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## Bankruptcy

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# BANKRUPTCY

## SURVIVAL OF PREBANKRUPTCY JUDGMENT LIENS

In *Ducker v. Standard Supply Co.*<sup>1</sup> the South Carolina Supreme Court rejected an opportunity to interpret a state statute in a manner that would enlarge the scope of relief granted the bankrupt in his bankruptcy discharge beyond that which is available under federal bankruptcy law. The court ruled that the discharge of judgment debts one year after bankruptcy proceedings, allowed to a judgment debtor under South Carolina law,<sup>2</sup> does not invalidate judgment liens that were vested in the judgment creditor before the filing of the debtor's petition in bankruptcy.<sup>3</sup> This opinion reaffirmed a rule of law in South Carolina that had not come before the court in three quarters of a century.<sup>4</sup> The decision is in accord with most jurisdictions<sup>5</sup> and be-

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1. 280 S.C. 157, 311 S.E.2d 728 (1984).

2. Section 15-35-630 of the South Carolina Code states:

Any time after one year has elapsed since a bankrupt was discharged from his debts, pursuant to the acts of Congress relating to bankruptcy, the bankrupt, his receiver, trustee or any other interested person may apply, upon proof of the bankrupt's discharge, to the court in which a judgment was rendered against him or, if rendered in a court not of record, to the court of which it has become a judgment by docketing it therein for an order directing the judgment to be cancelled and discharged of record. If it appears upon the hearing that the bankrupt has been discharged from the payment of that judgment or the debt upon which such judgment was recovered, an order must be made directing the judgment to be cancelled and discharged of record. And thereupon the clerk of the court shall cancel and discharge the judgment by marking on the docket thereof that it is cancelled and discharged by order of the court, giving the date of entry of the order of discharge.

The provisions of this section shall not operate to discharge any debt, judgment or claim that is not dischargeable under the Federal Bankruptcy Act or the law of this State.

S.C. CODE ANN. § 15-35-630 (1976).

3. 280 S.C. at 159, 311 S.E.2d at 730.

4. The *Ducker* opinion cites *Wagner & Co. v. Brown Bros.*, 82 S.C. 131, 62 S.E. 513 (1909), to support the rule, and no other decision on this issue has been written since that time. Several 19th century opinions support the concept that judgment liens survive bankruptcy proceedings. See, e.g., *Daniels v. Moses*, 12 S.C. 130, 138 (1879)(proceeding for the enforcement of a lien upon land in the possession of A, which demands no personal judgment against him, is not affected by a subsequent adjudication of bankruptcy against him); *Bain v. Stern*, 1 S.C. 415, 419 (1869).

cause it is not particularly novel, should have little effect on the South Carolina practitioner. Attorneys, however, should be aware of *Ducker* in order to avoid mistakes concerning judgment liens and their holders that may arise because of confusion over the distinction between judgment liens and judgment debts.<sup>6</sup> Further, the *Ducker* decision, in answering a relatively simple question, brings to light problems that may be subject to dispute in the future.

The *Ducker* case entailed a sequence of events that began when the respondents, Addison Products Co., Southern Bank and Trust Co., and Standard Supply Co.,<sup>7</sup> each independently obtained judgments against Emily Gaye B. Ducker. These judgments were duly recorded and indexed in the office of the Beaufort County Clerk of Court. At the time these judgments were filed, Ducker owned real property in Beaufort County.<sup>8</sup>

Ducker filed a voluntary bankruptcy petition on May 7, 1975, listing her judgment debts to respondents. Her discharge in bankruptcy was granted on June 26, 1975. Ducker retained title to the real property to which the judgment liens were attached and subsequently sold that property.<sup>9</sup>

In September 1980 Ducker commenced an action seeking the cancellation and discharge of record of the judgments held

5. Little support is found for the proposition that a judgment lien acquired prior to bankruptcy may be discharged as a debt of the judgment debtor that does not have to be paid. See 9 AM. JUR. 2D *Bankruptcy* § 267 (1980) ("The right to retain an existing lien until the debt secured thereby is paid is a substantive property right which may not be taken from the creditor except in a manner consistent with the Constitution.") See also 9 AM. JUR. 2D *Bankruptcy* §§ 270, 779 (1980).

