

Memorandum 99-5

Homestead Issues

This memorandum reopens the Commission's long-standing attempts to reform the California homestead exemption law. Many reforms have been accomplished, but several critical proposals could not be achieved in 1982 and again in 1996, leaving the law in a sorry and confusing state. The homestead exemption statutes do not achieve their intended purposes in many cases, are misunderstood and misapplied in state debt collection proceedings, are ignored in self-help transactions, and contribute to a morass of confusion in the personal bankruptcy arena.

As a starting point, the staff recommends that the Commission seek additional input on its 1996 recommendation (which remains essentially sound) and work toward sponsoring legislation, with any appropriate revisions, in the 2000 legislative session. A copy of the 1996 recommendation — *Homestead Exemption*, 26 Cal. L. Revision Comm'n Reports 37, 41-82 — is attached.

The Issues

The problems with existing law and the Commission's proposed remedial amendments are fully discussed in the attached recommendation. The following is a summary of the major points:

- Existing law provides an "automatic" homestead exemption that protects the home from forced sale by general creditors if the debtor's equity is below the applicable exempt amount (\$50,000 for individuals, \$75,000 for married persons and families, \$125,000 for elderly, disabled, and certain low income persons). The automatic homestead procedure is detailed and highly protective of the home. (See Code Civ. Proc. §§ 704.710-704.850.) It also protects proceeds from *involuntary* sales (on execution or eminent domain) or insurance proceeds in the exempt amount.
- A remnant of the older homestead declaration procedure, carried over from the Civil Code, also still exists. (See Code Civ. Proc. §§ 704.910-704.995.) Almost all functions of the old homestead declaration procedure have been taken over by the automatic exemption that has been in place since 1983. For most purposes, the declaration procedure

is *not* an independent exemption, but relies on the automatic exemption for determination of amounts. It is simply a recording procedure, subject to several confusing and unclear rules.

- The 1996 recommendation eliminates the declaration procedure. (See pages 69 & 73-80 in attached recommendation.) The remains of the declaration procedure are confusing and widely misunderstood, misleading to homeowners and largely ineffective in voluntary sales. Declarations complicate real property sales, since title companies search for and generally report homestead declarations. Stale declarations remain of record indefinitely. The availability of the procedure has led to a cottage industry of “declaration filing services” and some sharp practices, which in turn necessitated the regulations in the Business and Professions Code, and enforcement actions by district attorneys and the Attorney General. (See, e.g., *In re Morse*, 11 Cal. 4th 184 (1995).) Its protections appear to be largely illusory — the Commission staff has been told by creditor representatives and a bank attorney that they ignore homestead declarations. Contrary to popular notions, title companies report declarations, but have nothing to do with determining their validity or enforcing them in a voluntary sale transaction.
- The 1996 recommendation continues the intended benefit of the declaration procedure in the “automatic” homestead procedure — the ability to protect the debtors’ proceeds from a voluntary sale (up to applicable exemption limits) for a period of six months to enable the debtor to move the exemption to another qualifying homestead. The voluntary sale proceeds exemption has been in the declared homestead procedure since 1911. The recommended proceeds exemption is limited and directed toward its purpose of providing a baseline protection for the home. The intent of the law is “to allow the owner of the homestead to substitute one family home for another without losing his exemption.” *Thorsby v. Babcock*, 36 Cal. 2d 202, 205 (1950). The debtor should not be a “prisoner in his home.”
- The 1996 recommendation also continues special treatment of support judgments. This aspect of the proposal was worked out with the District Attorneys’ Family Support Council in the fall of 1995. The voluntary sale exemption does not apply against enforcement of child or spousal support unless the debtor obtains a court order for an equitable division of the proceeds where there are competing support obligees. (See proposed Code Civ. Proc. § 704.720(d).)
- There has been general support for eliminating the declared homestead procedure. The difficulty is in deciding how to accomplish the goal, and state bar committees and other commentators with whom we have worked have been unable to come to any consensus on that issue. The Commission’s 1995-96 work was initiated pursuant to a request from the State Bar Legal Services Section. The Debtor/Creditor and

Bankruptcy Committee of the State Bar Business Law Section also supported the concept of repealing the declared homestead procedure and continuing its protections in the automatic exemption. The Forms and Practices Committee of the California Land Title Association supported the repeal so long as existing protections were continued in the automatic homestead exemption. The National Association of Consumer Bankruptcy Attorneys supported the 1996 recommendation, with some amendments.

- In 1996, some opponents of the recommendation appeared to believe that recording a judgment lien prevents the debtor from recording an effective homestead declaration. This has not been the law since July 1, 1983. Under earlier law, the first to record the declaration or the judgment lien would prevail. An earlier homestead declaration *prevented* attachment of later judgment liens. And an earlier judgment lien was immune from a later homestead declaration. This is no longer the law. If the debtor records a homestead declaration after a judgment lien, the debtor is entitled to the exempt amount in effect at the time the lien attached. If the declaration was first, the debtor gets the benefit of future increases in exempt amounts enacted by the Legislature. The concept of “perfection” has no relevance to homestead declarations or judgment liens.

There have not been any significant developments in the law since 1996 to remedy these problems. In 1997, the Legislature increased the amount of the third-tier exemption from \$100,000 to \$125,000, but all the procedural complications and contradictory language remain in place. Two California Courts of Appeal have grappled with the language of the homestead declaration statute, with contradictory results. In *Teaman v. Wilkinson*, 59 Cal. App. 4th 1262, 69 Cal. Rptr. 2d 705 (1997), the court interpreted Section 704.950 to mean that a judgment lien does not “attach” to the property until a surplus equity develops. The court in *Smith v. Merrill*, 75 Cal. Rptr. 2d 108 (1998), correctly interpreted the statute, concluding that a judgment lien attached to the property under other law and that the homestead law governed the amount of the lien, not its priority in time. Until the law is clarified, whether through the Commission’s 1996 recommendation or some other reform, this confusion will continue.

SB 197 (1996) — Haven’t We Been Here Before?

The Commission’s recommendation was put before the Legislature in SB 197 (Kopp) in the 1996 session. The recommendation was amended into a bill that had already passed the Senate, so that its first hearing was in the Assembly Judiciary Committee. The then-majority Republicans on the Committee were not

receptive to extending the voluntary sale proceeds exemption — in fact, one member suggested that all debtors' exemptions should be repealed.

Working with the Committee consultant, we attempted to find some alternatives that would satisfy the likely Committee concerns, but the result was only to lose the probable support of the then-minority Democrats. The main element of the compromise was to limit the voluntary sale proceeds exemption to cases of hardship, i.e., a court-ordered sale in dissolution, job loss or transfer, or death or serious illness in the debtor's immediate family — patterned after rules governing withdrawals from tax-deferred savings plans (e.g., 403(b), 457). (The hearing was reported in the First Supplement to Memorandum 96-64.) Other possibilities were also discussed, such as applying a wage garnishment standard to voluntary sale proceeds, with the result that 25% of the exemption that would apply in forced sales would be available to satisfy creditors. This was particularly aimed at clearing smaller liens, as the Commission had been informed that over 90% of debts held by collection agencies were under \$10,000 (if memory serves). However, this proposal did not satisfy the opposition.

Positions on the 1996 bill can be summarized as follows: The State Bar Legal Services Section and the National Association of Consumer Bankruptcy Attorneys (NACBA) favored the policy of making the proceeds exemption effective and repealing the declaration procedure; however, NACBA was concerned about adding any limitations on the duration of the exemption, and the Legal Services Section didn't want to see revision of the "all liens and encumbrances" rule. The Department of Consumer Affairs thought the bill would be beneficial. The Family Support Council was concerned that the exemption should not cut into support enforcement, but this was addressed in the bill by providing for an equitable determination. The Forms and Practices Committee of the California Land Title Association supported the general recommendations, as long as the benefits of the declared homestead were carried over into the automatic homestead. The Debtor/Creditor and Bankruptcy Committee of the State Bar Business Law Section was on record as supporting the reform in general terms, but did not take a position on the bill, although individual committee members expressed varying degrees of agreement or concern. The California Association of Collectors and the Bank of America actively opposed the bill; efforts to find a compromise were unavailing.

The staff assumes that these basic positions will be largely the same now, although there is always hope that further study and experience will reduce or

eliminate some of the concerns. However, creditors do not want to give up an arbitrary advantage they currently enjoy. The Legislature has focused on raising the exemption amounts from time to time. While creditors naturally dislike increased exemptions, the effect on their immediate interests is ameliorated in the nonbankruptcy context because creditors, with the assistance of title insurers, can simply ignore the law and force payment, notwithstanding the ostensible statutory protections, by waiting for a voluntary sale or refinancing.

Those speaking for debtors do not want to give up the theoretical advantages of the declaration procedure, even though the special protections provided by the letter of the homestead declaration procedure in Article 4 are largely illusory. The fundamental protections are in the “automatic” Article 3 exemption. Thus, from a law reform perspective, it would be beneficial to simply repeal the homestead declaration procedure, thereby sweeping away all of its confusing, contradictory language and saving courts and parties the problems evidenced in the bankruptcy and state exemption cases. This approach would submit to the existing practice of ignoring the voluntary proceeds exemption and conform the law to the nearly uniform practice of creditors, title companies, and banking institutions. The policy of protecting voluntary sale proceeds should be confronted head on, but if the Legislature determines that it should not be made effective, it should be repealed.

The staff still doubts that it is possible to find a consensus solution to the problems in existing law, but since the Legislature has recently voted in support of the homestead exemption, by increasing the amount of the third-tier to \$125,000 (1997 Cal. Stat. ch. 82, § 1 (AB 451), amending Code Civ. Proc. § 704.730(a)(3)), we anticipate that the Legislature should be receptive to making the words of the statute effective in practice and eliminating the confusing homestead declaration procedure. The fundamental policy issue that calls for resolution is whether there should be an effective voluntary proceeds exemption and, if there is, its extent and conditions.

Accordingly, **the staff recommends that the Commission resubmit the 1996 recommendation with a number of substantive and technical improvements that were adopted by the Commission during the 1996 legislative process:**

1. The homestead filing service statute (Bus. & Prof. Code § 17537.6) should be repealed, as in the recommendation, but should not be replaced by a new crime, as set out in the new Section 17537.6 on page 58 of the attached recommendation. Making it a crime is probably overkill and results in additional fiscal review of the recommendation.

2. The option to pay voluntary sale proceeds into court in Section 704.720(e) should be deleted. (See page 62 of the attached recommendation.) This language resulted in the bill having a SMLP tag (pronounced “smalp”) — a State Mandated Local Program. Commentators also felt that there could be bureaucratic difficulties in depositing the money and getting it paid out again.

3. In the same subdivision (Section 704.720(e) on page 62), language should be added making clear that on deposit of the proceeds of sale, the creditor’s lien on the homestead property being sold is extinguished, since the lien attaches to the proceeds in the enforceable amount. This rule is necessary to make clear that there is no lien on the property in the hands of the purchaser. Otherwise, the purchaser would deduct the amount of the lien from the purchase price, and the exemption would be defeated.

