2007

Calculating Exemptions in Bankruptcy: All Points Capital Corp. v Meyer

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All Points Capital Corp. v Meyer
(In re Meyer) (BAP 9th Cir 2007) 373 BR 84

In determining extent of exemptions, liens against entire fee must be subtracted before computing value of debtor's interest in co-owned property.

Meyer co-owned a residence valued at $515,000 that was encumbered by a consensual debt of $232,005. He scheduled his 50-percent joint tenancy interest as worth $257,500. If he had liquidated the property on the day of bankruptcy, his share of the proceeds would have been $141,497.50, or $91,497.50 net of his $50,000 homestead exemption.

Meyer's interest was subject to two judgment liens. In first position was a lien of $275,000 owed to American Capital Resources, Inc. All Points Capital Corporation also had a judgment lien of $900,000.

Meyer filed a motion under 11 USC §522(f)(1) to avoid both judicial liens. Section 522(f)(2) provides a statutory formula for determining exceptions to exemptions that does not take fractional interests in property into account. American Capital Resources did not appear at the hearing.

All Points Capital argued that the American Capital lien should be avoided by default, and then the consensual lien should be subtracted from the property's value before computing the value of the debtor's interest in the co-owned property. Under that theory, the equity of $282,995 for all owners would leave Meyer with $141,497.50 in value, which after deducting the $50,000 homestead exemption would yield $91,497.50 that could survive the §522(f)(1) lien avoidance.

The bankruptcy court did not enter a default against All Points Capital, but did grant the avoidance motion in its entirety without making any findings.

The bankruptcy appellate panel vacated the order and remanded. Because an entry of default was not entered against American Capital, the bankruptcy court could not proceed to enter default judgment by granting the avoidance motion. Further, §522(f)(2) would provide nonexempt equity of $91,497.50 to which judgment liens could remain attached.

Judicial liens that are being avoided under §522(f) as impairing exemptions are deducted in reverse order of priority. *Bank of America v Hanger (In re Hanger)* (9th Cir 1999) 196 F3d 1292. Liens already avoided are excluded from the exemption-impairment calculation with respect to other liens. 11 USC §522(f)(2)(B).

The bankruptcy court did not enter default against American Capital, and therefore could not enter default judgment. Default judgment is a matter of discretion in which the court may consider, among other things, the merits of the substantive claim. If the plaintiff is not entitled to the relief requested, then the court should not enter default and may even enter judgment in favor of the defaulted defendant. *Cashco Fin. Servs., Inc. v McGee (In re McGee)* (BAP 9th Cir 2006) 359 BR 764. Meyer was not entitled to judgment on the merits.

An avoidance motion prevents the fixing of a judgment lien on an interest of the debtor in property to the extent that such lien impairs an exemption to which the debtor is entitled. 11 USC §522(f)(1)(A). The exemption is impaired if, subtracting all of the unavoidable liens and the exemption from the value of the debtor's half interest, the yield is zero or less. 11 USC §522(f)(2).

In the case of fractionally owned property, if all the consensual liens are subtracted from the fractional interest, as literally required by §522(f)(2), the result could be that judicial liens are avoided that do not impair an exemption. Congress intended to overrule judicial decisions that had the consequence of frustrating a debtor's ability to receive the full exemption authorized by law. A common-sense application, which conforms with congressional intent, nets out consensual liens against the entire fee in co-owned property

before determining the value of a debtor's fractional interest and excludes those liens from the calculation of "all other liens on the property" under §522(f)(2)(A)(ii).

By applying a mechanical approach, the bankruptcy court had effectively provided an exemption to Meyer of $141,497.50 when only $50,000 was merited. The goal is to achieve a balance between the creditor and debtor by assuring that the debtor receives the full exemption permitted by law and that the creditors secured by judicial liens do not lose their secured positions in value that is not exempt.

THE EDITOR'S TAKE: *All Points Capital Inc. v Meyer* attempts to resolve the issue of how to apply 11 USC §522(f)'s formula for avoiding judgment liens on property in which the debtor holds only a partial interest. The Bankruptcy Appellate Panel held that in determining the extent of avoidance, liens encumbering the entire property must be deducted from the whole property's value, not just from the value of the debtor's partial interest in the property.

Meyer makes it much easier for judgment liens on a debtor's partial interest in property to survive the debtor's bankruptcy. Attorneys practicing in the Ninth Circuit, however, should caution clients who hold judgment liens that they should not rely too heavily on *Meyer*. The case is likely to be reversed on its pending appeal to the Ninth Circuit because the BAP ignored §522(f)'s plain meaning.

A statute's plain meaning must not be ignored except in the rare instance when its plain meaning causes an absurd result demonstrably at odds with congressional intent. The *Meyer* panel engaged in pure judicial activism by admittedly ignoring §522(f)'s plain meaning and "generously" interpreting §522(f) to reach a result the court believed made "common sense" without any evidence that §522(f)'s plain meaning was contrary to congressional intent or caused an absurd result.

Determining the extent to which a judgment lien will be avoided under §522(f) by using a formula that deducts liens encumbering an entire property from the value of the debtor's partial interest in that property is not inherently absurd. That very formula is used in similar contexts, such as when determining whether a judgment lien holder may foreclose on a California debtor's partial interest in a homestead; it is the basis for an exemption under 11 USC §522(b)(3)(B). Further, §522(f)'s legislative history does not discuss in any way how the section impacts a debtor's partial interest in property. Thus, it is difficult to understand how the *Meyer* panel could have found that applying §522(f)'s plain meaning to a debtor's partial interest in property was demonstrably contrary to congressional intent.

In short, although at first blush *Meyer* seems to be a victory for judgment lien holders, the ultimate win likely will go to the debtors.—*Roger Bernhardt*