money security interests upon household goods were voidable in subsequent bankruptcy proceedings. Hence, any reliance that Commercial Credit placed upon its security interest was unreasonable and insubstantial, and the avoidance of Commercial Credit's security interest would not effect a substantial impairment of its protected property rights in violation of the Fifth Amendment. The court concurs with the result Judge Reynolds reached in *In re Osborne*, 11 B.R. 610 (Bkrtcy. D.S.C. 1981) and holds that the applica-tion of section 522(f)(2) to avoid security interests created after November 6, 1978, the date of the enactment of the Bankruptcy Code, does not violate the Fifth Amendment.

14 B.R. at 1007-08. *Accord, In re* Schrimp, 17 B.R. 36 (Bankr. W.D. Ky. 1981); G.F.C. Corp. v. Noland, 13 B.R. 766 (Bankr. D. Kan. 1981); Thorp Credit & Thrift Co. v. Pommerer, 10 B.R. 935 (Bankr. D. Minn. 1981); Kursh v. Dial Fin. Co., 9 B.R. 801 (Bankr. W.D. Mo. 1981); Sweeny v. Pacific Fin. Co., 7 B.R. 814 (Bankr. E.D. Wis. 1980); Baker v. G.F.C. Corp., 5 B.R. 397 (Bankr. W.D. Mo. 1980); Sioux Falls Veterans Admin. Employees Fed. Credit Union v. Van Gorkom, 4 B.R. 689 (Bankr. D.S.D. 1980); Boulton v. General Fin. Loan Corp., 4 B.R. 498 (Bankr. S.D. Iowa 1980).

Contra, In re Johnson, 11 B.R. 909 (Bankr. D. Kan. 1981); Dunn v. Dunn, 10 B.R. 385 (Bankr. W.D. Okla. 1981); Schutte v. Beneficial Fin., Inc., 8 B.R. 12 (Bankr. D. Kan. 1980); Lucero v. Security Indus. Bank., 4 B.R. 659 (Bankr. D. Colo. 1980).

47. 14 B.R. at 1008.

the enactment of the Bankruptcy Reform Act of 1978, then section 522(f)(2) cannot be applied retroactively. But if the lien is a security interest created after the Code's enactment, a debtor may use section 522(f)(2) to avoid the lien.

IV. The Nonretroactive Avoidance of Judicial Liens

Several cases in the District of South Carolina have considered a debtor's attempt to use section 522(f)(1) to avoid judicial liens. For example, in *Earnhardt v. Herring National Lease, Inc.*,[48] the debtor filed a complaint to avoid a judgment pursuant to section 522(f)(1). The bankruptcy court, however, dismissed the debtor's lien avoidance complaint, finding no enforceable judicial lien on any of the debtor's real or personal property.[49]

In *Earnhardt*, the bankruptcy court noted that under section 15-35-810[50] of the Code of Laws of South Carolina, "a judgment creates a lien only on the judgment debtor's real estate located in any county in South Carolina in which the judgment or transcript of judgment is entered."[51] Because the debtor owned no real property in the county where the judgment was recorded, no lien was created against the debtor's real property.[52] The court also observed that under section 15-39-100,[53] a lien on personal property does not attach until levy and execution.[54] Thus, because the judgment creditor had not yet attempted to levy and execute on the judgment, the court con-

48. 15 B.R. 86 (Bankr. D.S.C. 1981).

49. *Id.* at 87.

50. S.C. Code Ann. § 15-35-810 (1976) provides, in pertinent part:

> Final judgments and decrees in any court of record in this State, or in any circuit or district court of the United States within this State or of any other Federal court the final judgments and decrees of which, by act of Congress, shall be declared to create a lien, shall constitute a lien upon the real estate of the judgment debtor situate in any county in this State in which the judgment or transcript thereof is entered upon the book of abstracts of judgments and duly indexed, the lien to begin from the time of such entry on the book of abstracts and indices and to continue for a period of ten years from the date of such final judgment or decree.

51. 15 B.R. at 87.

52. *Id.*

53. S.C. Code Ann. § 15-39-100 (1976) states: "Executions shall not bind the personal property of the debtor, but personal property shall only be bound by actual attachment or levy thereon for the period of four months from the date of such levy."