The staff would not recommend reviving the necessity standard (discussed above) that was amended into the 1996 bill in its last stages, since this approach was not supported by either side.

The staff also suggests that the revised recommendation be circulated as a tentative recommendation. If the Commission is comfortable with the revisions listed above, we could circulate the proposal without additional review. This would serve to alert interested parties and generate some comment for the Commission to consider later this year. Alternatively, the Commission may wish to give interested persons an opportunity to comment on the proposal before it is circulated as a tentative recommendation, in which case we would bring this material back at the next meeting.

Bankruptcy Issues

The confusing and uncertain language of the homestead declaration procedure has unfortunate consequences in bankruptcy. The ill effects of confusing state language are amplified in the complex and at least equally confusing Bankruptcy Code. Bankruptcy complicates the situation by employing a concept of “lien impairment” in order to avoid liens on the property in the debtor’s estate. These rules do not coordinate well with the concepts used in the California Enforcement of Judgments Law. An overview of relevant Bankruptcy Code rules and recent bankruptcy cases relevant to the California homestead exemption, prepared by volunteer attorney Linda Verheecke, is attached hereto (following the 1996 recommendation).

The provisions in the Enforcement of Judgments Law relevant to the attachment and effect of liens and the extent of exemptions are essentially sound and should not be revised in any attempt to solve problems arising from unique bankruptcy rules and issues. In any event, the Bankruptcy Code is currently the subject of major efforts of reform in Congress, and the outcome is unpredictable. There may be mandatory federal bankruptcy exemptions or ranges of exemptions (as in the case of some homestead proposals). However, some commentators think that it is likely the federal exemption scheme will fail, as it has in the past.

Enactment of the Commission's 1996 recommendation would eliminate the source of a great deal of confusion on the bankruptcy side by repealing the homestead declaration procedure. The complications arising from application and interpretation of the bankruptcy rules on lien avoidance and homestead exemption impairment would be minimized if the parties can focus on one simpler homestead statute, the Article 3 "automatic" exemption.

Respectfully submitted,

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HOMESTEAD EXEMPTION

The Enforcement of Judgments Law¹ contains two procedures relating to homestead exemptions from enforcement of money judgments: the automatic homestead exemption and the homestead declaration.² This recommendation proposes repealing the homestead declaration procedure and preserving its primary benefit, the voluntary sale proceeds exemption, in the general automatic homestead exemption. Additional technical revisions are also proposed.

Background

The California Constitution requires the Legislature to “protect, by law, from forced sale a certain portion of the homestead and other property of all heads of families.”³ But there is no requirement that the law provide a homestead *declaration* procedure. The procedure for implementing this constitutional mandate is determined by the Legislature.⁴

California has not always had a homestead declaration procedure. A claimed homestead procedure existed from 1851 until it was superseded by the declared homestead in the early

1. See 1982 Cal. Stat. ch. 1364, operative July 1, 1983. The Enforcement of Judgments Law was enacted on recommendation of the Commission. See *1982 Creditors' Remedies Legislation*, 16 Cal. L. Revision Comm'n Reports 1001, 1009 (1982).

2. See Code Civ. Proc. §§ 704.710-704.850 (“automatic” homestead exemption), 704.910-704.995 (declared homesteads). (All further statutory references are to the Code of Civil Procedure, unless otherwise indicated.) The homestead declaration procedure is not complete, incorporating many substantive provisions of the automatic homestead exemption. See Sections 704.910(c) & (e), 704.950(c)(2), 704.960(a), 704.965, 704.970(b), 704.995(c). The Commission recommended repeal of the declared homestead in favor of the automatic homestead in its 1980 report. See *Tentative Recommendation Proposing the Enforcement of Judgments Law*, 15 Cal. L. Revision Comm'n Reports 2001, 2090-93, 2611-12 (1980).

3. Cal. Const. art. XX, § 1.5.

4. See, e.g., *Noble v. Hook*, 24 Cal. 638 (1864).

1860's.⁵ For over a century, the homestead was protected against money judgment liens only if the homestead declaration was recorded before the judgment lien. The principle of first in time, first in right was applied with drastic consequences to the tardy debtor. To protect families of debtors who failed to record the exemption before death, the probate homestead procedure was developed, permitting the court to declare an exemption.⁶

In 1974, the Legislature enacted a second procedure enabling a debtor who had not recorded a homestead declaration to claim an exemption when the dwelling was levied on under a writ of execution.⁷ The judgment creditor was required to petition for issuance of a writ of execution directed against a dwelling and give notice to the debtor who could then assert the exemption. This procedure was substantially revised in the Enforcement of Judgments Law enacted in 1982, resulting in the homestead exemption procedure in Code of Civil Procedure Sections 704.710-704.850. The probate homestead was put on an independent footing, unrelated to the homestead declaration.⁸

Automatic Homestead Exemption

The “automatic” homestead exemption — or dwelling house exemption, as it is also known — requires the judgment creditor to initiate court proceedings to determine whether the property is exempt and the amount of the exemption. Gener-

5. For detailed background on the history of the exemption, see Taylor v. Madigan, 53 Cal. App. 3d 943, 126 Cal. Rptr. 376 (1975); Adams, *Homestead Legislation in California*, 9 Pac. L.J. 723 (1978) (prepared by Commission consultant).

6. See Taylor v. Madigan, 53 Cal. App. 3d 943, 968, 126 Cal. Rptr. 376 (1975).

7. See 1974 Cal. Stat. ch. 1251, superseded by a revised but similar procedure, 1976 Cal. Stat. ch. 1000.

8. See Prob. Code §§ 60, 6520-6528; *Recommendation Relating to Probate Homestead*, 15 Cal. L. Revision Comm'n Reports 401 (1980).

ally where property is levied on to enforce a money judgment, the debtor is given notice of levy and must make an exemption claim within 10 days.⁹ A creditor who levies on a “dwelling,”¹⁰ which may be an exempt homestead, may not have it sold to enforce a money judgment without first obtaining a court order for sale. The creditor must apply for the order for sale within 20 days after notice of levy is served on the judgment debtor.¹¹ The judgment creditor’s application is not simple: the creditor must determine whether the county tax assessor’s records show a current homeowner’s exemption or disabled veteran’s exemption, must state on information and belief whether the dwelling is a homestead, the amount of the exemption, and whether there is a homestead declaration recorded, and must state the amount of liens and encumbrances and the address of other lien creditors and encumbrancers as shown in the recorder’s files.¹² The creditor must give notice of the application, including personal service on any occupant, at least 30 days before the hearing.¹³ At the hearing, the creditor has the burden of showing the dwelling is not exempt if there is a tax exemption on file in the tax assessor’s office; otherwise, the burden is on the debtor to prove the exempt status.¹⁴ The property is appraised, and if it is of sufficient value, it is ordered to be sold. Notice of the sale cannot be given until at least 120 days after the notice of levy.¹⁵ Ultimately, the homestead cannot be sold unless the bid exceeds the amount of the applicable homestead exemp-

9. Section 703.520.

10. A detailed definition of “dwelling” is set out in Section 704.710.

11. Sections 704.740-704.750.

12. Section 704.760.

13. Section 704.770.

14. Section 704.780(a). This delay affords an opportunity for the debtor to redeem from the lien.

15. Section 701.545.

tion plus the amount necessary to satisfy all liens and encumbrances on the property, and the price must be 90 percent of the appraised value unless the court orders otherwise.¹⁶ Proceeds of a sale are distributed first to pay off “all liens and encumbrances,” second to the debtor in the amount of the exemption, third to the levying officer for costs, and finally to the judgment creditor to apply to the judgment.¹⁷

This procedure is highly protective of debtors’ homesteads. There are multiple notices, including personal service, built-in delays and a second chance proceeding, significant procedural burdens, appraisals with presumptive minimum bids, and burden shifting. In light of these protections, there is no need for a separate homestead declaration procedure.

Modern Declared Homestead Exemption

The minimal declared homestead procedure that has existed since 1982 is largely a formality. A homeowner or spouse of a homeowner may record a homestead declaration describing the principal dwelling. The declaration must be acknowledged in the manner of a conveyance of real property.¹⁸ Unlike its predecessor, the modern homestead declaration has no effect on the right to convey or encumber the property.¹⁹ Nor does it prevent creation of judgment liens.²⁰ It does not prevent attachment liens²¹ or state tax liens.²²

While the real homestead protection lies in the automatic exemption statute, the homestead declaration provides several

16. Section 704.800.

17. Section 704.850.

18. Sections 704.920-704.930.

19. Section 704.940.

20. Section 704.950(c).

21. Section 487.025.

22. Gov’t Code § 7170(a).

distinct features that must be evaluated before the procedure can be repealed:

1. *Judgment lien attaches only to surplus value.* Section 704.950 is a major source of confusion. Subdivision (a) provides that judgment liens do not attach to property subject to a prior homestead declaration, seemingly preserving the old shield rule. However, subdivision (a) is subject to the exception provided in subdivision (c), which provides that a judgment lien *does* attach to the surplus value of the property over all senior liens and encumbrances plus the homestead exemption amount. Thus, the exception in subdivision (c) eats up the rule in subdivision (a).²³

This section presents a conceptual conundrum. How can it be determined whether the judgment lien has attached? The amount of the homestead exemption can change, as well as the amount of senior liens. A judgment lien attaches to any property owned or acquired by a debtor in the county where the abstract of judgment is recorded; it is a “dragnet” lien and is not directed at particular property.²⁴ How can it be determined when the lien attaches since the value of the property is unknown in the absence of a sale or appraisal? Section 704.950(a) provides that the lien does not attach, subject to the exception in subdivision (c). Subdivision (c) provides that the lien attaches to the surplus value, but does not say when the lien attaches. Arguably it attaches only when the surplus value exists. Section 704.965 locks in the exemption amount at the time when the lien attaches, but when is that?

This rule, then, does not appear to provide any clear advantage to the homestead declaration. Theoretically, it might be easier to sell real property free of the judgment lien if there

23. Subdivision (c) was added to Section 704.950 at the last opportunity when the bill was before the Legislature, as is evident from the Comment which was not revised to reflect the final statutory language.

24. See Section 697.340.

were a prior homestead declaration recorded, assuming that the debtor's equity in the property was agreed by all parties to be less than the homestead exemption amount at the time of transfer. But this does not appear to be a practical advantage, and does not justify continuing the cumbersome homestead declaration procedure.

2. *Exemption of proceeds of voluntary sale.* Section 704.960(a) protects the proceeds of a voluntary sale of the homestead for six months after the date of sale.²⁵ The automatic homestead exemption protects proceeds of sale, but only where the homestead is sold at an execution sale, is damaged or destroyed, or is acquired for public use — in other words, not in the case of a voluntary sale.²⁶ The proceeds exemption is limited, however, so that it does not include any increase in the exemption occurring after a judgment lien attaches.²⁷ This is consistent with the general rule that the amount of an exemption is determined according to the law in effect when the creditor's lien attaches to the property.²⁸

25. The voluntary sale proceeds exemption originated in 1911. See former Civ. Code § 1265, as amended by 1911 Cal. Stat. ch. 45, § 1. The proceeds exemption remained essentially unchanged until it was replaced by Section 704.960 in 1982. See 1982 Cal. Stat. ch. 497, § 8; 1982 Cal. Stat. ch. 1364, § 2.

