UNITED STATES BANKRUPTCY COURT
DISTRICT OF NEW JERSEY

In Re: **MACHELE SNIPES,** Debtor.	Case No.: 16-27921 (JKS) Judge: Hon. John K. Sherwood

DECISION AND ORDER
RE: DEBTOR'S MOTION
TO SET ASIDE TRANSFER AS A PREFERENCE

The relief set forth on the following pages, numbered two (2) through nine (9), is hereby **ORDERED**.

2/14/17

INTRODUCTION

1. Machele Snipes ("Debtor") owns a condominium in Newark, New Jersey that she estimates is worth $98,000. It is clear that there is no equity in the home. The Debtor owes approximately $187,000 to Nationstar Mortgage ("Nationstar") on her first mortgage. In addition, there is a second mortgage to Resurgent Capital for over $35,000 and various judgment liens. Finally, and most relevant for the purposes of the matter before the Court, there is a $25,000 lien for unpaid condominium fees against the property held by Community Hills Condominium Association, Inc. ("Community Hills"). Through her Chapter 13 plan, the Debtor proposes to enter into a loan modification with her first mortgage lender, Nationstar, and to treat the balance of the liens against her condominium as unsecured claims.

2. Towards this objective, the Debtor has filed a motion pursuant to section 522(h) of the Bankruptcy Code to avoid the Community Hills lien as a preference under section 547(b) because the lien was recorded within 90 days of the date the Debtor filed her Chapter 13 petition.

3. If she is successful, the Debtor will be able to treat the Community Hills claim as unsecured and wipe out the lien under her Chapter 13 plan. If the Community Hills lien cannot be avoided, the Debtor will have to modify her Chapter 13 plan.[1]

JURISDICTION

4. The Court has jurisdiction over the motion pursuant to 28 U.S.C. §§ 1334(b), 157(a), and the Standing Order of Reference from the United States District Court for the District of New

[1] Community Hills argues that the Debtor's motion is procedurally defective as Federal Rule of Bankruptcy Procedure 7001 requires that any attempt to determine the validity, priority, or extent of a lien must be brought through an adversary proceeding. The Debtor argues that the Court has flexibility to rule on the merits of the motion because all facts necessary for the Court to render a decision are properly before it. The Court agrees with the Debtor on this point.

Jersey. This matter is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(F) and (K). Venue is proper under 28 U.S.C. §§ 1408 and 1409(a).

DISCUSSION

A. THE DEBTOR'S POWER UNDER SECTION 522(h) TO AVOID A PREFERENTIAL TRANSFER

5. The Debtor contends that because Community Hills filed its lien against the condominium within 90 days of the petition date, it obtained a preference over other unsecured creditors. A central policy underlying the Bankruptcy Code is the equal treatment of similarly situated creditors. In order to achieve equality of distribution, trustees are provided with power under section 547(b) to avoid and recover a transfer made within a certain period before the commencement of a bankruptcy case that gives a creditor an unfair advantage over others.[2] A transfer includes the creation of a lien, as well as the voluntary or involuntary disposition of property or an interest in property.[3]

6. Chapter 13 trustees have the ability to avoid such transfers pursuant to section 103(a), which applies Chapter 5 of the Bankruptcy Code and its preference provisions to Chapter 13 cases. But, a trustee may decide not to bring a preference action where there is no perceived financial benefit to the estate. In that instance, a preferential transfer might stand and the debtor may not be able to recover property that she otherwise would be entitled to exempt from the estate.[4]

7. In certain limited circumstances, Chapter 13 debtors are provided with avoidance powers where a trustee has failed to assert them. Section 522(h) provides, in relevant part, that a debtor "may avoid a transfer of [her] property . . . to the extent that the debtor could have exempted

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[2] *See Union Bank v. Wolas*, 502 U.S. 151, 161 (1991) ("By authorizing the avoidance of such preferential transfers, § 547(b) empowers the trustee to restore equal status to all creditors.").
[3] 11 U.S.C. § 101(54).
[4] *See* 3 *Norton Bankr. L. & Prac.* 3d § 56:31 (2017).

such property" if the trustee had the ability to avoid the transfer. This avoidance power is not unlimited, however, as section 522(g)(1) prohibits the debtor from avoiding voluntary transfers or transfers of property that the debtor concealed. Here, the Debtor relies on section 522(h) to set aside the Community Hills lien.

8. Several courts have identified a five-prong test to determine the ability of a debtor to avoid a transfer of exempt property under section 522(h): (1) the transfer was not a voluntary transfer of property by the debtor; (2) the debtor did not conceal the property; (3) the trustee did not attempt to avoid the transfer; (4) the debtor seeks to exercise an avoidance power available to the trustee under sections 544, 545, 547, 548, 549, or 724(a) of the Bankruptcy Code; and (5) the transferred property is of a kind that the debtor would have been able to exempt from the estate if the trustee had avoided the transfer under one of the provisions of section 522(g).[5]

9. In this case, neither party contends that the condominium was concealed, that the trustee attempted to avoid the lien, or that the Debtor may not utilize the trustee's avoidance power under section 547. Instead, the arguments focus on two aspects of the test: (1) whether the Debtor would be able to claim an exemption in the property when there is no equity; and (2) whether the granting of the lien by the Debtor was voluntary.