6. The *Ducker* case clearly resolves the issue of whether or not preexisting judgment liens survive bankruptcy proceedings. These liens clearly do survive both the proceedings and a discharge under § 13-35-630. Therefore, attorneys should be wary of mistakenly advising judgment debtors that a discharge under § 15-35-630 will invalidate all debts to a judgment creditor if there is a valid prebankruptcy judgment lien, or of advising judgment creditors that a discharge under § 15-35-630 has invalidated any prebankruptcy liens that they hold.

7. 280 S.C. at 158, 311 S.E.2d at 729. Although each of the respondents had an outstanding judgment lien against Ducker, only Addison stood to gain a significant financial benefit from the outstanding liens. Thus, Addison became the dominant force behind the respondents and was the respondent of record before the South Carolina Supreme Court.

8. Record at 5-6. See also Brief for Respondent Addison Products Co. at 1.

9. Record at 5. See also Brief for Respondent Addison Products Co. at 1. It is unclear why the trustee did not liquidate this real estate, subject to liens as it was, but perhaps the trustee simply abandoned the property because there was no equity in it.

by respondents.<sup>10</sup> The action was filed pursuant to section 15-35-630 of the South Carolina Code, which authorizes a debtor to apply for an order to cancel and discharge outstanding judgments at any time after one year since the debtor's discharge in bankruptcy.<sup>11</sup>

The trial court ruled that the discharge in bankruptcy was a determination of Ducker's *personal liability*. Further, any judgment liens upon real property acquired *after* the date of the original bankruptcy petition were similarly discharged. The trial court ruled, however, that respondents' judgment liens, established before bankruptcy upon property retained after the bankruptcy, were not discharged, but retained their validity.<sup>12</sup> The South Carolina Supreme Court unanimously affirmed this decision.

The court pointed out that section 15-35-630 does not provide for the discharge of any debt, judgment, or claim not already dischargeable under either federal bankruptcy law or South Carolina law.<sup>13</sup> Thus, the Discharge in Bankruptcy Order filed in the United States District Court released Mrs. Ducker only from her personal liability on any judgment obtained in any court before the discharge.<sup>14</sup> The court then cited *Wagner & Co. v. Brown Bros.*<sup>15</sup> in support of the proposition that a discharge of the personal liability of a judgment debtor does not affect liens securing the judgment debts.<sup>16</sup> The court also noted that several other jurisdictions have held that similar statutes did not affect judgment liens that attached to the judgment debtor's real property prior to the commencement of bankruptcy proceedings.<sup>17</sup>

The reasoning behind the *Ducker* opinion appears to be sound. The goal of statutes such as section 15-35-630 is to clear

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10. Record at 5. See also Brief for Respondent Addison Products Co. at 1; 280 S.C. at 158, 311 S.E.2d at 729.

11. For text of statute, see *supra* note 2.

12. Record at 6-7; 280 S.C. at 159, 311 S.E.2d at 730.

13. 280 S.C. at 159, 311 S.E.2d at 730.

14. *Id.* at 159, 311 S.E.2d at 729.

15. 82 S.C. 140 (1909), *denying reh'g* of 82 S.C. 131, 62 S.E. 513 (1908).

16. 280 S.C. at 159, 311 S.E.2d at 730.

17. The court in *Ducker* cited *Albritton v. General Portland Cement Co.*, 344 So. 2d 574 (Fla. 1977); *Olsen v. Nelson*, 125 Minn. 286, 146 N.W. 1097 (1914); *John Leslie Paper Co. v. Wheeler*, 23 N.D. 477, 137 N.W. 412 (1912); *Bush v. Shepard*, 186 Or. 105, 205 P.2d 842 (1949). Each of these cases is factually similar to *Ducker*.

the record after the bankruptcy and to keep prebankruptcy liens from attaching to property acquired after bankruptcy.<sup>18</sup> Judgment liens acquired prior to bankruptcy proceedings are property rights that have vested in the creditor.<sup>19</sup> Courts have consistently upheld the right of the judgment creditor to enforce these liens.<sup>20</sup>