26. See Section 704.720(b).

27. Section 704.965. This rule was added to the law in conjunction with a bill increasing the amount of the homestead exemption. See 1984 Cal. Stat. ch. 454. The limitation in Section 704.965 is irrelevant to the homestead exemption as applied in a forced sale by the judgment creditor. See Section 704.970(b). If a second homestead is purchased with exempt proceeds limited by the rule in Section 704.965, it appears that the exemption of voluntary sale proceeds from the second homestead would also be limited to the level locked in by the order of recording the judgment lien and initial homestead declaration. Similarly, if the homestead declaration had been recorded before any attachment or judgment lien, the debtor would have the benefit of any increased exemption amounts based solely on order of recording.

28. Section 703.050. See also Section 703.060 (liens deemed granted by statute in recognition of power of state to repeal, alter, or add to exemptions).

Under existing law, a sufficiently sophisticated debtor would simply record a homestead declaration before a voluntary sale of the home and thereby protect the proceeds for six months in the amount applicable when the creditor's lien attached. The Commission can envision no public policy that is served by the formality of recording a declaration in such circumstances. The creditor cannot prevent the recording of the declaration. The proceeds exemption follows mechanically from the act of recording a piece of paper. The specific amount of the voluntary proceeds exemption depends on the fortuity of the order in which the debtor and the creditor record their respective papers. The recording has no relation to any other act. It is not reviewed and notice is not given. It is not subject to contest at the time of recording. The protection of voluntary sale proceeds depends solely on the arbitrary factor of whether the debtor has remembered to record a paper, a paper which will then clutter up the public records for years, since it describes as a homestead property that the debtor intends to sell shortly after the declaration is recorded.

The justification for the reforms of the old homestead declaration, which resulted in the modern automatic homestead exemption, apply as well to the exemption of proceeds. Since a prior judgment lien does not prevent recording a homestead declaration with its attendant voluntary sale proceeds exemption, the proceeds exemption should be incorporated into the automatic homestead exemption. The better procedure is the general one — proceeds of a voluntary sale are exempt for six months following sale and the burden is on the debtor to prove the exemption and trace the proceeds.²⁹ Consistent with general principles,³⁰ the exemption amount would be deter-

29. For the general rules applicable to proceeds exemptions, see, e.g., Sections 703.030 (manner of claiming exemptions; effect of failure to claim), 703.080 (tracing exempt funds).

30. See Section 703.100.

mined under the law in effect at the time the judgment creditor's lien attached to the homestead.

An important limitation on the proceeds exemption should be codified. The purpose of the proceeds exemption is to enable the judgment debtor to substitute one home for another without losing the exemption.³¹

3. *Relation-back of declared homestead.* Section 704.960(b) provides a portability feature, permitting the debtor to record a homestead declaration on property acquired with proceeds from a sale of a declared homestead and continue the original recording priority in the new homestead. This applies to any exempt homestead proceeds, whether from voluntary or forced sale, or reimbursement from insurance, so long as the new declaration is recorded within six-month period during which proceeds are protected.

This feature also permits the debtor to lock in the opportunity to take advantage of later statutory increases in the homestead exemption amounts.³² A person who records a homestead declaration before a creditor's lien attaches can preserve that priority and receive the benefit of increased exemptions in proceeds and in a home purchased with exempt proceeds.³³

31. *Thorsby v. Babcock*, 36 Cal. 2d 202, 205, 222 P. 2d 863 (1950); *Ortale v. Mulhern*, 58 Cal. App. 3d. 861, 864, 130 Cal. Rptr. 277 (1976).

32. See Section 704.965.

33. The exact outcome depends on the interpretation given Section 704.965. If the creditor's judgment lien attaches as of the time it is recorded, notwithstanding the language of Section 704.950(c) concerning what amount the lien attaches to (surplus over senior liens and homestead exemption amount under Section 704.730), then the problem is a simple one of comparing dates of recording. But if the creditor "obtains" a lien only at the instant that the value of the homestead actually exceeds the value of liens senior to the judgment lien at the time it was recorded plus the value of the homestead exemption — then the increased exemption, by relation back, would have the effect of forestalling the time when the judgment lien could attach to any surplus value. It is also assumed that Section 704.965 serves as an exception to the general rule in Section 703.050 that the amount of an exemption is fixed as of the time the creditor's lien is created on the property.

The general rule is that the amount of an exemption is determined under the law in effect when the creditor's lien attached to the property.³⁴ The general rule should be applied to homesteads, independent of the fortuity of whether a homestead declaration may have been filed.

4. *Continuation of homestead after death.* Section 704.995 provides that the protection of the declared homestead from a creditor having an attachment lien, execution lien, or judgment lien continues after the death of the declared homestead owner if the dwelling was the principal dwelling of the surviving spouse or a member of the decedent's family to whom an interest in the dwelling passes. But subdivision (c) provides that the amount of the exemption is determined under Section 704.730 in the general procedure depending on the circumstances of the case at the time the amount is required to be determined.³⁵ Where special protection of the family home is appropriate, the probate homestead is the better procedure.³⁶ The existing homestead declaration procedure provides no meaningful, additional protection in the case of enforcement proceedings. Section 704.995 harks back to a time when the declared homestead created important rights in homestead property that could descend to the survivors even contrary to a testamentary disposition.

5. *Prima facie evidence.* Section 704.940 provides that the homestead declaration is prima facie evidence of the matters stated, which would include the statement that the property is the dwelling of the persons listed. Arguably, this provision may put some burden on the judgment creditor in proceedings to sell a dwelling. However, the relevant procedural provi-

34. Section 703.050.

35. This is in apparent conflict with the rule in Section 704.965.

36. See Prob. Code §§ 60, 6520-6528; *Recommendation Relating to Probate Homestead*, 15 Cal. L. Revision Comm'n Reports 401 (1980).

sions do not shift the burden to the creditor as in the case of a current homeowner's tax exemption or disabled veteran's tax exemption.³⁷ While the creditor is required to determine and report whether there is homestead declaration³⁸ as part of the procedure for obtaining an order for sale of a dwelling, no statutory duty results from the report.

Problems Created by Separate Homestead Declaration Procedure

The declared homestead provisions present a number of problems which should be weighed against any claimed advantages:

1. *Uncertainty.* The one feature a declared homestead procedure based on filing with the county recorder should have is certainty — yet no one can rely on the validity of a homestead declaration. The filing sits in the records, but has little meaning unless it is tested in execution proceedings. The debtor may have moved to another residence or the debtor's marriage may be dissolved. A later declaration as to different property acts as an abandonment *pro tanto* of the interest of the declarant.³⁹ Thus, if spouses choose to live apart, and a second (or second and third) declaration is recorded, the first declaration becomes meaningless.

2. *Illusory protection.* The homestead declaration provides little real protection for the family home. The most important protections (other than the voluntary sale proceeds exemption) are embodied in the automatic homestead. The homestead declaration can only give a false sense of security. In any event, most homeowners have no need for the protection, because most homeowners never become judgment debtors. If

37. See Section 704.780.

38. Section 704.760(b).

39. Section 704.990(b).

they do become judgment debtors, the statute should provide essential protections without regard to whether a paper may have been filed at some time in the past.

3. *Opportunity for misleading homestead declaration mills.* Anyone who has purchased a house in recent years has probably received one or more solicitations from the homestead declaration mills.⁴⁰ Experience with these dubious operations, whose broadsides typically misrepresent the law, impelled the Legislature to enact a consumer protection statute governing homestead filing services.⁴¹ One operator who ran afoul of the statute mailed approximately four million solicitations in a four-year period *after* enactment of the regulatory statute.⁴² Repeal of the declared homestead would put an end to the opportunity to profit from causing undue alarm and confusing homeowners throughout the state.

Satisfaction of Other Liens and Encumbrances

The minimum bid in the sale of a homestead must include an amount sufficient to satisfy “all liens and encumbrances on the property.”⁴³ This language is an artifact surviving from the time when a judgment lien could not attach if there was a prior homestead declaration on record.⁴⁴ Notwithstanding the

40. See Arthur M. Louis, *Homesteading Scam Targets Unwary Homeowners*, San Francisco Chronicle, Sept. 19, 1994, at B1, B3. For a sample solicitation from Morse & Associates, see Memorandum 95-22, Exhibit pp. 22-24, on file with California Law Revision Commission. The text of the solicitation is also set out in Appendix A to *In re Morse*, 11 Cal. 4th 184, 900 P.2d 1170, 44 Cal. Rptr. 2d 620, 637-39 (1995).

41. See Bus. & Prof. Code § 17537.6.

42. See *People v. Morse*, 21 Cal. App. 4th 259, 25 Cal. Rptr. 2d 816 (1993); see also *In re Morse*, 11 Cal. 4th 184, 900 P.2d 1170, 44 Cal. Rptr. 2d 620 (1995).

43. Section 704.800.

44. See discussions of prior law in *Tentative Recommendation Proposing the Enforcement of Judgments Law*, 15 Cal. L. Revision Comm’n Reports 2001,

prior homestead declaration, however, the creditor could seek enforcement of the money judgment by writ of execution. If the property was sold on execution without a pre-existing judgment lien in favor of the creditor, there would be no junior liens practically speaking, and *all* the other liens on the property, whether mortgage liens, tax liens, other judgment liens, would be superior to the creditor's execution lien. If the creditor had won the race to the recorder's office and the judgment lien had attached first, then there would be no application of the "all liens and encumbrances" language since the homestead exemption would not apply. Instead, the various lienors would have had an opportunity to engage in several rounds of redemptions, with junior lienholders redeeming from their seniors and the debtor redeeming where possible.

Under existing law, the "all liens and encumbrances" language can act in an arbitrary and unreasonable manner, benefiting the profligate or severely unlucky debtor. If a debtor has enough liens on the property, no creditor can reach it because any creditor would have to pay off all other liens, junior and senior, under the terms of the statute. On the other side of the coin, the home of a more responsible debtor would not be as hard to reach.

Recommendations ⁴⁵

Continuation of voluntary sale proceeds exemption. The Commission proposes repealing the declared homestead exemption and amending the automatic homestead exemption to protect proceeds of a voluntary sale for a six-month period on the same basis as other homestead proceeds are protected. Dwelling proceeds would be exempt to the extent traceable in

2094 (1980); Adams, *Homestead Legislation in California*, 9 Pac. L.J. 723 (1978); Taylor v. Madigan, 53 Cal. App. 3d 943, 126 Cal. Rptr. 376 (1975).

45. Additional technical revisions would also be made. These changes are noted in the Comments to the sections in the proposed legislation, *infra*.

deposit accounts and cash or its equivalent, with the burden on the exemption claimant to prove the exemption.

Limitation on use of proceeds. Exempt proceeds would be held as agreed by the debtor and creditor or deposited in a controlled account subject to the limitation that the funds could be applied only to a new qualifying homestead or to satisfaction of the judgment. This rule is consistent with the purpose of the exemption to protect a home for the debtor and the debtor's family. During the six-month period, the exempt fund would continue to be subject to unsatisfied liens on the homestead.

