



New Jersey N2K Hour:

The Impacts of Bankruptcy
on Title in NJ

Presented By: Susan Bavaro

Tuesday, August 13, 2024



What is a Bankruptcy?

Legal proceeding in federal bankruptcy court seek relief from some or all of their debts

a creditor may file an involuntary petition against a debtor.

The idea is to provide creditors an opportunity to get paid, while simultaneously giving the debtor a fresh start.

The BK petition contains schedules setting forth the debtor's assets, liabilities, creditors, etc.

All the debtor's assets are then evaluated, and the assets may be used to repay a portion of the outstanding debt under a plan that is approved and confirmed by the BK TE, the court and the creditors

What is bankruptcy

The property of the debtor, which is referred to as the BK estate, passes automatically into the control of the trustee by operation of law (i.e., automatically).

When the property passes to the trustee, it does so subject to liens, claims, and rights of others in and to the property.

If property is encumbered by a mortgage or judgments or whatever, the trustee will administer the property in the same condition, with the liens, unless the trustee exercises the trustee's avoidance powers to expunge or avoid the liens which we discuss later.

Property is not washed of liens simply by passing to the bankruptcy estate

Statutory Basis of Bankruptcy Law

- Before bankruptcy laws were enacted, the only option was Debtor's prison!
- In a Debtor's prison, the debtor would work off their debt via labor, or until someone from the outside paid the debt. One of the oldest English debtor's prisons was the Clink Prison, which is also the origin of the phrase to throw someone in the clink!
- The first Bankruptcy Act was adopted in 1898.
- The 1898 BK Act remained in effect until the BK Reform Act 1978.
- The 1978 BK Act remained in effect until 2005 when the BK Abuse Prevention & Consumer Protection Act of 2005 went into effect.

Bankruptcy Abuse Prevention & Consumer Protection Act of 2005

- * A case may be dismissed for abuse, demonstrated by the totality of the circumstances or bad faith.
- * Credit Counseling requirement added.
- * Attorney accountability added: Attorney certifies having no knowledge, after an inquiry, that information in the petition is incorrect.
- * Abusive creditor practices addressed.
- * Domestic support obligations defined and made first priority and non-dischargeable.
- * New disclosure requirements for debt relief agencies.

Bankruptcy Abuse Prevention & Consumer Protection Act of 2005 (con't)

- * New exceptions to the automatic stay for proceedings concerning child custody, domestic violence and divorce not involving division of property; garnishment to pay support; interception of tax refunds for domestic support obligations; and withholding of licenses from debtors who do not pay support.
- * If a debtor files a new case after two or more dismissed cases were pending in the previous year, no automatic stay goes into effect, unless ordered by the Court, after notice and a hearing establishing that the latest case is filed in good faith.

Bankruptcy Abuse Prevention & Consumer Protection Act of 2005 (con't)



- * Maintenance and other fees arising with respect to a debtor's interest in a residential condominium, cooperative or homeowner's association are non-dischargeable for as long as the debtor has a legal, possessory, or equitable interest in such property.
- * Random audits imposed for 1 out of every 250 filings.
- * Extends the Trustee look back period to two years, so a Trustee can avoid fraudulent transfers made within two years before filing, rather than the prior one-year period.

Federal BK Laws vs. NJ Property Laws

- * For the most part, real property is governed by the laws of the state where the property sits, and that is the case in NJ also.
- * But there is one major exception to this rule: Bankruptcy – a Federal statutory enactment.
- * The power to enact laws dealing with Bankruptcy was granted to the United States Congress by the United States Constitution.
- * Federal law takes priority over state law.
- * Bankruptcy law changes the way we apply state law to real estate transactions.