54. 15 B.R. at 87.

cluded that there existed no lien against the debtor's personal property to avoid under section 522(f)(1).[55]

Another case involving a debtor's attempt to avoid a judicial lien pursuant to section 522(f)(1) is *Mosely v. Mozingo*.[56] In *Mosely*, the debtor filed a complaint under section 522(f)(1) to avoid certain judicial liens on the debtor's residence.[57] The liens totaled more than 26,000 dollars. Using the federal exemptions,[58] the debtor claimed a homestead exemption of 7,500 dollars under section 522(d)(1) and an "any property" exemption of 400 dollars under section 522(d)(5).[59]

The court used two formulas to determine the debtor's equity in the co-owned property and the extent to which the judicial liens were avoidable under the debtor's statutory exemptions.[60] First, the court calculated one-half of the equity remaining in the residence after deducting the amount due on the first mortgage. After determining one-half of the equity remaining in the residence, the court calculated the amount of the allowable secured claim by subtracting from the one-half equity an amount equal to the debtor's statutory exemptions under section 522(d)(1) and (5).[61] Based upon these calculations, the court

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55. *Id.*

56. No. 81-00351 (Bankr. D.S.C. Oct. 19, 1981).

57. No. 81-00351, slip op. at 2.

58. At the time of filing, the federal exemptions were still in effect. South Carolina "opted out" of the federal exemptions on May 5, 1981. S.C. CODE ANN. § 15-41-425 (Supp. 1982).

59. 11 U.S.C. § 522(d) states:

> The following property may be exempted . . .:
>
> (1) The debtor's aggregate interest, not to exceed $7,500 in value, in real property or personal property that the debtor or a dependent of the debtor uses as a residence, ...
>
> * * *
>
> (5) The debtor's aggregate interest, not to exceed in value $400 plus any unused amount of the exemption provided under paragraph (1) of this subsection, in any property.

60. The court adopted the formulas used in Jordan v. Borda, 5 B.R. 59 (Bankr. D.N.J. 1980).

61. The court calculated the amount of the secured claim as follows:

One-Half of Equity	$13,900
Less Lien Avoidance pursuant to § 522(f)(1) as impairment of exemptions under § 522(2)(1) & (5)	7,900
Equity to which the judgments may be applied	$6,000

granted judgment for the debtor in the amount of 7,900 dollars, an amount equal to the debtor's exemptions under section 522(d)(1) and (5).

The bankruptcy court also considered the use of section 522(f)(1) to avoid judicial liens in *Hinson v. Lexington State Bank*.[62] In *Hinson*, the debtors filed a joint petition for relief under Chapter 13 of the Bankruptcy Code, but the case was later voluntarily converted to Chapter 7. In their joint petitions for relief, each debtor claimed a homestead exemption of 5,000 dollars in their residence pursuant to section 15-41-200.[63]

Three mortgages encumbered the debtors' residence. However, before the third mortgage was executed and recorded, four judicial liens were entered in the county's abstracts of judgments against the debtors' residence.[64] The debtors sought to avoid the judicial liens to the extent the liens impaired their homestead exemptions.

Two of the judgment creditors questioned the court's authority to set aside their liens. Based upon section 30-7-10,[65] the judgment creditors argued that their judicial liens did not impair the debtors' homestead exemptions in relation to the mortgage because their liens were created prior to the execution and

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62. 20 B.R. 753 (Bankr. D.S.C. 1982). *See supra* notes 27-35 and accompanying text.

63. S.C. CODE ANN. § 15-4-1200 (Supp. 1982) provides, in part:

> The following real and personal property of a debtor domiciled in this State shall be exempt from attachment, levy and sale under any mesne or final process issued by any court or bankruptcy proceedings:
>
> (1) The debtor's aggregate interest, not to exceed five thousand dollars in value, in real property or personal property that the debtor or a dependent of the debtor uses as a residence, in a cooperative that owns property that the debtor or a dependent of the debtor uses as a residence, ... *Provided*, however, that the aggregate value of multiple homestead exemptions allowable with respect to a single living unit may not exceed ten thousand dollars. If there are multiple owners of such a living unit exempt as a homestead, the value of the exemption of each individual owner may not exceed his fractional portion of ten thousand dollars.