Priority treatment of support enforcement. The proceeds from a voluntary sale of a homestead should presumptively be subject to enforcement of judgments for child, family, or spousal support. However, if a support obligor has other obligations for child, family, or spousal support, the support obligor should be able to seek a court order on noticed motion for an equitable determination of the extent to which the exemption should apply.⁴⁶

Elimination of "all liens and encumbrances" rule. The statute should be revised to require satisfaction of *senior* liens and encumbrances, rather than *all* liens and encumbrances on the property, and junior liens would be extinguished, consistent with the general rule applicable to execution sales.

46. This proposal rectifies a confusing aspect of the existing statutes. Under general exemption rules provided in Section 703.070, exemptions apply to enforcement of child, family, or spousal support unless the support obligee obtains an order for the equitable determination of the extent to which the exemption can be applied to the support obligation. However, under Section 704.950(b), a homestead declaration does not apply to a judgment lien created by recording a support judgment. The full implications of this section are unclear, but it has been interpreted in practice to mean that there is no exemption of proceeds of a voluntary sale of a homestead.

PROPOSED LEGISLATION

Bus. & Prof. Code § 17537.6 (repealed). Homestead filing service regulation

SECTION 1. Section 17537.6 of the Business and Professions Code is repealed.

~~17537.6. (a) It is unlawful for any person to make any untrue or misleading statements in any manner in connection with the offering or performance of a homestead filing service. For the purpose of this section, an “untrue or misleading statement” means and includes any representation that any of the following is true:~~

~~(1) The preparation or recordation of a homestead declaration will in any manner prevent the forced sale of a judgment debtor’s dwelling.~~

~~(2) The preparation or recordation of a homestead declaration will prevent the foreclosure of a mortgage, deed of trust, or mechanic’s lien.~~

~~(3) Any of the provisions relating to the homestead exemption set forth in Article 4 (commencing with Section 704.710) of Chapter 4 of Division 2 of Title 9 of Part 2 of the Code of Civil Procedure are available only to persons who prepare or record a homestead declaration.~~

~~(4) A homestead declaration is in any way related to the obtaining of any applicable homeowner’s exemption to real property taxes.~~

~~(5) The preparation or recordation of a homestead declaration is required by law in any manner.~~

~~(6) The offeror of the homestead filing service has a file or record covering a person to whom a solicitation is made.~~

~~(7) The offeror of the homestead filing service is, or is affiliated with, any charitable or public service entity unless the offeror is, or is affiliated with, a charitable organization~~

~~which has qualified for a tax exemption under Section 501(c)(3) of the Internal Revenue Code.~~

~~(8) The offeror of the homestead filing service is, or is affiliated with, any governmental entity. A violation of this paragraph includes, but is not limited to, the following:~~

~~(A) The misleading use of any governmental seal, emblem, or other similar symbol.~~

~~(B) The use of a business name including the word "homestead" and the word "agency," "bureau," "department," "division," "federal," "state," "county," "city," "municipal," "California," or "United States," or the name of any city, county, city and county, or any governmental entity.~~

~~(C) The use of an envelope that simulates an envelope containing a government check, tax bill, or government notice or an envelope which otherwise has the capacity to be confused with, or mistaken for, an envelope sent by a governmental entity.~~

~~(b)(1) It is unlawful to offer to perform a homestead filing service without making the following disclosure:~~

~~THIS HOMESTEAD FILING SERVICE IS NOT ASSOCIATED WITH ANY GOVERNMENT AGENCY.~~

~~YOU DO NOT HAVE TO RECORD A HOMESTEAD DECLARATION.~~

~~RECORDING A HOMESTEAD DECLARATION DOES NOT PROTECT YOUR HOME AGAINST FORCED SALE BY A CREDITOR. YOU MAY WISH TO CONSULT A LAWYER ABOUT THE BENEFITS OF RECORDING A HOMESTEAD DECLARATION.~~

~~IF YOU WANT TO RECORD A HOMESTEAD, YOU CAN FILL OUT A HOMESTEAD DECLARATION FORM BY YOURSELF, HAVE YOUR SIGNATURE NOTARIZED, AND HAVE THE FORM RECORDED BY THE COUNTY RECORDER.~~

~~(2) The disclosure specified in paragraph (1) shall be placed at the top of each page of every advertisement or promotional material disseminated by an offeror of a homestead filing service and shall be printed in 12-point boldface type enclosed in a box formed by a heavy line.~~

~~(3) The disclosure specified in paragraph (1) shall be recited at the beginning of every oral solicitation and every broadcast advertisement and shall be delivered in printed form as prescribed by paragraph (2) before the time each person who responds to the oral solicitation or broadcast advertisement is obligated to pay for any service.~~

~~(c) In addition to any other service, every offeror of a homestead filing service shall deliver each notarized homestead declaration to the appropriate county recorder for recordation as soon as needed or required by a homestead declarant, but no later than 10 days after the homestead declaration is notarized. The offeror of the homestead filing service shall pay all fees charged in connection with the notarization and recordation of the homestead declaration.~~

~~(d) No offeror of a homestead filing service shall charge, demand, or collect any money until after the homestead declaration is recorded. The total amount charged, demanded, or collected by an offeror of a homestead filing service, including all fees for notarization and recordation, shall not exceed twenty-five dollars (\$25).~~

~~(e) For the purposes of this section, the following definitions apply:~~

~~(1) "Homestead filing service" means any service performed or offered to be performed for compensation in connection with the preparation or completion of a homestead declaration or in connection with the assistance in any manner of another person to prepare or complete a homestead declaration. "Homestead filing service" does not include any service performed by an attorney at law authorized to practice~~

~~in this state for a client who has retained that attorney or an employee of that attorney acting under the attorney's direction and supervision.~~

~~(2) A "homestead declaration" has the meaning described in Article 5 (commencing with Section 704.910) of Chapter 4 of Division 2 of Title 9 of Part 2 of the Code of Civil Procedure.~~

Comment. Former Section 17537.6 is superseded by new Section 17537.6.

Bus. & Prof. Code § 17537.6 (added). Unlawful to offer homestead filing service

SEC. 2. Section 17537.6 is added to the Business and Professions Code, to read:

17537.6. (a) On and after January 1, 1997, it is unlawful for any person to offer a homestead filing service.

(b) For the purposes of this section, the following definitions apply:

(1) "Homestead filing service" means any service performed or offered to be performed for compensation in connection with the preparation or completion of a homestead declaration or in connection with the assistance in any manner of another person to prepare or complete a homestead declaration.

(2) A "homestead declaration" has the meaning provided in former Article 5 (commencing with Section 704.910) of Chapter 4 of Division 2 of Title 9 of Part 2 of the Code of Civil Procedure.

Comment. Section 17537.6 reflects the repeal of the homestead declaration procedure. See also Code Civ. Proc. § 694.090 (effect of homestead declaration under former law).

Code Civ. Proc. § 487.025 (repealed). Right to attach declared homestead

SEC. 3. Section 487.025 of the Code of Civil Procedure is repealed:

~~487.025. (a) The recording of a homestead declaration (as defined in Section 704.910) does not limit or affect the right of a plaintiff to attach the declared homestead described in the homestead declaration, whether the homestead declaration is recorded before or after the declared homestead is attached.~~

~~(b) An attachment lien attaches to a homestead (as defined in Section 704.710) in the amount of any surplus over the total of the following:~~

~~(1) All liens and encumbrances on the homestead at the time the attachment lien is created.~~

~~(2) The homestead exemption set forth in Section 704.730.~~

~~(c) Nothing in subdivision (a) or (b) limits the right of the defendant to an exemption under subdivision (b) of Section 487.020.~~

~~(d) Notwithstanding subdivision (b), a homestead (as defined in Section 704.710) is exempt from sale to the extent provided in Section 704.800 when it is sought to be sold to enforce the judgment obtained in the action in which the attachment was obtained.~~

Comment. Section 6528 is repealed because it is not necessary in view of the repeal of the homestead declaration procedure. See also Code Civ. Proc. § 694.090 (effect of homestead declaration under former law).

Code Civ. Proc. § 694.090 (amended). Effect of homestead declaration

SEC. 4. Section 694.090 of the Code of Civil Procedure is amended to read:

694.090. On and after the operative date *January 1, 1997*, a declaration of homestead made under prior law pursuant to Title 5 (commencing with Section 1237) of Part 4 of Division 2 of the Civil Code is effective only to the extent provided in

or Article 5 (commencing with Section 704.910) of Chapter 4 of Division 2 *of this code is ineffective.*

Comment. Section 694.090 is amended to reflect the repeal of the homestead declaration procedure in Sections 704.910-704.995. The homestead exemption is governed by Sections 704.710-704.860. The protection of voluntary sale proceeds under the former homestead declaration procedure is continued in Section 704.720.

Code Civ. Proc. § 703.145 (added). Homestead exemption in bankruptcy

SEC. 5. Section 703.145 is added to the Code of Civil Procedure, to read:

703.145. For the purpose of subdivision (a) of Section 703.140, the amount of and qualifications for the homestead exemption shall be determined under Article 4 (commencing with Section 704.710) without regard to the procedural rules, the rules governing the rights of judgment creditors, and other limitations and conditions provided by that article.

Comment. Section 703.145 is new. This section is intended to avoid problems in applying the state homestead exemption in bankruptcy pursuant to Section 703.140. Substantive rules are applied but not procedural rules, since the procedural rules are designed for use in state money judgment enforcement proceedings. For bankruptcy purposes, only the substantive rules governing the homestead exemption are borrowed. Thus, the amount of the exemption is determined based on the bankrupt's personal circumstances under Section 704.730. If proceeds are claimed as exempt in bankruptcy proceedings, the protection provided in Section 704.720 would apply, but is not limited to six months or for the purpose of purchasing another qualifying homestead. Similarly, the rules concerning creditors' rights and agreements between debtors and creditors should not apply in the bankruptcy context.

Code Civ. Proc. § 704.720 (amended). Homestead exemption

SEC. 6. Section 704.720 of the Code of Civil Procedure is amended to read:

704.720. (a) A homestead is exempt from *enforcement of a money judgment as provided in this article and is exempt*

from sale under this division to the extent provided in Section 704.800.

(b) The proceeds from a disposition of a homestead are exempt for the purpose of purchasing another qualifying homestead under the following conditions:

(1) If a homestead is sold under this division or is damaged or destroyed or is acquired for public use, the proceeds of sale or of insurance or other indemnification for damage or destruction of the homestead or the proceeds received as compensation for a homestead acquired for public use are exempt in the amount of the homestead exemption provided in Section 704.730. ~~The proceeds are exempt for a period of six months after the time date the proceeds are actually received by or become payable in an amount certain to the judgment debtor, whichever is the earlier date except that, if a homestead exemption is applied to other property of the judgment debtor or the judgment debtor's spouse during that period, the proceeds thereafter are not exempt.~~

(2) If a homestead is voluntarily sold, or otherwise sold in a manner not described in paragraph (1), the proceeds of sale are exempt in the amount of the homestead exemption provided in Section 704.730 for a period of six months after the date of sale.