There is one further aspect of the relationship between bankruptcy proceedings and judgment liens that is worthy of mention. There exists the possibility that liens that are valueless at the time of bankruptcy, because of superior creditor interests or valid homestead exemptions,<sup>21</sup> could become more valuable as property values increase and owners build their equity in the property. In *Everett v. Page Brothers* the Oregon Supreme Court ruled that such a benefit to creditors was valid.<sup>22</sup> In the interest of transferability of property, however, the Oregon legislature subsequently established procedures through which judgment debtors could void liens that secure no actual interest.<sup>23</sup> Although other states have been slow to deal with this situation, the United States Congress seems to have addressed the problem.

In amending section 506 of the Federal Bankruptcy Code,<sup>24</sup>

18. 344 So. 2d at 576.

19. 9 AM. JUR. 2D *Bankruptcy* §§ 267, 270, 779 (1980).

20. For authorities, see *supra* note 17. See also 9 AM. JUR. 2D *Bankruptcy* §§ 267, 779 (1980). The following three constitutional arguments might be applicable to protect the validity of prebankruptcy liens from discharge: (1) the prohibition against the deprivation of property without due process of law; (2) the prohibition against ex post facto laws; and (3) the prohibition against the impairment of the obligations of contracts. See 344 So. 2d at 575-76.

21. Section 522(f) of the Bankruptcy Code provides in pertinent part:

Notwithstanding any waiver of exemptions, the debtor may avoid the fixing of a lien or 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 exception if such lien is—

(1) a judicial lien . . . .

11 U.S.C. § 522(f) (1978), Section 522(b) provides that

an individual debtor may exempt from the property of the estate . . .

(2)(A) any property that is exempt under . . . State or local law . . . .

*Id.* § 522(b). S.C. CODE ANN. § 15-41-200(1)(1976) exempts homesteads of debtors up to the value of \$5,000.

22. See *Everett v. Page*, 269 Or. 575, 525 P.2d 996 (1974).

23. OR. REV. STAT. § 23.280 (1975). See also *Credit Serv. Co. v. Cameron*, 41 Or. App. 57, 597 P.2d 363 (1979).

24. 11 U.S.C. § 506(d) (1978).

Congress provided that to the extent that judgment liens secure claims against the debtor that are not allowed secured claims, the lien is void unless the sole reason it is not an allowed secured claim is improper filing.<sup>25</sup> Formerly, such liens were void only if a party in interest requested a determination of the lien's validity.<sup>26</sup> An allowed secured claim created by a judgment lien exists to the extent of the value of the creditor's interest in the debtor's interest in the property.<sup>27</sup> In other words, a creditor has an allowed secured claim only to the extent to which the value of the property securing the debt exceeds the interests of prior creditors. The balance of such a claim is treated as an unsecured claim. This change affects all cases filed more than 90 days after July 10, 1984.<sup>28</sup> Congress thus seems to have precluded judgment creditors from sitting on their rights while their liens accrue in value after a bankrupt debtor has taken appropriate steps to clear up his financial record. The recovery against a debtor now seems to be limited to the value of the lien at the time of the ruling of the bankruptcy court, regardless of any ensuing increase in either the judgment debtor's equity or the value of the property.<sup>29</sup> While this interpretation seems logical, the courts may read the new version of the statute differently.

It is important that practitioners be familiar with both *Ducker v. Addison Products* and section 15-36-630. In representing judgment debtors and judgment creditors, attorneys should realize that default judgments under section 15-36-630 may not discharge valid prebankruptcy judgment liens. Further, attorneys for judgment debtors may find section 506(d) of the Bankruptcy Code useful in protecting the debtors postbankruptcy increases in property value from lienholders' efforts to enforce those prebankruptcy liens.

*Frank L. Eppes*

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25. Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353 § 448, 98 Stat. 333, 374.

26. 11 U.S.C. § 506(d)(1978).

27. 11 U.S.C. § 506(a)(1978).

28. Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, § 553(a), 98 Stat. 333, 392.

29. *Id.*