Your Search Contains a Bankruptcy Return

2865061

REF: 198410315916

UNITED STATES BANKRUPTCY COURT

BANKRUPTCY NUMBER: BK-15843-2012 VOLUNTARY
PETITION FILED: 03/06/12 CHAPTER 7
ORDER FOR RELIEF: 03/06/12 PREV CHAPTER 13

IN THE MATTER OF:

WILLIAM R. TOTTEN, SSN: XXX-XX-6349
312 WARREN ST E, EDGEWATER PARK, NJ 08010
ATTORNEY: LEE MARTIN PERLMAN
LEE M. PERLMAN
1926 GREENTREE ROAD, SUITE 10 CHERRY HILL, NJ 08003
SUSAN J. TOTTEN, SSN: XXX-XX-2003
A/K/A SUSAN J. ASTORF
A/K/A SUSAN J. DIMARCO
A/K/A SUSAN J. WILDER
312 WARREN ST E, EDGEWATER PARK, NJ 08010
ATTORNEY: LEE MARTIN PERLMAN
(SEE ABOVE FOR ADDRESS),

TRUSTEE: BRIAN THOMAS
TRUSTEE APPOINTED: 06/26/2013
DISCHARGE OF DEBTOR: 10/04/2013
FINAL DECREE: 04/01/2014

*** End of Abstract ***

DIRECT HIT!

Differences Between Chapters 7, 11, 12 & 13

Chapter 7 –Anticipates liquidation of any assets owned by debtor or debtor’s business.

Wipes out personal obligation for dischargeable debts

A Chapter 7 trustee will be appointed to administer the case.

Chapter 13 – Wage earner plan, debtor pays all or part of his/her arrears over 3 to 5 years.

Only available to individuals.

Plan must be paid in full to obtain a discharge.

Debtor must also continue paying ongoing debts on time, ie., regular mortgage payments.

Chapter 11 and 12

Chapter 11 – Reorganization plan, business bankruptcy. In most Chapter 11 cases, a trustee is not appointed; rather, the debtor serves as debtor-in-possession [DIP], and exercises the powers of a trustee.

Chapter 12 – Farmers and Fishermen reorganization plan.

Chapter 11, 12 and 13 are all considered ‘reorganization’ plans.

During the course of bankruptcy proceedings, Chapter 11 and 13 cases are sometimes converted to Chapter 7 cases, or vice versa.

A Bankruptcy is not a lien

It is **NOTICE** of the existence of a bankruptcy case.

A prior BK should not be set up as an exception in your commitment.

But a BK that is still open and pending should be set up as a requirement (require proof of authority for subject transaction. More on that shortly)

A bankruptcy on the search often provides useful information in reviewing other judgments that appear on your judgment search, such as the last 4 digits of the social security number, and at least one known address associated with this person.

In a title insurance context, bankruptcy issues arise in one of three ways

- PAST - a prior bankruptcy which has been concluded;
- PRESENT - a pending or ongoing bankruptcy proceeding; and
- FUTURE - a flaw in the insured transaction which will render it subject to attack in a future bankruptcy proceeding.

Prior concluded bk

A BK case is concluded for title insurance purposes when the trustee is discharged, or when an order has been entered closing the case (and not when the debtor receives his or her personal discharge).

If it's a prior concluded BK, probably no action is needed.

Caveat:

Note the dates of the BK filing/closing vs any deed, judgment liens or any foreclosures that may be on the record, due to effects of Automatic Stay.

The Automatic Stay

United States Code 11 USC § 362

Stops all collection activity while the debtor attempts to get their affairs in order . The stop is referred to as a stay.

- “Automatic Stay” serves a couple of purposes:
breathing room from creditors - stops all collection efforts, all harassment, and all foreclosure actions.
- Allows for orderly distribution of assets.
- It is ‘automatic’ and applies whether or not parties to a proceeding know that a bankruptcy has been filed.
- Applies to all bankruptcies regardless of chapter
- Applies to all debtors whether individual or entity

The Automatic Stay (con't.)

Stays most acts against the debtor, the debtor's property, and property of the estate;

Prevents commencement or continuation of pending litigation;

Prevents enforcement of judgments;

Prevents perfection of liens against property of the estate or debtor.