(3) If a homestead exemption is applied to other property of the judgment debtor or the judgment debtor's spouse during the six-month period provided in paragraph (1) or (2), the proceeds exemption terminates.

(c) If the judgment debtor and spouse of the judgment debtor reside in separate homesteads, only the homestead of one of the spouses is exempt and only the proceeds of the exempt homestead are exempt.

(d) The exemption of proceeds provided in paragraph (2) of subdivision (b) does not apply to the enforcement of a judgment for child, family, or spousal support, unless the

judgment debtor has other obligations for child, family, or spousal support and obtains an order, on noticed motion, that all or part of the proceeds are exempt. In making this determination, the court shall apply the standards provided in subdivision (c) of Section 703.070.

(e) Except as otherwise agreed by the judgment debtor and judgment creditor, if an exemption is claimed for proceeds under this section, the proceeds shall be deposited with the court, or held in a controlled deposit account, subject to the judgment creditor's lien. At any time during the applicable six-month exemption period provided in subdivision (b), the court shall, on noticed motion of the judgment debtor, make an order applying all or part of the proceeds to the purchase of another dwelling that qualifies for a homestead exemption under this article. Unless the judgment debtor purchases another dwelling that qualifies for a homestead exemption under this article during the six-month exemption period, the court, on noticed motion, shall order the proceeds applied to the satisfaction of the judgment.

(f) The proper court for filing motions under this section is the court where an application for an order of sale of the dwelling would be made under Section 704.750.

Comment. Subdivision (a) of Section 704.720 is revised for clarity and for consistency with other exemption provisions. See, e.g., Sections 703.010, 704.010, 704.020.

Subdivision (b) is amended to adopt as a general rule the exemption for proceeds of voluntary sales under former Section 704.960 (homestead declaration). Subdivision (b)(3) is generalized from the last clause of former subdivision (b) of this section. See also Section 703.080 (tracing exempt funds).

Subdivision (d) is a new provision that implements the application of the general rule on equitable division of exemptions in Section 703.070 in a situation where the judgment debtor has multiple support obligees. Unlike the general rule, however, subdivision (d) places the burden on the judgment debtor to file the motion and seek the court order.

Subdivision (e) provides a new procedure for claiming the proceeds exemption and restricting the availability of the funds to the purpose of

acquiring a new homestead. Accordingly, during the six-month period during which proceeds are exempt, the money is held in a court account or other controlled account for the purchase of another homestead that qualifies under this article. The judgment creditor's lien priority is preserved on the proceeds during the six-month period. If the proceeds have been levied upon after they were received by the judgment debtor, such as in a case where the debtor has deposited the proceeds in a deposit account, the general exemption procedure following levy of execution is applicable. See Section 703.510 *et seq.* The tracing rules in Section 703.080 apply to determine the extent to which a fund contains the exempt proceeds from disposition of a homestead.

Subdivision (f) specifies the proper court for proceedings under this section.

Revised Background Comment (1982). Subdivision (a) of Section 704.720 supersedes former Civil Code Section 1240 (providing for a declared homestead) and former Code of Civil Procedure Sections 690.3 and 690.31(a) (providing for a claimed dwelling exemption). Unlike the former provisions, Section 704.720 does not specify the interest that is protected and does not limit the homestead in a leasehold to a long-term lease; any interest sought to be reached by the judgment creditor in the homestead may be entitled to the exemption. The homestead exemption does not apply where a lien on the property other than an enforcement lien is being foreclosed. See Section 703.010.

Subdivision (b)(1) provides an exemption for proceeds of an execution sale of a homestead, for proceeds from insurance or indemnification for the damage or destruction of a homestead, and for an eminent domain award or proceeds of a sale of the homestead for public use. Subdivision (b)(1) supersedes portions of former Civil Code Sections 1256 and 1265 and of former Code of Civil Procedure Sections 690.8 and 690.31(k). The exemption for insurance proceeds was not found in former law. *But see* Houghton v. Lee, 50 Cal. 101, 103 (1875) (insurance proceeds for destruction of declared homestead exempt).

Subdivision (c) is new. The spouses may select which of the homesteads is exempt. If the spouses are unable to agree, the court determines which homestead is exempt. See Section 703.110 (application of exemptions to marital property). Note that a married person may, after a decree of legal separation or an interlocutory judgment of dissolution of marriage, be entitled to a homestead in his or her own right, and this right is not affected by subdivision (c). See Section 704.710(d) ("spouse" defined) & Comment.

Code Civ. Proc. § 704.760 (amended). Contents of application for sale of dwelling

SEC. 7. Section 704.760 of the Code of Civil Procedure is amended to read:

704.760. The judgment creditor's application shall be made under oath, shall describe the dwelling, and shall contain all of the following:

(a) A statement whether or not the records of the county tax assessor indicate that there is a current homeowner's exemption or disabled veteran's exemption for the dwelling and the person or persons who claimed ~~any such~~ *the* exemption.

(b) A statement, which may be based on information and belief, whether the dwelling is a homestead and the amount of the homestead exemption, if any, ~~and a statement whether or not the records of the county recorder indicate that a homestead declaration under Article 5 (commencing with Section 704.910) that describes the dwelling has been recorded by the judgment debtor or the spouse of the judgment debtor.~~

(c) A statement of the amount of any liens or encumbrances on the dwelling, the name of each person having a lien or encumbrance on the dwelling, and the *person's* address of ~~such person~~ used by the county recorder for the return of the instrument creating ~~such~~ *the* person's lien or encumbrance after recording.

Comment. Subdivision (b) of Section 704.760 is amended to delete the obsolete reference to the repealed homestead declaration procedure. See also Section 694.090 (effect of homestead declarations under prior law). The other changes are technical, nonsubstantive revisions.

Code Civ. Proc. § 704.780 (amended). Hearing

SEC. 8. Section 704.780 of the Code of Civil Procedure is amended to read:

704.780. (a) The burden of proof at the hearing is determined in the following manner:

(1) If the records of the county tax assessor indicate that there is a current homeowner's exemption or disabled veteran's exemption for the dwelling claimed by the judgment debtor or the judgment debtor's spouse, the judgment creditor has the burden of proof that the dwelling is not a homestead. If the records of the county tax assessor indicate that there is not a current homeowner's exemption or disabled veteran's exemption for the dwelling claimed by the judgment debtor or the judgment debtor's spouse, the burden of proof that the dwelling is a homestead is on the person who claims that the dwelling is a homestead.

(2) If the application states the amount of the homestead exemption, the person claiming the homestead exemption has the burden of proof that the amount of the exemption is other than the amount stated in the application.

(b) The court shall determine whether the dwelling is exempt. If the court determines that the dwelling is exempt, the court shall determine the amount of the homestead exemption and the fair market value of the dwelling. The court shall make an order for sale of the dwelling subject to the homestead exemption, unless the court determines that the sale of the dwelling would not be likely to produce a bid sufficient to satisfy any part of the amount due on the judgment pursuant to Section 704.800. The order for sale of the dwelling subject to the homestead exemption shall specify the amount of the proceeds of the sale that is to be distributed *pursuant to Section 704.850* to each person having a lien or encumbrance on the dwelling *that is superior to the judgment creditor's lien*, and shall include the name and address of

each such person. Subject to the provisions of this article, the sale is governed by Article 6 (commencing with Section 701.510) of Chapter 3. If the court determines that the dwelling is not exempt, the court shall make an order for sale of the property in the manner provided in Article 6 (commencing with Section 701.510) of Chapter 3.

(c) The court clerk shall transmit a certified copy of the court order (1) to the levying officer and (2) if the court making the order is not the court in which the judgment was entered, to the clerk of the court in which the judgment was entered.

(d) The court may appoint a qualified appraiser to assist the court in determining the fair market value of the dwelling. If the court appoints an appraiser, the court shall fix the compensation of the appraiser in an amount determined by the court to be reasonable, not to exceed similar fees for similar services in the community where the dwelling is located.

Comment. Subdivision (b) of Section 704.780 is amended to make clear that only liens with priority over the judgment creditor's lien, upon which the property is to be sold, are entitled to satisfaction from the proceeds of sale. See also Sections 704.800 (minimum bid), 704.850 (distribution of proceeds).

Code Civ. Proc. § 704.800 (amended). Minimum bid at sale of homestead

SEC. 9. Section 704.800 of the Code of Civil Procedure is amended to read:

704.800. (a) If no bid is received at a sale of a homestead pursuant to a court order for sale that exceeds the amount of the homestead exemption plus any additional amount necessary to satisfy all liens and encumbrances on the property, including but not limited to any attachment or judgment lien, *that are superior to the judgment creditor's lien*, the homestead shall not be sold and shall be released and is not thereafter subject to a court order for sale upon

subsequent application by the same judgment creditor for a period of one year *after the date set for the sale*.

(b) If no bid is received at the sale of a homestead pursuant to a court order for sale that is 90 percent or more of the fair market value determined pursuant to Section 704.780, the homestead shall not be sold unless the court, upon motion of the judgment creditor, does one of the following:

(1) Grants permission to accept the highest bid that exceeds the amount of the minimum bid required by subdivision (a).

(2) Makes a new order for sale of the homestead.

Comment. Subdivision (a) of Section 704.800 is amended to provide that only liens senior to the judgment creditor's lien, taking into account any relation back, are entitled to satisfaction out of the proceeds from the sale of a dwelling under this article. See also Sections 704.780 (hearing), 704.850 (distribution of proceeds).

Code Civ. Proc. § 704.840 (amended). Costs incurred in sale proceedings

SEC. 10. Section 704.840 of the Code of Civil Procedure is amended to read:

704.840. (a) Except as provided in subdivision (b), the judgment creditor is entitled to recover reasonable costs incurred in a proceeding under this article.

(b) If no bid is received at a sale of a homestead pursuant to a court order for sale that exceeds the amount of the homestead exemption plus any additional amount necessary to satisfy all liens and encumbrances on the property *that are superior to the judgment creditor's lien*, the judgment creditor is not entitled to recover costs incurred in a proceeding under this article or costs of sale.

Comment. Section 704.840 is amended for consistency with Section 704.800.

Code Civ. Proc. § 704.850 (amended). Distribution of proceeds of sale of homestead

SEC. 11. Section 704.850 of the Code of Civil Procedure is amended to read:

704.850. (a) The levying officer shall distribute the proceeds of sale of a homestead in the following order:

(1) To the discharge of all liens and encumbrances, ~~if any,~~ on the property *that are superior to the judgment creditor's lien.*

(2) To the judgment debtor in the amount of any applicable exemption of proceeds pursuant to Section 704.720.

(3) To the levying officer for the reimbursement of the levying officer's costs for which an advance has not been made.

(4) To the judgment creditor to satisfy the following:

(A) First, costs and interest accruing after issuance of the writ pursuant to which the sale is conducted.

(B) Second, the amount due on the judgment with costs and interest, as entered on the writ.