B. THE DEBTOR CANNOT AVOID THE LIEN BECAUSE SHE HAS NO EQUITY INTEREST IN THE HOME

10. Can the Debtor exempt her interest in the condominium from the bankruptcy estate when there is no equity in the property? The Debtor lists the value of the property at $98,000 and indicates that Nationstar holds a $187,000 first mortgage.[6] Community Hills argues that the Debtor

[5] *See, e.g. In re DeMarah,* 62 F.3d 1248, 1250 (9th Cir. 1995); *Matter of Hamilton,* 125 F.3d 292, 297 (5th Cir. 1997); *In re Dickson,* 655 F.3d 585, 592 (6th Cir. 2011).
[6] [ECF No. 14].

cannot take a homestead exemption because there is no equity in the condominium. The Debtor counters that section 522(h) imposes no such requirement and that she is entitled to claim the exemption regardless of whether there is available equity.

11. Upon filing a bankruptcy petition, all of a debtor's legal and equitable interests in property become property of the bankruptcy estate.[7] Section 522(b) operates to allow a debtor to exempt certain property, "based either on an enumerated list of federal exemptions or on any alternative exemptions provided by the state."[8] Section 522(d)(1) provides in part that a debtor may exempt her "aggregate interest" up to $23,675 in her homestead. In her bankruptcy petition, the Debtor states that the value of her homestead exemption is $0.00.[9]

12. As set forth below, the legislative history, legal treatises and various court cases make clear that a debtor's "aggregate interest" under the Bankruptcy Code is her equity interest in the property.

13. Under the Bankruptcy Reform Act of 1978, it was the intent of Congress that "property may be exempted" even if subject to a lien, but "only the unencumbered portion of the property is to be counted in computing value of the property for the purposes of exemption."[10] Thus, for example, "a residence worth $30,000 with a mortgage of $25,000 will be exemptible to the extent of $5,000."[11]

14. *Collier* states that the homestead exemption applies "only to the value of the debtor's interest in the property – in other words, the debtor's equity in the property."[12]

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[7] 11 U.S.C. 541(a)(1); *In re Traverse,* 753 F.3d 19, 24 (1st Cir. 2014) ("all of the debtor's legal and equitable interests in property…become the property of the bankruptcy estate").
[8] *In re Cunningham,* 513 F.3d 318, 323 (1st Cir. 2008).
[9] [ECF No. 14].
[10] *In re Hyman,* 123 B.R. 342, 346 (9th Cir. BAP 1991) (quoting H.R. 595, 95th Congress, 1st Sess. 360-61 (1977)).
[11] H.R. 595, 95th Congress, 1st Sess. 360-61 (1977).
[12] 4 *Collier on Bankruptcy,* ¶ 522.09[1] at p. 522-61 (16th ed.).

15. The Supreme Court examined exemptions in *Owen v. Owen,* and noted that:

> Property that is property exempted under section 522 is (with some exceptions) immunized from liability for prebankruptcy debts… [n]o property can be exempted (and thereby immunized), however, unless it first falls within the bankruptcy estate. Section 522(b) provides that the debtor may exempt certain property "from property of the estate"; obviously, then, an interest that is not possessed by the estate cannot be exempted. Thus, if a debtor holds only bare legal title to his house – if, for example, the house is subject to a purchase-money mortgage for its full value – then only that legal interest passes to the estate; the equitable interest remains with the mortgage holder, section 541(d). And since the equitable interest does not pass to the estate, neither can it pass to the debtor as an exempt interest in property. [13]

16. Similarly, in *In re Simonson,* the Third Circuit addressed the homestead exemption as it related to the ability to strip judicial liens.[14] The Chapter 7 debtors, with two mortgages totaling more than the value of their home, sought to avoid judicial liens under section 522(f) because they impaired the debtors' homestead exemption. Noting that section 522 did not define "interest of the debtor in property," the Court held that because the value of the home was less than the amount of the mortgages, "the debtor[s] had no interest in the property to which an exemption could attach."[15] Had the property been worth more than the mortgages, "the debtor[s] would have had an exemptible interest in the excess" and "would have been entitled to avoid the judgment liens . . . so as to preserve that interest for application of the exemption."[16]

17. However, in 1994, the Bankruptcy Reform Act overturned the *Simonson* Court's decision and made it clear that a debtor does have an exemptible interest in her home, even if there is no equity, for the purpose of avoiding a judicial lien under section 522(f).[17] Congress further

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[13] 500 U.S. 305, 308-09 (1991).
[14] 758 F.2d 103 (3d Cir. 1985).
[15] *Id.* at 105.
[16] *Id.*
[17] H.R. 835, 103d Congress, 2d Sess. 52-54 (1994).

amended section 522(f) of the Code to include a mathematical formula to help guide courts in determining whether a judicial lien is avoidable.