64. 20 B.R. at 755-56.

65. S.C. CODE ANN. § 30-7-10 (1976) provides, in pertinent part:

> All deeds . . . mortgages . . . or other liens on real or personal property or both, created by law or by agreement of the parties . . . shall be valid so as to affect the rights of subsequent creditors . . . only from the day and hour when they are recorded . . . . [I]n the case of a subsequent lien creditor on real estate . . . the instrument evidencing such subsequent holder to claim under this section as a subsequent creditor . . . and the priority shall be determined by the time of filing for record.

recording of the third mortgage.[66] Nevertheless, the court rejected the creditors' argument and adopted the view expressed in *Atlas Supply Co. v. Davis*[67] that section 30-7-10 protects only "subsequent creditors" who extend credit after a mortgage is executed but before it is recorded.[68] Since the creditors in *Hinson* did not extend credit after the execution of the third mortgage, the court held that the judgment creditors were not entitled to the protection afforded by section 30-7-10.[69] Thus, the court concluded that the debtors could avoid the judicial liens pursuant to section 522(f)(1) to the extent of the debtors' exempt equity in their residence.[70]

V. When Is a Purchase-Money Security Interest Not a Purchase-Money Security Interest?

Much of the section 522(f)(2) litigation in the District of South Carolina has involved the distinctions between a purchase-money and a nonpurchase-money security interest. The latter is avoidable under section 522(f)(2); the former is not. These cases can be divided into two categories: (1) those cases which determined whether the security interest created was a purchase-money security interest; and (2) those cases which determined whether a valid, purchase-money security interest lost its purchase-money character because the creditor subsequently

66. 20 B.R. at 756.

67. 273 S.C. 392, 256 S.E.2d 859 (1979).

68. In discussing whether a judgment recorded prior to the execution and recording of a mortgage had priority over the mortgage, the South Carolina Supreme Court stated: "[T]he recording statute was intended to protect [sic] against the lien of an unrecorded mortgage, persons who, without notice of it, subsequent to its exemption might reasonably have extended credit to the mortgagor, or purchased the mortgaged property, in reliance upon his apparently unencumbered ownership. . . ." *Id.* at 394, 256 S.E.2d at 860 (quoting Prudential Ins. Co. of Am. v. Wadford, 232 S.C. 476, 480, 102 S.E.2d 889, 891-92 (1958)).

69. 20 B.R. at 757.

70. The court calculated the debtors' equity in the real estate as follows:

Fair Market Value of the residence	$74,900.00
Less Value of the Three Mortgages	-59,558.87
Less Trustee's Commission for Sale of Residence	1,629.59
Less Real Estate agent's commission for sale of residence	5,247.12
Yields Equity	8,464.42

refinanced the debt.

A. *Determining Whether a Purchase-Money Security Interest Was Created*

The bankruptcy court considered whether the security interest created was a nonpurchase-money security interest in *Manuel v. Blazer Financial Services, Inc.*[71] In *Manuel*, the debtors executed a security agreement granting Blazer a security interest in the debtors' household goods and furnishings. Blazer issued several checks to the debtors to enable the debtors to pay off their existing accounts with other creditors, some of which involved the purchase of household goods. None of the funds advanced were used to purchase household goods or furnishings. In fact, the debtors purchased all of their household goods and furnishings prior to granting Blazer its security interest.[72]

In determining whether Blazer's security interest was a purchase-money security interest, the court relied upon comment 2 to section 36-9-207.[73] Comment 2 states that if a secured party is not a seller, the secured party must give "present consideration" in order to claim a purchase-money security interest.[74] The court then adopted the definition of "present consideration" contained in *In re Brooks*,[75] which held that present consideration passes when the creditor gives the debtor value contemporaneously with the debtor's acquisition of the property.[76]

Based upon these definitions, the court in *Manuel* held that Blazer did not have a purchase-money security interest in the debtor's household goods and furnishings because Blazer's loan did not enable the debtors "to acquire rights in or the use of"

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71. 18 B.R. 403 (Bankr. D.S.C. 1981).
72. 18 B.R. at 404.
73. *Id.*
74. S.C. CODE ANN. § 36-9-107 (1976), comment 2, states:

> When a purchase money interest is claimed by a secured party who is not a seller, he must of course have given present consideration. This section therefore provides that the purchase money party must be one who gives value "by making advances or incurring an obligation": the quoted language excludes from the purchase money category any security interest taken as security for or in satisfaction of a pre-existing claim or antecedent debt.