(5) *To any other judgment creditors who have delivered writs of execution to the levying officer, accompanied by instructions to levy on the proceeds of sale, in the amounts to which the persons are entitled in order of their respective priorities.*

(6) To the judgment debtor in the amount remaining.

(b) Sections 701.820 and 701.830 apply to distribution of proceeds under this section.

Comment. Subdivision (a)(1) of Section 704.850 is amended for consistency with Section 704.800. The words "if any" are deleted as surplus. A new subdivision (a)(5) is added to permit junior creditors whose liens will be extinguished pursuant to Section 704.860 to seek satisfaction from any excess proceeds at the sale, by delivering a writ of execution and levy instructions to the levying officer. This procedure is consistent with the general rule in Section 701.810(g) (distribution of proceeds of sale or collection). Note that under the rule in Section 704.800(a) the items listed in paragraphs (1) and (2) of subdivision (a) are of equal priority since the homestead may not be sold unless all

senior liens and encumbrances are satisfied and the judgment debtor receives the full amount of the applicable exemption.

Revised Background Comment (1982). Subdivision (a) of Section 704.850 continues the priority of distribution of proceeds provided by subdivision (j) of former Section 690.31 and of former Civil Code Section 1255. This section is an exception to the general rules on distribution of proceeds provided by Section 701.810. Liens and encumbrances required to be satisfied under subdivision (a)(1) include not only preferred labor claims to be satisfied pursuant to Section 1206 and the amount of any state tax lien (as defined in Government Code Section 7162) but also any other liens and encumbrances with priority over the judgment creditor's lien.

Subdivision (b) makes clear that the general provisions governing the time for distributing proceeds (Section 701.820) and the resolution of conflicting claims to proceeds (Section 701.830) apply to the distribution of proceeds from the sale of a homestead.

Code Civ. Proc. § 704.860 (added). Extinction of liens upon sale

SEC. 12. Section 704.860 is added to the Code of Civil Procedure, to read:

704.860. If property is sold pursuant to this article, the lien under which it is sold and any liens subordinate thereto on the property sold are extinguished.

Comment. Section 704.860 is new. The rule in this section applicable to homestead sales is consistent with the general rule under Section 701.630.

Code Civ. Proc. §§ 704.910-704.995 (repealed). Declared homestead

SEC. 13. Article 5 (commencing with Section 704.910) of Chapter 4 of Division 2 of Title 9 of Part 2 of the Code of Civil Procedure is repealed.

Note. The text of Sections 704.910-704.995 is set out *infra*. See material under "Comments to Repealed Sections."

Gov't Code § 7170 (technical amendment). Attachment of tax lien

SEC. 14. Section 7170 of the Government Code is amended to read:

7170. (a) Except as provided in subdivisions (b) and (c), a state tax lien attaches to all property and rights to property whether real or personal, tangible or intangible, including all after-acquired property and rights to property, belonging to the taxpayer and located in this state. ~~A state tax lien attaches to a dwelling notwithstanding the prior recording of a homestead declaration (as defined in Section 704.910 of the Code of Civil Procedure).~~

(b) A state tax lien is not valid as to real property against the right, title, or interest of any of the following persons where the person's right, title, or interest was acquired or perfected prior to recording of the notice of state tax lien in the office of the county recorder of the county in which the real property is located pursuant to Section 7171:

(1) A successor in interest of the taxpayer without knowledge of the lien.

(2) A holder of a security interest.

(3) A mechanic's lienor.

(4) A judgment lien creditor.

(c) A state tax lien is not valid as to personal property against:

(1) The holder of a security interest in the property whose interest is perfected pursuant to Section 9303 of the Commercial Code prior to the time the notice of the state tax lien is filed with the Secretary of State pursuant to Section 7171.

(2) Any person (other than the taxpayer) who acquires an interest in the property under the law of this state without knowledge of the lien or who perfects an interest in accordance with the law of this state prior to the time that the

notice of state tax lien is filed with the Secretary of State pursuant to Section 7171.

(3) A buyer in ordinary course of business who, under Section 9307 of the Commercial Code, would take free of a security interest created by the seller.

(4) Any person (other than the taxpayer) who, notwithstanding the prior filing of the notice of the state tax lien:

(A) Is a holder in due course of a negotiable instrument.

(B) Is a holder to whom a negotiable document of title has been duly negotiated.

(C) Is a bona fide purchaser of a security.

(D) Is a purchaser of chattel paper or an instrument who gives new value and takes possession of the chattel paper or instrument in the ordinary course of business.

(E) Is a holder of a purchase money security interest.

(F) Is a collecting bank holding a security interest in items being collected, accompanying documents and proceeds, pursuant to Section 4210 of the Commercial Code.

(G) Acquires a security interest in a deposit account or in the beneficial interest in a trust or estate.

(H) Acquires any right or interest in letters of credit, advices of credit, or money.

(I) Acquires without actual knowledge of the state tax lien a security interest in or a claim in or under any policy of insurance including unearned premiums.

(J) Acquires any right or interest in property subject to a certificate of title statute of another jurisdiction under the law of which indication of a security interest on the certificate of title is required as a condition of perfection of the security interest.

(5) A judgment lien creditor whose lien was created by the filing of a notice of judgment lien on personal property with the Secretary of State prior to the time the notice of state tax

lien is filed with the Secretary of State pursuant to Section 7171.

Comment. The second sentence of Section 7170(a) is deleted in view of the repeal of the homestead declaration procedure. See also Code Civ. Proc. §§ 688.030 (exemptions from enforcement of tax), 694.090 (effect of homestead declaration under former law), 704.850 (satisfaction of liens upon execution sale of homestead).

Prob. Code § 6528 (repealed). Declared homestead

SEC. 15. Section 6528 of the Probate Code is repealed.

~~6528. Nothing in this chapter terminates or otherwise affects a declaration of homestead by, or for the benefit of, a surviving spouse or minor child of the decedent with respect to the community, quasi-community, or common interest of the surviving spouse or minor child in property in the decedent's estate. This section is declaratory of, and does not constitute a change in, existing law.~~

Comment. Section 6528 is repealed because it has no purpose in view of the repeal of the homestead declaration procedure. See also Code Civ. Proc. § 694.090 (effect of homestead declaration under former law). Repeal of this section has no effect on the ability of a surviving judgment debtor to take advantage of the homestead exemption provided in Code of Civil Procedure Sections 704.710-704.860.

COMMENTS TO REPEALED SECTIONS

Code Civ. Proc. §§ 704.910-704.995 (repealed). Declared homestead

Note. Sections 704.910-704.995 are set out below for reference purposes. A Comment to each section indicates its proposed disposition in the revised statute or its relation to the general homestead exemption provisions that supersede the homestead declaration procedure.

Article 5. Declared Homesteads

§ 704.910 (repealed). Definitions

704.910. As used in this article:

(a) “Declared homestead” means the dwelling described in a homestead declaration.

(b) “Declared homestead owner” includes both of the following:

(1) The owner of an interest in the declared homestead who is named as a declared homestead owner in a homestead declaration recorded pursuant to this article.

(2) The declarant named in a declaration of homestead recorded prior to July 1, 1983, pursuant to former Title 5 (commencing with Section 1237) of Part 4 of Division 2 of the Civil Code and the spouse of such declarant.

(c) “Dwelling” means any interest in real property (whether present or future, vested or contingent, legal or equitable) that is a “dwelling” as defined in Section 704.710, but does not include a leasehold estate with an unexpired term of less than two years or the interest of the beneficiary of a trust.

(d) “Homestead declaration” includes both of the following:

(1) A homestead declaration recorded pursuant to this article.

(2) A declaration of homestead recorded prior to July 1, 1983, pursuant to former Title 5 (commencing with former Section 1237) of Part 4 of Division 2 of the Civil Code.

(e) “Spouse” means a “spouse” as defined in Section 704.710.

Comment. Former Section 704.910 is superseded by Section 704.710.

§ 704.920 (repealed). Manner of selection of homestead

704.920. A dwelling in which an owner or spouse of an owner resides may be selected as a declared homestead pursuant to this article by recording a homestead declaration in the office of the county recorder of the county where the dwelling is located. From and after the time of recording, the dwelling is a declared homestead for the purposes of this article.

Comment. Former Section 704.920 is superseded by the homestead exemption procedure in Sections 704.710-704.860. See also Sections 694.090 (effect of homestead declaration under prior law), 704.710 (definitions).

§ 704.930 (repealed). Execution and contents of homestead declaration

704.930. (a) A homestead declaration recorded pursuant to this article shall contain all of the following:

(1) The name of the declared homestead owner. A husband and wife both may be named as declared homestead owners in the same homestead declaration if each owns an interest in the dwelling selected as the declared homestead.

(2) A description of the declared homestead.

(3) A statement that the declared homestead is the principal dwelling of the declared homestead owner or such person’s spouse, and that the declared homestead owner or such person’s spouse resides in the declared homestead on the date the homestead declaration is recorded.

(b) The homestead declaration shall be executed and acknowledged in the manner of an acknowledgment of a conveyance of real property by at least one of the following persons:

(1) The declared homestead owner.

(2) The spouse of the declared homestead owner.

(3) The guardian or conservator of the person or estate of either of the persons listed in paragraph (1) or (2). The guardian or conservator may execute, acknowledge, and record a homestead declaration without the need to obtain court authorization.

(4) A person acting under a power of attorney or otherwise authorized to act on behalf of a person listed in paragraph (1) or (2).

(c) The homestead declaration shall include a statement that the facts stated in the homestead declaration are known to be true as of the personal knowledge of the person executing and acknowledging the homestead declaration. If the homestead declaration is executed and acknowledged by a person listed in paragraph (3) or (4) of subdivision (b), it shall also contain a statement that the person has authority to so act on behalf of the declared homestead owner or the spouse of the declared homestead owner and the source of the person's authority.

Comment. Former Section 704.930 is superseded by the homestead exemption procedure in Sections 704.710-704.860.

§ 704.940 (repealed). Right to convey or encumber not limited; evidentiary effect of homestead declaration

704.940. A homestead declaration does not restrict or limit any right to convey or encumber the declared homestead. A homestead declaration, when properly recorded, is prima facie evidence of the facts therein stated, and conclusive evidence thereof in favor of a purchaser or encumbrancer in good faith and for a valuable consideration.

Comment. Former Section 704.940 is superseded by the homestead exemption procedure in Sections 704.710-704.860. See also Section 704.780 (burden of proof in hearing on homestead exemption).

§ 704.950 (repealed). Attachment of judgment lien to homestead

704.950. (a) Except as provided in subdivisions (b) and (c), a judgment lien on real property created pursuant to Article 2

(commencing with Section 697.310) of Chapter 2 does not attach to a declared homestead if both of the following requirements are satisfied:

(1) A homestead declaration describing the declared homestead was recorded prior to the time the abstract or certified copy of the judgment was recorded to create the judgment lien.

(2) The homestead declaration names the judgment debtor or the spouse of the judgment debtor as a declared homestead owner.

(b) This section does not apply to a judgment lien created under Section 697.320 by recording a certified copy of a judgment for child, family, or spousal support.