Prevents the debtor from disposing of assets of the estate without BK court approval

- EXCEPTION: Property Taxes – continue to accrue but cannot be foreclosed.

The Automatic Stay (con't)

- * A judgment entered in violation of the automatic stay is void, including foreclosure complaints and service of the complaints, foreclosure judgments, sheriff's sales.
- * A judgment entered in violation of the automatic stay should still be set up with a requirement that it be removed of record.
- * **11 USC §362(h)** provides for the recovery of actual damages, costs and attorneys fees if a creditor refuses to sign a warrant to satisfy or otherwise have the judgment removed of record once the creditor is advised that their judgment was entered in violation of the automatic stay.

The Automatic Stay (con't)

The automatic stay remains in effect until:

- * The entry of an Order closing the bankruptcy case;
- * The entry of an Order dismissing the bankruptcy case; or
- * The granting of a Discharge in bankruptcy.
- * The entry of an Order Vacating the stay;

Judgment Liens ~ “But I have a discharge!”

The single greatest misconception among debtors AND lawyers is that a personal discharge in bankruptcy will discharge liens.

- The discharge of the debtor only discharges the debtor’s personal obligation to pay the debt which the judgment or other lien secures;
- The discharge does not affect the lien!
- The BK proceeding does not affect the quality of title of the debtor’s real estate.
- BK does not wash away liens!

Why Do We Care?

Because the creditor may enforce its lien against the property!

Courts have upheld this! “While a discharge ... generally prevents ... actions against the discharged debtor, it does not prohibit creditors from proceeding in rem against the debtor’s property.”

ALSO, when the debtor sells property encumbered by the lien, the lienholder may be able to enforce the lien against the purchaser and lender (the insureds). That’s a claim !!!!

Our NJ courts have affirmed this also: “the discharge in bankruptcy only discharges the personal liability incurred by the debtors. Unless avoided or released during the bankruptcy proceeding, the judgment remains enforceable against the real property owned by the debtor.”

Judgments as liens

The fact that the debtor has obtained a personal discharge is an insufficient basis to waive judgment liens as exceptions.

Note also that §524 of the Code was amended in 1984 so to confirm this point.

For property owned by the debtor prior to a bankruptcy discharge, the fact that a particular lien has been scheduled and discharged is usually irrelevant to the lien's continued viability.

Judicial Lien Avoidance

11 USC §522(f) Is the provision that is used to remove judgment liens in the bankruptcy court. It is a part of the debtor's "Fresh Start".

Only affects judgment liens/judicial liens, not mortgages.

There must be a lien to avoid.

But BK lawyers don't usually take the step to file the motion to avoid the lien, or to include the avoidance of the lien in the BK plan.

Judicial Lien Avoidance – State Court

N.J.S.A. 2A:16-49.1 Since the judgment liens are usually not avoided during the course of a bankruptcy, we have this procedure to avoid the lien by application to a state court.

- * Application after at least one year has passed after bankruptcy discharge;
- * Underlying debt must have been scheduled and discharged;
- * Action must be filed in Court where judgment was entered
- * On notice to creditor

The Order must be forwarded to Clerk of the Court, Judgment section, to enter this order as a Satisfaction of the judgment.

After Acquired Property

Where a debtor acquires real estate AFTER their discharge in a previous BK, judgment liens are not enforceable against after-acquired real estate, provided the underlying debt was discharged in bankruptcy.

If the underlying debt was:

- (a) properly scheduled in the bankruptcy;
- (b) was a dischargeable debt; and
- (c) a discharge was issued,

no lien will attach to the debtor's subsequently acquired property.

Remember, the judgment will still appear in the search, but it is not an enforceable lien against the realty.

What debts are not dischargeable?

Non-dischargeable debts may include, but are not limited to:

- alimony
- child support
- unscheduled debts
- student loans
- taxes
- intentional torts
- fraud
- some DMV judgments

Non-Dischargeable Debts

DMV surcharges!!!!. - These surcharges have been held to be statutory liens, not judicial liens, and they may not be avoided under 11 U.S.C. §522(f).