75. 29 U.C.C. Rep. Serv. 660 (Callaghan)(Bankr. D.Me. 1980).
76. *Id.* at 663-64.

those items.[77] Instead, the court concluded that Blazer held a nonpurchase-money security interest in household goods and furnishings which the debtor could avoid pursuant to section 522(f)(2).

The bankruptcy court faced another issue in determining whether a security interest is a purchase-money security interest in *Haus v. Barclays American Corp.*[78] and *Horlbeck v. Dixie Furniture.*[79] In both cases the court considered whether a creditor's security interests lost their purchase-money character because each of the consumer goods listed on the security agreement secured a total indebtedness greater than its own indebtedness.

In *Haus*, the debtors and the original seller consolidated and refinanced four purchase-money debts into two security agreements. The seller subsequently assigned the agreements to two unrelated assignees.[80] The court in *Haus* held that the security agreement[81] did not create a purchase-money security interest because at least one of the listed goods secured a total indebtedness greater than its own indebtedness and because the subsequent security agreement did not provide a formula for the application of payments to particular items.[82]

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77. 18 B.R. at 405.

78. 18 B.R. 413 (Bankr. D.S.C. 1982). *See infra* notes 90-97 and accompanying text.

79. No. 81-01782 (Bankr. D.S.C. July 9, 1982). *See infra* notes 92-101 and accompanying text.

80. 18 B.R. at 415.

81. One of the security agreements listed only one item of collateral. *Id.* Thus, this one item could not secure an indebtedness greater than its own indebtedness and, therefore, was not subject to attack on that ground.

82. The court concluded:

> [The creditor's] security interest in the television and washer and dryer also secured the range which had been paid off when the security agreement was executed on May 24, 1979. This security agreement made no provision for the application of payments to particular items and did not indicate the order in which purchases were to be paid off and the individual amounts due on each item. Therefore, at least one of the consumer goods listed on the May 24, 1979 security agreement which was assigned to Barclays secured an indebtedness other than its own, and, therefore, the May 24, 1979 security agreement did not create a purchase-money security interest.

18 B.R. at 417-18. *Accord*, King v. Citizens & S. Nat'l Bank, 19 B.R. 409 (Bankr. M.D. Ga. 1982); Kelley v. United Am. Bank, 17 B.R. 770 (Bankr. E.D. Tenn. 1982); *In re* Luczak, 16 Bankr. 743 (Bankr. D. Wis. 1982); McLemore v. Simpson County Bank (*In re* Krulik) 6 Bankr. 443 (Bankr. M.D. Tenn. 1980); *In re* Scott, 5 Bankr. 37 (Bankr. M.D. Tenn. 1980); *In re* Scott, 5 Bankr. 37 (Bankr. M.D. Pa. 1980). *Contra*, Transamerica Fin. Serv. v. Matthews, 20 Bankr. 654 (Bankr. 9th Cir. 1982); Slay v. Pioneer Credit Co., 8

In *Horlbeck*, the debtor purchased a sofa suite and executed a security agreement granting the seller a purchase-money security interest. Later, the debtor purchased a television from the same seller and executed a security agreement in which the seller added the unpaid balance on the sofa suite to the amount owed on the television. The debtor later purchased a second television from the same seller and once again executed a security agreement in which the seller added the unpaid balance on the sofa and first television to the amount owed on the second television.[83]

In his petition for relief under Chapter 7 of the Bankruptcy Code, the debtor claimed the sofa suite and second television as exempt property. The debtor then filed an action to avoid the seller's lien on these two items.