(c) A judgment lien attaches to a declared homestead in the amount of any surplus over the total of the following:

(1) All liens and encumbrances on the declared homestead at the time the abstract of judgment or certified copy of the judgment is recorded to create the judgment lien.

(2) The homestead exemption set forth in Section 704.730.

Comment. Former Section 704.950 is superseded by the homestead exemption procedure in Sections 704.710-704.860.

§ 704.960 (repealed). Proceeds exemption after voluntary sale; reinvestment of proceeds of voluntary or involuntary sale and effect of new declaration

704.960. (a) If a declared homestead is voluntarily sold, the proceeds of sale are exempt in the amount provided by Section 704.730 for a period of six months after the date of sale.

(b) If the proceeds of a declared homestead are invested in a new dwelling within six months after the date of a voluntary sale or within six months after proceeds of an execution sale or of insurance or other indemnification for damage or destruction are received, the new dwelling may be selected as a declared homestead by recording a homestead declaration

within the applicable six-month period. In such case, the homestead declaration has the same effect as if it had been recorded at the time the prior homestead declaration was recorded.

Comment. Former Section 704.960 is superseded by the homestead exemption procedure in Sections 704.710-704.860. The proceeds exemption is continued in Section 704.720(b).

§ 704.965 (repealed). Determination of amount of exemption

704.965. If a homestead declaration is recorded prior to the operative date of an amendment to Section 704.730 which increases the amount of the homestead exemption, the amount of the exemption for the purposes of subdivision (c) of Section 704.950 and Section 704.960 is the increased amount, except that, if the judgment creditor obtained a lien on the declared homestead prior to the operative date of the amendment to Section 704.730, the exemption for the purposes of subdivision (c) of Section 704.950 and Section 704.960 shall be determined as if that amendment to Section 704.730 had not been enacted.

Comment. Former Section 704.965 is superseded by the homestead exemption procedure in Sections 704.710-704.860. The principle in former Section 704.965 is applicable under the general rule in Section 703.050 (exemptions in effect at time of lien govern).

§ 704.970 (repealed). Effect of article on rights after levy of execution

704.970. Whether or not a homestead declaration has been recorded:

(a) Nothing in this article affects the right of levy pursuant to a writ of execution.

(b) Any levy pursuant to a writ of execution on a dwelling (as defined in Section 704.710) and the sale pursuant thereto shall be made in compliance with Article 4 (commencing with Section 704.710) and the judgment debtor and the judgment creditor shall have all the rights and benefits provided by that article.

Comment. Section 704.970 is repealed as unnecessary following repeal of the homestead declaration procedure. The homestead exemption is now governed exclusively by Article 4 (commencing with Section 704.710) and related rules.

§ 704.980 (repealed). Declaration of abandonment

704.980. (a) A declared homestead may be abandoned by a declaration of abandonment under this section, whether the homestead declaration was recorded pursuant to this article or pursuant to former Title 5 (commencing with former Section 1237) of Part 4 of Division 2 of the Civil Code.

(b) A declaration of abandonment shall be executed and acknowledged in the manner of an acknowledgment of a conveyance of real property. It shall be executed and acknowledged by a declared homestead owner or by a person authorized to act on behalf of a declared homestead owner. If it is executed and acknowledged by a person authorized to act on behalf of a declared homestead owner, the declaration shall contain a statement that the person has authority to act on behalf of the declared homestead owner and the source of the person's authority.

(c) The declaration of abandonment does not affect the declared homestead of any person other than the declared homestead owner named in the declaration of abandonment.

Comment. The procedure for abandonment in former Section 704.980 is obsolete in view of the repeal of the homestead declaration procedure. See also Section 694.090 (effect of homestead declarations under prior law).

§ 704.990 (repealed). Abandonment of homestead by recording homestead declaration for different property

704.990. (a) A declared homestead is abandoned by operation of law as to a declared homestead owner if the declared homestead owner or a person authorized to act on behalf of the declared homestead owner executes, acknowledges, and records a new homestead declaration for

the declared homestead owner on different property. An abandonment under this subdivision does not affect the declared homestead of any person other than the declared homestead owner named in the new homestead declaration.

(b) Notwithstanding subdivision (a), if a homestead declaration is recorded which includes property described in a previously recorded homestead declaration, to the extent that the prior homestead declaration is still valid, the new homestead declaration shall not be considered an abandonment of the prior declared homestead.

Comment. Former Section 704.990 relating to abandonment is obsolete in view of the repeal of the homestead declaration procedure. See also Section 694.090 (effect of homestead declarations under prior law).

§ 704.995 (repealed). Continuation of protection after death of declared homestead owner

704.995. (a) The protection of the declared homestead from any creditor having an attachment lien, execution lien, or judgment lien on the dwelling continues after the death of the declared homestead owner if, at the time of the death, the dwelling was the principal dwelling of one or more of the following persons to whom all or part of the interest of the deceased declared homestead owner passes:

- (1) The surviving spouse of the decedent.
- (2) A member of the family of the decedent.

(b) The protection of the declared homestead provided by subdivision (a) continues regardless of whether the decedent was the sole owner of the declared homestead or owned the declared homestead with the surviving spouse or a member of the decedent's family and regardless of whether the surviving spouse or the member of the decedent's family was a declared homestead owner at the time of the decedent's death.

(c) The amount of the homestead exemption is determined pursuant to Section 704.730 depending on the circumstances

of the case at the time the amount is required to be determined.

Comment. Former Section 704.995 is superseded by the homestead exemption procedure in Sections 704.710-704.860. The general homestead exemption applies with full force to the interest of the survivor, consistent with the rule in subdivision (c). Additional protection is provided by the probate homestead procedure. See Prob. Code §§ 6520-6527.

REVISED COMMENT

Code Civ. Proc. § 704.710 (revised comment). Definitions

Revised Background Comment (1982). Subdivision (a) of Section 704.710 supersedes the provisions of former law pertaining to the property that could be exempt as a homestead or dwelling. See former Civ. Code § 1237 (declared homestead); former Code Civ. Proc. §§ 690.3 (house trailer, mobile home, houseboat, boat, or other waterborne vessel), 690.31(a) (dwelling house). Subdivision (a) is intended to include all forms of property for which an exemption could be claimed under former law and any other property in which the judgment debtor or the judgment debtor's spouse actually resides.

Subdivision (b) continues the substance of former Civil Code Section 1261(2) except that the minor grandchild of a deceased spouse and a child or grandchild of a former spouse are included in the listing.

Subdivision (c) is intended to preclude a judgment debtor from moving into a dwelling after creation of a judgment lien or after levy in order to create an exemption. Subdivision (c) also makes clear that, even though an abstract of judgment has been recorded to create a judgment lien, the existence of the lien does not prevent a homestead exemption on after-acquired property that is acquired as the principal dwelling using exempt proceeds. Subdivision (c) is an exception to the rule of Section 703.100 (time for determination of exemption).

Subdivision (d) preserves the effect of former Civil Code Sections 1300-1304 (married person's separate homestead). The effect of subdivision (d) is to permit each spouse to claim a separate homestead after entry of a judgment decreeing legal separation or of an interlocutory judgment of dissolution of the marriage, because subdivision (c) of Section 704.720 is not applicable.

Revised Background Comment (1983). Section 704.710 is amended to delete "actually" which appeared before "resides" or "resided" in various provisions. The word "actually" is deleted to avoid a possible construction that a person temporarily absent (such as a person on

vacation or in the hospital) could not claim a homestead exemption for the principal dwelling merely because the person is temporarily absent, even though the dwelling is the person's principal dwelling and residence.

January 12, 1999

To: Stan Ulrich
From: Linda Verheecke
Re: Homestead Exemption and Bankruptcy Law

You have asked me to summarize the current bankruptcy law as it relates to the California homestead exemption. Case law in this area deals with two separate issues: (1) the avoidance of judicial liens under federal bankruptcy law, and (2) the attachment of judicial liens to surplus equity under California homestead law.

Under California law, a debtor is protected by an automatic homestead exemption in the event of a forced lien sale. Code Civ. Proc. §§ 704.720(b) & 704.740(a). In the event of a voluntary sale, the debtor is protected only if he has recorded a declaration of homestead. Code Civ. Proc. § 704.960.

Section 522 of the Bankruptcy Code gives the debtor a statutory choice between a federal list of exemptions or applicable state exemptions. 11 U.S.C. § 522. California has opted out of the federal set of exemptions and instead provides the bankruptcy debtor a choice between those exemptions that are available to California judgment debtors generally, including the homestead exemption, and a list of exemptions which closely parallel the federal bankruptcy exemptions. Code Civ. Proc. § 703.140. Thus, substantive issues regarding the extent to which a debtor is entitled to an exemption are governed by California law. *In re Canino*, 185 B.R. 584, 590 (9th Cir. BAP 1995). However, once it is determined that a debtor is entitled to a certain exemption, questions concerning impairment and lien avoidance under Section 522(f) are controlled by federal law. *In re Herman*, 120 B.R. 127, 129 (9th Cir. BAP 1990).

I. AVOIDANCE OF JUDICIAL LIENS AS IMPAIRING HOMESTEAD EXEMPTION

A. The Avoidance Provisions of Section 522(f)

Section 522(f) of the Bankruptcy Code allows a bankruptcy debtor the opportunity to avoid judicial liens that impair the debtor's homestead exemption. The statute reads: "... 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 (2) a nonpossessory, nonpurchase-money security interest" 11 U.S.C. § 522(f).

In a 1991 case, the U.S. Supreme Court held that a judicial lien may be avoided under federal bankruptcy law as impairing a debtor's state law exemptions, even though the state has defined exempt property in such a way as specifically to exclude property encumbered by such liens. *Owen v. Owen*, 500 U.S. 305 (1991). The Court found that, with respect to both federal and state exemptions, bankruptcy courts should ask not whether the lien impairs an

exemption to which the debtor is in fact entitled, but whether it impairs an exemption to which he *would have been entitled* but for the lien itself.

A 1995 BAP case addressed the issue of whether a debtor can avoid the fixing of a judgment lien when the lien would have priority to the debtor's homestead exemption under state law. *In re Hastings*, 185 B.R. 811 (9th Cir. BAP 1995). The debtors in this case were not living on the property at the time the judgment lien attached, although they later moved onto the property. The lower bankruptcy court ruled that the lien was immune from and superior to the debtor's homestead rights under California law. The BAP disagreed, arguing that as when analyzing Section 522(f) lien avoidance problems as a matter of federal law, bankruptcy courts should "consider, in the abstract, whether the debtor would be entitled to an exemption under state law if the lien did not exist." 185 B.R. at 814. Applying *Owen v. Owen*, the BAP ruled that since the debtors owned the property prior to the fixing of the lien, the pre-existing lien fixed "on an interest of the debtor" and therefore impaired the homestead exemption.