Intentional Torts – If I ram my car into your car because I’m mad at you, that’s intentional. If you sue me and get a judgment, and I later file for BK, you would be able to object to my effort to discharge that debt.

Fraud – If I take a mortgage signing someone else’s name, or using a POA that I know is now void, that would be fraud.

Federal Tax liens

CURRENT BANKRUPTCY

What to do if your seller, borrower, or buyer are in an open bankruptcy?

GET AN ORDER ALLOWING THE TRANSACTION!

If a Seller is in Bankruptcy

- If a seller is in bankruptcy, there must be an Bankruptcy Court Order authorizing the sale and specifying the terms.
- Strict adherence to the terms outlined by the Court Order.
- The Order will either allow the sale subject to all mortgages and other liens, in which case everything must be paid off and discharged.
- Or, it will be free and clear of all mortgages and liens.
- If a chapter 13, verify what the Trustee's payoff includes – You are probably only paying off the plan amount, ie, the arrears, to the trustee. You must also obtain payoffs from the mortgage lenders and other lien holders. Otherwise your payoff to the trustee will not be a complete payoff.

Order to Sell Free and Clear – Chapter 7 or 13

- The bankruptcy trustee may sell estate property free and clear of liens or other interests. Part of Trustee's Avoidance powers - can remove liens encumbrances, etc from estate property that the trustee wants to liquidate.
- A sale is free and clear of liens only if the notice of the proposed sale and the subsequent order permitting the sale states 'free and clear'.
- The following requirement may be appropriate:
 - Proof is required that the proposed sale is to be made free and clear of liens in accordance with the provisions of 11 U.S.C. §363(f).
- Deed will come from the trustee.

Chapter 11, 12, 13

If it is a Chapter 11, 12 or 13, which calls for a reorganization of debts, you must review the BK plan to determine if the plan was confirmed and if the proposed transaction is permitted and under what terms.

Raise a requirement:

Proof is required that the Plan of Reorganization has been confirmed and the proposed transaction will be made in accordance with the provisions of that plan.

If a Chapter 13, remember you are paying off the trustee for the balance of the plan payments (arrears) due by the debtor.

Still requires an order to sell/finance

If a Borrower is in Bankruptcy –

- Get an Order approving the new financing. Remember there is an automatic stay in place!
- If a Chapter 13, obtain a payoff statement from the Trustee and payoff the balance of the plan at closing.
- Verify what the Trustee's payoff includes – Remember you are probably only paying off the plan (arrear) amount to the trustee. You must also obtain payoffs from the mortgage lenders and other lien holders. Otherwise your payoff to the trustee will not be a complete payoff.
- Pay off all mortgages and other liens including municipal property/utility amounts due. Judgments must be satisfied if lien has not been vacated by Bankruptcy Court Order.

If a Purchaser is in Bankruptcy –

If a purchaser is in an active bankruptcy, a court order approving of the purchase transaction and mortgage must be obtained.

Abandoned Property by Trustee

The trustee in bankruptcy may abandon property of the estate.

Property is under water, over-encumbered with secured debt, and thus of no value to unsecured creditors. Abandonment usually occurs in Chapter 7 cases.

The trustee will circulate a notice of proposed abandonment to creditors. It is incumbent on the creditors to object to the proposed abandonment.

If no objections are received, the abandonment automatically becomes effective on the date set forth in the original notice.