As in *Haus*, the court in *Horlbeck* considered whether each of the consumer goods listed on the last security agreement secured a total indebtedness greater than its own indebtedness, thus creating avoidable nonpurchase-money security interests. The court first distinguished the security agreement in *Horlbeck* from the one in *Haus* by stating that an original seller may cross-collateralize under section 37-2-408(1)[84] and must apply the payments on the cross-collateralized debts as outlined in section 37-2-409(1).[85] Because an applicable statutory formula

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Bankr. 355 (Bankr. E.D. Tenn. 1980).

83. No. 81-01782, slip op. at 1-2.

84.

> In addition to contracting for a security interest pursuant to the provisions on security in sales or leases (§ 37-2-407), a seller in a consumer credit sale may secure the debt arising from the sale by contracting for a security interest in other property if as a result of a prior sale the seller has an existing security interest in the other property. The seller may also contract for a security interest in the property sold in the subsequent sale as security for the previous debt.

S.C. CODE ANN. § 37-2-408(1) (1976).

85.

> If debts arising from two or more consumer credit sales, other than sales . . . pursuant to a revolving charge account, are secured by cross-collateral (§ 37-2-408) or consolidated into one debt payable on a single schedule of payments, and the debt is secured by security interests taken with respect to one or more of the sales, payments received by the seller after the taking of the cross-collateral or the consolidation are deemed, for the purpose of determining the amount of the debt secured by the various security interests, to have been applied pro rata to the payment of the debts arising from the sales. Proration shall be computed on the original debts secured by the various security

existed for applying payments to each item of collateral, the court concluded that no one item secured an indebtedness greater than its own. Thus, the security interests in question retained their purchase-money character.[86]

The different results in *Haus* and *Horlbeck* demonstrate that whether a security interest is a purchase-money security interest may depend upon whether the secured party is an "original seller."[87] If the secured party is an "original seller," then be-

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interests. To the extent debts are paid according to this section, security interests in items of property terminate as the debts originally incurred with respect to each item are paid.

S.C. CODE ANN. § 37-2-409(1) (1976). The court distinguished *Horlbeck* from *Haus* as follows:

> Although S.C. Code § 37-2-408 (1976) allows a seller in a consumer credit sale to cross-collateralize, "an assignee not related to the original seller" may not. Since the assignees in *Haus* were "not related to the original seller," they were note entitled to cross-collateralize under S.C. Code § 37-2-409(1) (1976) nor bound by the language of S.C. Code § 37-2-409(1) (1976) which sets out a rule for applying payments to debts secured by cross-collateral. . . . Due to the absence of a contractual or statutory formula for the application of payments in *Haus*, this court held the security interests to be nonpurchase-money security interests.
>
> The instant case, however, is distinguishable from *Haus*. Dixie, being the original seller, *may cross-collateralize under S.C. Code § 37-2-408(1) (1976), and is bound to apply the payments on the cross-collateralized debts in the manner set out in S.C. Code § 37-2-409(1) (1976).*

No. 81-01782, slip op. at 4-5 (citation and footnotes omitted)(emphasis added).

86. After determining that an applicable statutory formula existed for applying payments pro rata to the unpaid balance due on cross-collateralized debts, the court applied a complex formula to the items of collateral to determine the remaining balance due on each debt.

To apply the formula, the court first determined the "original debt" or the percentage of the cash price that each item bears to the total actual cash price of all the items. No. 81-01782, slip op. at 5. These percentages of the payments received are allocated pro rata to each item of collateral to determine the amount paid on that item. When the pro rated payments on any item are equal to that item's percentage of the total debt secured, including finance charges, insurance, and any other charges, then the security interest on that item is satisfied and terminated; any unpaid balance constitutes a purchase-money debt. *Id.*

The court laboriously applied this formula so that in future cases sellers who must apply payments to cross-collateralized debts would have an example to follow. Also, the court appeared to suggest that sellers who desired to use this rule to preserve their purchase-money status must provide the court with an accounting of the payments received and their application to the items of collateral under the formula.