B. Definition of "Impairment" Under Section 522(f)

1. Prior to Bankruptcy Reform Act of 1994

Prior to 1993, the Ninth Circuit Bankruptcy Appellate Panel (BAP) took a broad view of "impairment," holding that a bankruptcy debtor can avoid a judicial lien in its entirety if the equity in his home does not exceed the homestead exemption. *In re Galvan*, 110 B.R. 446 (Bankr. 9th Cir. 1990). This approach, which preserved the debtor's "fresh start" and had the effect of allowing the debtor any appreciation in the property after the filing of the bankruptcy petition, was followed by numerous courts. See, e.g., *In re Morgan*, 149 B.R. 147 (Bankr. 9th Cir. 1992); *In re Patterson*, 139 B.R. 229 (Bankr. 9th Cir. 1992).

This broad view of whether a judicial lien impaired a debtor's homestead exemption was changed by the Ninth Circuit Court of Appeals in *In re Chabot*, 992 F.2d 891 (9th Cir. 1993). In *Chabot*, the court held that the debtors could not avoid a judicial lien where there was surplus equity in the property even if there was insufficient equity for the entire judicial lien to attach. Many commentators criticized the *Chabot* holding as inconsistent with the fresh start purposes of the Bankruptcy Code, by failing to recognize a debtor's equitable interests such as equity of redemption, right to future equity, and right of possession, which are arguably entitled to protection under bankruptcy law. See, e.g., Schmidt, Note, *R.I.P. Chabot? Ninth Circuit Bankruptcy Debtors' Right to Avoid a Judicial Lien on a Homestead Is Still "Impaired" and the Clarification Doctrine in Doubt After In re Wilson*, 31 U.S.F. L. Rev. 1051, 1073 (1997). Under *Chabot*, any appreciation in equity, due to increase in the property value or to additional mortgage payments made by the debtor after the bankruptcy petition is filed, would accrue to the lienholder.

2. Bankruptcy Reform Act of 1994

In 1994 Congress enacted the Bankruptcy Reform Act, which included an amendment to 11 U.S.C. § 522. The new subsection 522(f)(2)(A) provides a mathematical formula for determining whether or not a debtor's homestead exemption is impaired by a lien within the meaning of Section 522. 11 U.S.C. § 522(f)(2)(A) (1994). Under the new law, a lien shall be considered to impair an exemption to the extent that the sum of the lien, all other liens on the property, and the allowable exemptions exceed the value of the debtor's interest in the property in the absence of any liens. The legislative history of the amendment indicates that Congress intended to overrule cases such as *Chabot* in which the existence of surplus equity had the result of allowing any postpetition appreciation (or equity created by mortgage payments from the debtor's postpetition income) to accrue to the benefit of the lienholder. See H.R. Rep. No. 103-835, at 52-53 (1994), cited in Schmidt, Note, *supra*.

An example of the application of the mechanical formula provided by the new law is as follows: If there is a judicial lien in the amount of \$10,000, a mortgage in the amount of \$25,000, a homestead exemption of \$7,500 (totaling \$42,500), and the value of the property is \$30,000, then the lien can be avoided in its entirety because the difference of \$12,500 exceeds the amount of the lien. If the property is worth \$42,500 or more, the exemption is not impaired and the lien cannot be avoided at all. If the property is worth \$40,000, then the lien can be avoided to the extent of \$2,500. See Waxman, *The Bankruptcy Reform Act of 1994*, 11 Bankr. Dev. J. 311, 323-24 (1995).

The House Report on the amendment to Section 522 provides another example. If the debtor has \$10,000 homestead exemption, a \$50,000 house, and a \$40,000 first mortgage, a judicial lien of \$20,000 can be avoided in its entirety because the exemption is impaired to the extent of \$20,000 (\$70,000 total liens and exemptions less \$50,000 value of the property). Under *Chabot*, the debtor could only avoid \$10,000 of the judicial lien (because there is \$10,000 surplus equity in the property), leaving the creditor after bankruptcy with a \$10,000 lien attached to the debtor's exempt interest in the property. This would result in any equity created by mortgage payments from the debtor's postpetition income going to the benefit of the lienholder. See H.R. Rep. No. 103-835, at 52-53 (1994), reprinted in 1994 U.S.C.C.A.N. 3340, 3361-52.

The Ninth Circuit determined in a 1996 case that the new provisions of the Bankruptcy Reform Act applies only in bankruptcy cases filed on or after October 22, 1994, since the statutory amendment was not made retroactive. *In re Wilson*, 90 F.3d 347 (9th Cir. 1996). Bankruptcy courts have therefore continued to apply *Chabot* in cases filed prior to October 22, 1994. See, e.g., *In re Amiri*, 184 B.R. 60 (1995) (no impairment of homestead exemption regardless of whether there was little or no equity); *In re Nielsen*, 197 B.R. 665 (1996) (no avoidance of lien if after deducting homestead exemption from debtor's fractional interest in total equity, surplus equity exists). Some commentators have argued that since the purpose of the new section was to clarify rather than to change the law, its provisions should be applied retroactively. See, e.g., Schmidt, Note, *supra*.

C. Recent Cases Applying Section 522(f)

1. Absence of Equity in Property

Applying Section 522(f)(2)(A), the BAP held in 1996 that a debtor could avoid a judicial lien even though there was no equity in the property. *In re Higgins*, 201 B.R. 965 (1996). The sum of the lien, another two liens on the property, and the amount of the exemption the debtor could claim if there were no liens, exceeded the value of the property in the absence of any liens. Therefore the lien impaired the exemption and could be avoided under Section 522(f).

2 Partial Impairment

The Ninth Circuit BAP recently reversed a lower court ruling allowing a debtor to avoid a judicial lien in its entirety even though the lien only partially impaired the homestead exemption. *In re Hanger*, 217 B.R. 592 (9th Cir. BAP, 1997). The lower bankruptcy court argued that since in passing the Bankruptcy Reform Act of 1994 Congress intended to overrule *Chabot*, the full value of a judicial lien was now avoidable if it impaired the homestead exemption at all. The BAP disagreed, holding that “Section 522(f)(1) was not intended to free the debtor’s property of judicial liens altogether; rather it was intended to preserve the debtor’s exemption.” Here, applying the calculation set forth in Section 522(f)(2)(A), the sum of the lien, all other liens, and the homestead exemption exceeded the value of the debtors’ interest in the property absent liens. The lien impaired the exemption *to the extent of the excess* of this sum over the value of the property absent liens; therefore the judicial liens could be avoided up to that amount. The court applied the formula by subtracting the liens in order of reverse priority and by adjusting the calculation for any liens avoided. The BAP noted that the result based on the new provision was different than it would have been under the *Chabot* holding, in which the calculation of impairment was based on surplus equity. Under the new law, a debtor’s interest in any postpetition appreciation would be protected because a lien would be avoided in a case where there was no equity, but where there would be equity in the absence of the liens.

3. Property Interests to Which Avoidance Applies

In a Ninth Circuit BAP case, the issue was whether a debtor can avoid a lien placed on a community property residence if the residence thereafter becomes the debtor’s separate property. *In re Stoneking*, 98 Daily Journal D.A.R. 11004 (9th Cir. BAP 1998). The court applied a 1991 case in which the U.S. Supreme Court held that a debtor may not use section 522(f) to avoid the fixing of a lien created by a divorce decree that extinguishes all previous interests the parties had in the family homestead. *Farrey v. Sanderfoot*, 500 U.S. 291 (1991). The critical inquiry in *Farrey* was whether the debtor possessed an interest to which the lien attached before the fixing of the lien. In *Stoneking*, the lien encumbered the community property of the debtor and his former spouse, in which the debtor held an interest before the lien attached. The BAP held that the debtor could therefore avoid the lien.

A 1995 bankruptcy case filed in U.S. District Court found that a debtor was entitled to claim an automatic homestead exemption in his 20% undivided interest in property held in joint tenancy with family members, even though his mother had also filed a homestead exemption on the same property. *In re Hsia*, 183 B.R. 201 (1995). The court found that under California law, each tenant of an undivided interest is entitled to select a homestead on jointly held property. 183 B.R. at 204, citing *Schoenfeld v. Norberg*, 11 Cal. App. 3d 755, 90 Cal. Rptr. 47 (1970); *Squibb v. Squibb*, 190 Cal. App. 2d 766, 12 Cal. Rptr. 346 (1961).

4. Judgment Arising Out of a Mortgage Foreclosure

11 U.S.C. Section 522(f)(2)(C) provides that the avoidance provisions of Section 522(f) do not apply with respect to a judgment arising out of a mortgage foreclosure. This “savings clause” was enacted along with the lien impairment formula in section 522(f)(2)(A) as part of the Bankruptcy Reform Act of 1994. In an appeal from the Ninth Circuit BAP, the Ninth Circuit Court of Appeals considered whether a junior lienholder whose deed of trust was extinguished by a mortgage foreclosure sale possessed a “judgment arising out of a mortgage foreclosure” within the meaning of Section 522(f)(2)(C). *In re Been*, 153 F.3d 1034 (9th Cir. 1998). The Court of Appeals agreed with the BAP finding that since the lien was extinguished by the foreclosure sale, the sold-out junior lien holder’s suit arose out of an independent action on the underlying promissory note rather than out of the mortgage foreclosure itself. Section 522(f)(2)(C) was thus inapplicable.

II. ATTACHMENT OF JUDICIAL LIENS ON HOMESTEADED PROPERTY

A separate issue from the avoidance of judicial liens under bankruptcy law is when, under California law, a judicial lien can attach to homesteaded property.

Section 704.950 of the Code of Civil Procedure provides that a judgment lien does not attach to property on which a declared homestead was recorded prior to the time the abstract judgment was recorded. However, subsection (c) of Section 704.950 provides that a judgment lien attaches to a declared homestead in the amount of surplus equity, i.e. the market value of the home in excess of all prior liens and the homestead exemption. In *In re Jones*, 106 F.3d 923 (9th Cir. 1997), a residence on which a homestead had been declared had no surplus equity when a creditor recorded its abstract of judgment, but had appreciated in value when the homeowner filed a bankruptcy petition. The Ninth Circuit held in a two-to-one decision that if no surplus equity exists at the time a judgment lien is recorded, then the lien does not attach to the property. The dissent argued that a judicial lien should attach to a declared homestead once there is equity surplus in the residence during the existence of the lien. The dissent noted that the *Jones* majority decision was not binding on state courts.

In *Teaman v. Wilkinson*, the Second District Court of Appeal agreed with the *Jones* dissent. 59 Cal. App. 4th 1262, 69 Cal. Rptr. 2d 705 (2 Dist. 1997). That

court held that a judgment creditor is entitled to reach surplus equity which accrues after the date the abstract of judgment is recorded. However, the court suggested that until surplus equity develops, the judgment lien does not attach to the declared homestead. 59 Cal. App. 4th at 1263-67.

In a 1998 case, the Fourth District Court of Appeal held that a judgment lien attaches to a homestead when the abstract of judgment is recorded and is not dependent upon the existence of surplus equity. *Smith v. Merrill*, 75 Cal. Rptr. 2d 108 (4 Dist. 1998). The court held that section 704.950(c) does not govern *when* a judgment lien attaches to a declared homestead, but only the *amount* of the lien. Thus, although the judgment lien attaches to the homestead when the abstract of judgment is recorded, the amount of the lien will vary over time pursuant to Section 704.950(c).