18. Importantly, section 522(f) only applies to situations where a judicial lien impairs an exemption. The Bankruptcy Code defines a judicial lien as "a lien obtained by judgment, levy, sequestration, or other legal or equitable process or proceeding."[18] For a lien to be judicial, "there must be some judicial or administrative process or proceeding that ultimately results in the obtaining of the lien."[19]

19. On the other hand, consensual liens such as "mortgages and [UCC] Article 9 security interests, and statutory liens" are not judicial liens and "cannot be avoided under section 522(f)."[20] There is no indication that section 522(f) applies to anything other than judicial liens. If Congress sought to make section 522(f)(2)'s mathematical formula applicable to non-judicial liens like the Community Hills lien, it would have so stated.

20. Given the legislative history, case law and a plain reading of sections 522(f) and (h), the Debtor cannot take a homestead exemption where there is no equity in the home. The only exception is that a debtor can avoid a judicial lien where there is no equity under section 522(f). That exception does not apply here because the Community Hills lien is not a judicial lien. Thus, the Debtor cannot avoid Community Hills' lien under section 522(h).

C. THE DEBTOR CANNOT AVOID THE LIEN BECAUSE THE TRANSFER WAS VOLUNTARY

21. Assuming, *arguendo*, that there was equity in the condominium, the Debtor would also have to show that the lien was not a voluntary transfer in order to have standing under section 522(h)

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[18] 11 U.S.C. § 101(36).
[19] *In re Schick*, 418 F.3d 321, 328 (3d Cir. 2005).
[20] *Bankruptcy Law Manual*, § 5:39 (5th Ed. 2016); *see also In re Schick*, 418 F.3d at 324 ("a statutory lien arises solely by force of a statute on specified circumstances or conditions…but does not include a judicial lien") (internal quotations omitted).

to avoid the lien.[21] Community Hills asserts that the transfer was voluntary because the Debtor agreed to grant the lien through her acceptance of the deed to the property. The Debtor counters that the transfer in question is not the granting of the lien itself, but the recording of the lien that gave rise to the perfected security interest.

22. The Bankruptcy Code does not define the term "voluntary." Nevertheless, courts have attempted to assign meaning to the term. A transfer is voluntary "if a debtor, with knowledge of all essential facts and free from the persuasive influence of another, chooses of her own free will to transfer property to the creditor."[22] Further, a transfer is voluntary if a debtor has "knowledge of all of the essential facts pertaining to the transfer."[23]

23. In the context of an avoidance action under section 522(h), courts have routinely found that the granting of a security interest in property is voluntary.

24. In *In re Bloom,* within 90 days of the bankruptcy filing, a creditor obtained two judgments against the debtors and sought to levy upon their vehicle.[24] In order to prevent the sale of the vehicle, the debtors executed a security agreement with the creditor to secure payment of the judgment amount. In exchange, the creditor agreed to release the judicial liens. Upon the filing of his bankruptcy, the debtor claimed that the granting of the security interest was not voluntary and brought an action under section 547 to avoid the lien as a preference. In holding that the transfer was voluntary and denying the debtors' preference claim, the court stated that "a threat to take action to collect a debt or a judgment by legal means does not constitute such

[21] *See* 11 U.S.C. § 522 (g)(1)(A).
[22] *In re Reaves,* 8 B.R. 177. 181 (Bankr. D.S.D. 1981).
[23] *In re Seidel,* 27 B.R. 347, 352 (Bankr. E.D. Pa. 1983).
[24] 28 B.R. 571 (Bankr. D. Ore. 1983).

coercion as to transform the voluntary grant of a security interest into an involuntary transfer of property."[25]

25. On December 21, 2006, the deed granting ownership interest in the property was delivered to the Debtor in exchange for $180,000.[26] The deed's legal description indicates the specific unit and percentage in the condominium that the Debtor was purchasing "subject to the Community Hills Master Deed, dated August 22, 2000, and recorded in the office of the Essex County recording officer on August 23, 2000."

26. The Master Deed provides that "[a]ll charges and expenses chargeable to any Unit constitute a lien against that Unit in favor of the Association."[27] Further, the Master Deed states that "All liens may be recorded in accordance with N.J.S.A. 46:8B-21 and foreclosed by the Association in the manner [ ] mortgages may be foreclosed."

27. Community Hills recorded its lien on July 11, 2016 and became entitled under N.J.S.A. 46:8B-21 to a six-month priority lien over Nationstar for unpaid fees and costs owed by the Debtor. There is no question that the Debtor voluntarily gave Community Hills the right to do this. Even though the lien was recorded within 90 days of the filing of the Debtor's petition, the grant of the lien and the right to record it under New Jersey law was voluntary in all respects. Thus, the Debtor does not have standing under section 522(h) to avoid the lien as a preference.

CONCLUSION

28. For the foregoing reasons, the Debtor's motion is denied.

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[25] *In re Bloom,* 28 B.R. at 573; *see also In re Trentman,* 278 B.R. 133, 136 (Bankr. N.D. Ohio 2002) (A debtor who voluntarily grants a mortgage upon property is not entitled to "avoid a mortgage through the exercising of the trustee's avoiding powers" under section 522.).
[26] [ECF No. 30, Ex. "A"].
[27] [ECF No. 30, Ex. "A"].