87. S.C. CODE ANN. § 37-2-408(1) (1976) states that "*[s]eller* in this section does not include an assignee not related to the original seller." (emphasis in original). The South Carolina Consumer Protection Code, however, does not define "original seller," although a "seller" is defined at § 37-2-107.

cause of the statutory formula,[88] each item of collateral retains its purchase-money character, even if the debt is cross-collateralized. The statutory formula is used to determine when each item of collateral is paid off and the security interest in that item is terminated. This procedure prevents any item of collateral from securing a total indebtedness greater than its own indebtedness and rendering the security interest nonpurchase-money in nature. If, however, the seller is not an "original seller," and the security agreement contains no formula for applying payments, then the security interest is considered nonpurchase-money.

B. Determining the Effect of Refinancing Purchase-Money Security Interests

Those cases considering the effect of section 522(f)(2) on refinanced purchase-money security interests fall into two categories: (1) cases involving purchase-money security interests retained by sellers under section 36-9-107(a), and (2) cases involving purchase-money security interests retained by nonsellers under section 36-9-107(b).[89]

1. Refinanced Purchase-Money Security Interests Under Section 36-9-107(a)

Two cases have discussed the effects of refinancing a purchase-money security interest, retained by the seller under section 36-9-107(b), and the avoidability of such a security interest under section 522(f)(2)(A). In *Haus v. Barclays American Corp.*,[90] the debtors executed four sales contracts for the purchase of household goods. The seller, Cate-McLaurin Company, Inc. (Cate-McLaurin), retained title to the merchandise

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88. *See supra* note 85.

89. S.C. CODE ANN. § 36-9-107 (1976) provides:

> A security interest is a "purchase money security interest" to the extent that it is (a) taken or retained by the seller of the collateral to secure all or part of its price; or (b) taken by a person who by making advances or incurring an obligation gives value to enable the debtor to acquire rights in or the use of collateral if such value is in fact so used.

90. 18 B.R. 413 (Bankr. D.S.C. 1982). *See supra* notes 78, 80-82 and accompanying text.

until the purchase price was paid in full. Several months later, the debtors signed two security agreements granting Cate-McLaurin security interests in the merchandise purchased through and listed in the sales contracts. These security agreements were assigned to Barclays American Corporation (Barclays) and Westinghouse Credit Corporation (Westinghouse), neither of which was related to the original seller, Cate-McLaurin.

The debtors later filed a petition for relief under Chapter 7 of the Bankruptcy Code. In their petition for relief, the debtors claimed the merchandise listed in the four sales contracts, and later in the two security agreements, as exempt property. The debtors then filed an action to avoid Barclays' and Westinghouse's liens in the household goods. Barclays and Westinghouse answered, claiming to be holders of purchase-money security interests not avoidable under section 522(f)(2)(A).

The court's first step in *Haus* was to examine the nature of the liens held by the original seller, Cate-McLaurin.[91] The court concluded that the four sales contracts (in which the seller retained title to the merchandise until payment in full was received) were security agreements as described in section 36-9-203(1)(a),[92] because the sales contracts adequately described the collateral and were signed by the debtors. The court also found that these four sales contracts created purchase-money security interests under section 36-9-107(a),[93] which were automatically perfected under section 36-9-302(1)(d).[94]

The court then applied the refinancing rule contained in

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91. The court stated that this step was necessary because:

> In South Carolina the assignee of a contract acquires a purchase-money security interest when it is assigned a contract in which the assignor previously has acquired a purchase-money security interest. 1967-1968 Op. Att'y Gen., No. 2407, p.52. Therefore, whether the defendants have purchase-money security interests depends on whether the seller, . . . possessed—at the time of assignment to the defendants—purchase-money security interests in the goods.

18 B.R. at 415.

92. "[A] security interest is not enforceable against the debtor or third party unless (a) the collateral is in the possession of the secured party; . . . ." S.C. CODE ANN. § 36-9-203(1)(a) (1976).

93. *See supra* note 89.

94. S.C. CODE ANN. § 36-9-302(1)(d) states, in part: "A financing statement must be filed to perfect all security interest(s) except the following: (d) a purchase money security interest in consumer goods; . . . ."

