

Memorandum 81-9

Subject: Study D-300 - Enforcement of Judgments (Discharge of Judgment Liens)

If a judgment lien has been recorded against property and the debtor desires to sell the property, sale may be impossible if the amount of the judgment lien exceeds the value of the property. This is because the lien stays on the property until it is satisfied, and a buyer will be unwilling to pay full value for the property if the lien remains on. The judgment creditor may voluntarily release the judgment lien and accept the proceeds of sale as a partial satisfaction of the judgment if the creditor is satisfied that a fair price is being given for the property. But if the judgment creditor is not satisfied with the amount received, or if the judgment creditor believes the property will appreciate in value and wishes to wait until the whole lien can be satisfied, or if the judgment creditor is simply unreasonable and desires to give the debtor trouble, the lien will remain on the property and the property cannot be sold.

A similar situation arises where the property is a homestead and the sale price is not adequate to satisfy both the judgment lien and the homestead exemption. Unless the judgment creditor voluntarily releases the lien the debtor must either give up the homestead exemption or remain trapped in the property.

At the November 1980 meeting the Commission approved a staff draft of a statute designed to remedy both these situations. Under the draft a judgment debtor who has entered into a contract of sale of property against which a judgment lien has been recorded may obtain a court order discharging the lien. The judgment creditor has the option of either accepting the proceeds of sale that will go to satisfy the judgment in part, or purchasing the property at the sale price. The purchase right is the creditor's protection against an unduly low sale price.

In preparing the enforcement of judgments recommendation for introduction in the 1981 Legislature, the staff has discovered a major defect in the scheme for discharging the judgment lien. The scheme works fine in most situations; however, it breaks down where there is

more than one judgment lien, each of which overburdens the property. Take, for example, property worth \$50,000 but burdened by two judgment liens, each for \$100,000. In this situation the judgment debtor would be unable to sell the property since even though one judgment lien could be discharged under the statute, the other would still overburden the property.

There are other problems with the discharge scheme. It offers the judgment debtor an opportunity to favor one creditor over another despite their priorities and an opportunity to force the discharge of a lien at a price far below the security of the lien. Take again our \$50,000 property with two \$100,000 liens. The debtor could offer the property to the second lienholder for \$25,000. The second lienholder would take the offer since it would receive in exchange the \$50,000 property free of liens, whereas otherwise it would have little hope of recovering anything out of the property burdened by a prior \$100,000 lien. The lien of the first lienholder would be discharged and the first lienholder would get only \$25,000. It would do the first lienholder no good to exercise the purchase option for \$25,000, since all it would get in exchange for \$25,000 is a \$50,000 piece of property burdened by a \$100,000 lien elevated from second position to first.

One way to avoid these problems is to provide a procedure for the discharge of all judgment liens on the property. However, to ensure fairness to persons whose liens are being discharged there would then have to be either (1) a court determination that the sale price of the property was fair or (2) an opportunity for the lienholders to bid against each other to purchase the property free of liens at a price equal to or in excess of the debtor's proposed sale price for the property. Neither of these solutions is satisfactory in the staff's opinion since they both involve court supervision. A major object of any discharge procedure should be to provide an expeditious means of removing the liens.

Another possible solution is to permit the debtor to require the judgment lienholder either to proceed against the property by way of execution or to release the lien. This solution is subject to several objections: (1) It entails the delays and expenses of an execution sale. (2) It requires the debtor to waive the minimum bid protection of a homestead.

After reviewing the problems, the staff has come to the conclusion that a simpler and more effective remedy for the judgment debtor whose property is overburdened is bankruptcy or the threat of bankruptcy. A debtor who desires to sell property overburdened with judgment liens can offer the lienholders payment of the sale price in exchange for release of the liens. If the sale price is fair the creditors should accept; otherwise the debtor can go into bankruptcy court, which will discharge not only the liens on the property, but the underlying judgments of the lienholders as well. In a case where the judgment debtor does not desire bankruptcy, the possibility or threat of bankruptcy may be sufficient to induce the creditor to release the lien.

The staff recommends that the procedure for discharge of judgment liens be deleted from the Commission's enforcement of judgments recommendation, in reliance on the availability of bankruptcy. Bankruptcy is designed to handle the very sort of problems that confront the discharge procedure--i.e., problems that arise where the debts exceed the assets available to satisfy them.

Respectfully submitted,

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