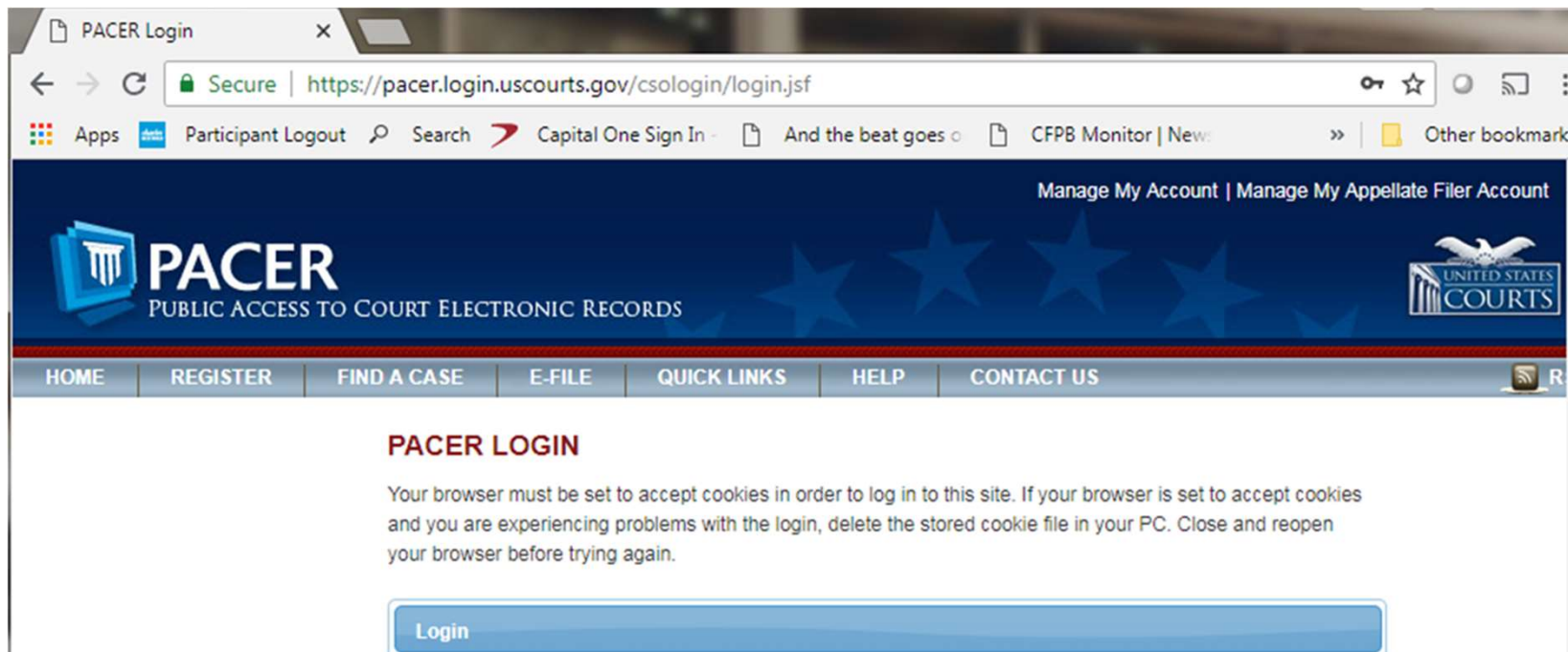
If the property is abandoned, there will not be a court order. Both the court and the trustee regard a court order as unnecessary.

Abandonment (con't)

Once you have received proof of abandonment, title must be insured as if the bankruptcy proceeding had not occurred.

- All liens must be set up as exceptions, then paid and discharged.
- Municipal property taxes and utilities must be paid as usual
- The fact that property has been abandoned by the trustee does not dispose of those liens.
- Bankruptcy does not wash away the liens.

Verify All Bankruptcy Information



<http://pacer.psc.uscourts.gov/>

Keep in mind:

- Debtor can take a voluntary dismissal of the BK proceeding.
- Any Bankruptcy Court Order may be appealed within 14 days, unless the court orders otherwise.
- NEVER EVER EVER omit property taxes or other municipal liens
- Most important thing is to obtain that order authorizing the transaction, or your transaction will be in violation of the Automatic Stay. The Code permits the trustee to avoid a transfer “that is not authorized [by the Bankruptcy Code] or by the Court.”
- If the insured transaction is later voided by the Trustee, it will result in a claim from that insured.