Rosen v. Associates Financial Services Co.[95] and held that the seller's refinancing of the debts secured by the four purchase-money security interests extinguished the security interests' purchase-money character.[96] Therefore, the debtors could avoid the assigned security interests to the extent that they impaired the debtors' exemptions in household goods.[97]

The second case considering refinanced purchase-money security interests was *Horlbeck v. Dixie Furniture.*[98] In *Horlbeck*, the debtor claimed a sofa suite and second television as exempt property and subsequently filed a complaint to avoid the creditor's liens on those items. The creditor answered, claiming to be the holder of three purchase-money security interests not avoidable under section 522(f)(2)(A).

Because the purchase-money security interest in the sofa suite had been refinanced twice, the court, based upon *Haus*, held that the purchase-money security interest in that item was extinguished, thus creating a nonpurchase-money security interest in the sofa suite which the debtor could avoid.[99] However, since the purchase-money debt was never refinanced, the security interest in the second television retained its purchase-money character and was not avoidable under section 522(f)(2)(A).[100]

After *Haus* and *Horlbeck*, the refinancing of a purchase-money security interest retained by a seller under section 36-9-107(a) extinguishes the security interest's purchase-money character. Debtors may avoid a nonpurchase-money security interest under section 522(f)(2) to the extent it impairs the debtor's exemption.

2. *Refinanced Purchase-Money Security Interests Under Section 36-9-107(b)*

The applicability of section 522(f)(2) to a purchase-money security interest retained by a secured party other than the orig-

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95. 18 B.R. 723 (Bankr. D.S.C. 1981). *See infra* notes 101-104 and accompanying text. Mulcahy v. Indianapolis Morris Plan Corp., 3 B.R. 454 (Bankr. S.D. Ind. 1980).

96. 18 B.R. at 413.

97. *Id.* at 418.

98. No. 81-01782 (Bankr. D.S.C. July 9, 1982). *See supra* notes 79, 83-88 and accompanying text.

99. No. 81-01782, slip op. at 8.

100. *Id.*

inal seller and subsequently refinanced represents another difficult area. One case dealing with this subject is *Rosen v. Associates Financial Services Co.*[101] In *Rosen*, a finance company retained a valid purchase-money security interest in the debtor's household appliances. Twenty-eight days after the first purchase-money loan was made, the finance company made a second loan to the debtor. The second loan was also secured by the same appliances. The proceeds from the second loan were used to satisfy the first loan.

In its analysis, the court first determined that the second loan merely refinanced the first loan.[102] The court then stated that since the major portion of the funds from the second loan were used to pay off and refinance an antecedent debt, the finance company had not given the present consideration necessary under section 36-9-107(b) to create a purchase-money security interest in the collateral.[103] The court then held that the security interest was nonpurchase-money in nature and, therefore, avoidable under section 522(f)(2)(A).[104]

VI. CONCLUSION

This Article has attempted to briefly survey those bankruptcy cases decided in the District of South Carolina which affect lien avoidance under section 522(f). This survey should assist debtors, creditors, and their attorneys in understanding the current case law interpreting this section. It is hoped that this improved understanding will further the efficient administration of bankruptcy cases in the District of South Carolina.

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101. 18 B.R. 723 (Bankr. D.S.C. 1981).

102. In reaching this decision, the court examined such factors as (1) the same collateral secured the second debt as well as the original debt, and (2) the debtor acquired his rights in the collateral at the time of the first loan, rather than at the second loan.

103. *See supra* note 89.

104. The Court stated that "[w]hen the proceeds from the renewal vote were used to satisfy the original note, the purchase-money character of the security interest was extinguished with the result that it became a nonpurchase-money security instru-ment." 18 B.R. at 725. *Accord,* Safeway Fin. v. Ward, 15 B.R. 549 (Bankr. S.D. Ga. 1981); King v. Citizens & S. Nat'l Bank, 19 B.R. 409 (Bankr. M.D. Ga. 1982); *In re* Calloway, 17 B.R. 212 (Bankr. W.D. Ky. 1982); *In re* Lay, 15 B.R. 841 (Bankr. S.D. Ohio 1981); *In re* Jones, 5 B.R. 655 (Bankr. M.D.N.C. 1980). *Contra,* Transamerica Fin. Serv. v. Matthews, 20 B.R. 654 (Bankr. 9th Cir. 1982); *In re* Georgia, 22 B.R. 31 (Bankr. S.D. Ohio.