Future bankruptcy

A flaw in your current transaction that will render it subject to attack in a future bankruptcy!!! WHAT???

One of the most important powers given to the trustee is the ability to avoid certain interests which affect the property of the estate:

- can be used to remove liens, encumbrances, and defects from estate property which the trustee may wish to convey

- can be used by the trustee to attack certain transactions which have occurred prior to the filing of the bankruptcy petition.

Unperfected Interests

Unperfected Interests.

- the document must be recorded or filed within 30 days of the creation of the interest it secures or conveys.
- lack of compliance with recording requirements or the failure to record it promptly may make a particular transaction vulnerable to attack under the Code
- if a borrower files a bankruptcy petition shortly after a loan closing, and the mortgage is not timely recorded, the trustee may attempt to set aside the transaction as a preferential transfer.

Unrecorded or Defectively Recorded

Unrecorded or Defectively Recorded Documents.

- if a deed or mortgage was unrecorded at the time the bankruptcy petition was filed, the trustee may be able to avoid interest created thereby
- In one decision, the court found that under New Jersey law a defectively acknowledged mortgage was not entitled to have been recorded. Thus, the debt was treated as unsecured, and its holder was relegated to the status of an unsecured creditor. That's a claim! As an unsecured creditor, a lender may only receive pennies on the dollar, if anything, as opposed to a secured creditor which usually receives full value.

Creditor's Rights Issues

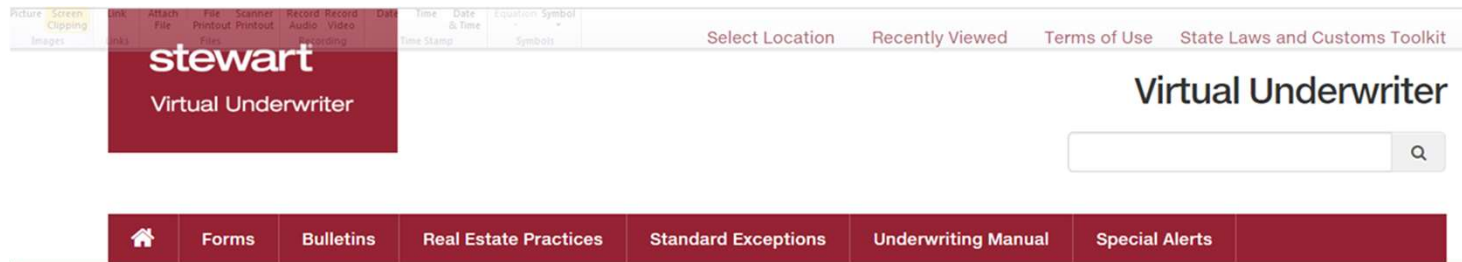
11 USC §548

FRAUDULENT TRANSFERS – Made with actual intent to defraud existing or future creditors (subjective); or Debtor receives less than reasonably equivalent value and one of three conditions exist:

- 1) Debtor was insolvent;
- 2) Remaining capital was unreasonably small; or
- 3) Future debts were beyond debtors' ability to pay.

Fraudulent Transfers may be set aside.

www.VUwriter.com



The screenshot shows the top portion of the Stewart Virtual Underwriter website. At the top left is a Windows taskbar with icons for 'Picture Clipping', 'Images', 'stewart', and 'Virtual Underwriter'. Below the taskbar is a navigation bar with links: 'Select Location', 'Recently Viewed', 'Terms of Use', and 'State Laws and Customs Toolkit'. The main header area features the 'stewart Virtual Underwriter' logo on the left and the text 'Virtual Underwriter' on the right, with a search input field below it. A secondary navigation bar contains links for 'Home', 'Forms', 'Bulletins', 'Real Estate Practices', 'Standard Exceptions', 'Underwriting Manual', and 'Special Alerts'.

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Please mark your calendars for our next N2K hour:

NJ Title History
Tuesday
September 17, 2024
11:00AM