UNITED STATES BANKRUPTCY COURT
DISTRICT OF SOUTH DAKOTA
Southern Division

In re:	)	Bankr. No. 96-40095
TAMARA E. HOFER	)	Chapter 7
Soc. Sec. No. 504-94-7037 Debtor.	)	
DUANE MEHLHAF	)	Adv. No. 97-4045
Plaintiff,	)	MEMORANDUM OF DECISION RE:
-vs-	)	TRUSTEE'S CLARIFICATION MOTION,
CAITLIN COLLIER	)	DEBTOR'S § 522(f) MOTION, AND THE CROSS SUMMARY JUDGMENT MOTIONS REGARDING MEHLHAF'S LIEN PRIORITY COMPLAINT
Defendant.	)	

The matters before the Court are the Trustee's MOTION FOR CLARIFICATION OF COURT'S DIRECTIVE CONCERNING DISBURSEMENT OF FUNDS and Debtor's MOTION TO AVOID LIEN ON EXEMPT PROPERTY under 11 U.S.C. § 522(f) in Bankr. No. 96-40095 and the parties' cross motions for summary judgment in Adversary No. 97-4045 regarding the priority of a certain lien and mortgages. These are core proceedings under 28 U.S.C. § 157(b)(2). This MEMORANDUM OF DECISION and accompanying ORDER and JUDGMENT shall constitute the Court's findings and conclusions under F.R.Bankr.P. 7052. As set forth below, the Court concludes that Debtor's § 522(f) motion must be denied pursuant to *Farrey v. Sanderfoot*, 111 S.Ct. 1825 (1991). Further, the Court concludes that Duane Mehlhaf's lien on Debtor's homestead proceeds has priority over the surviving mortgage of Debtor's attorney.

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I.

Tamara Hofer and Duane Mehlhaf sought a divorce. A bench ruling was made December 15, 1994. The formal JUDGMENT AND DECREE OF DIVORCE was entered February 24, 1995. The divorce court awarded Hofer the marital residence and obligated her to assume the mortgage and taxes on the property. The divorce court also directed that Hofer

> shall pay to [Mehlhaf] as property settlement, the sum of $12,995.17. . . . That said sum shall be paid within four years from the date of this decree, and said sum shall earn interest from the date of this decree, and said sum shall earn interest at the rate of 6% per annum. Further, that said sum shall be a judgment lien on the marital residence awarded to [Hofer].

The divorce court valued the residence at $82,500.00, with a mortgage of $32,783.00 and a delinquent tax obligation of $975.77 against it, resulting in a net value of $48,741.23.

In the FINDINGS OF FACT AND CONCLUSIONS OF LAW also entered on February 24, 1995, the divorce court stated

> [Hofer] shall have four years to pay the property settlement sum ordered to balance the equities, and that this sum shall incur interest at the rate of 6% (six percent) per annum, and that this sum shall be a judicial lien upon the marital residence awarded to [Hofer].

On February 24, 1995, Hofer also gave her divorce counsel, Caitlin Collier, a mortgage on her homestead to secure legal fees totaling $3,613.00. This mortgage did not recognize Mehlhaf's lien. On March 17, 1995, Mehlhaf quit claimed his interest in the property to Hofer. The deed was filed March 20, 1995. Attorney Collier's mortgage was subsequently recorded on March 29, 1995.

The legal description of the marital home was missing from the judgment entered February 24, 1995. On August 25, 1995, the divorce court entered a supplemental judgment that recited the legal description of the residence to which Mehlhaf's lien attached.

Following an order by the state court directing him to pay certain of his ex-wife's attorney's fees, Mehlhaf paid the county sheriff $1,595.55 to satisfy this obligation. The sheriff in turn paid Attorney Collier $1,501.51 on August 31, 1995. Attorney Collier did not apply all the funds to the debt but gave or lent Hofer $1,000.00 for living expenses. No note or mortgage was created regarding this new debt.

The JUDGEMENT AND DECREE OF DIVORCE that had been entered February 24, 1995 was docketed by the clerk of courts on the judgment docket on September 7, 1995.

On January 29, 1996, Hofer gave Attorney Collier another mortgage on her homestead for $2,012.26 for bankruptcy-related attorney's fees. This mortgage was recorded January 30, 1996.

On February 21, 1996, Hofer (Debtor) filed a Chapter 7 petition. Debtor scheduled her ex-husband as an unsecured claim holder for $12,995.17 and "[o]ther unknown amounts." She did not clearly acknowledge the lien imposed by the divorce court for his benefit. Debtor included the residence on her schedule of exempt property and valued her exemption at $30,000.00 and the residence at $81,109.33. She also recognized the two mortgages on the

residence by her attorney. No objections to Debtor's claim of exemptions were filed timely.

By order entered June 18, 1996, the case trustee was authorized to sell the residence. He sold the property for $75,000.00. The sale order identified encumbrances held by the original mortgagor, Debtor's attorney, and Debtor's ex-husband. In addition, the Court ordered $800.00 in rent to be paid to the purchasers from Debtor's share of the proceeds so that Debtor could stay in possession of the residence an extra month. The case trustee paid from the sale proceeds the $800.00 in rent, the sales commission, the undisputed senior lien holder, and $20,000.00 to Debtor in recognition of her homestead exemption. In August 1996, Debtor paid her counsel $1,613.87 for services rendered.

In October 1996, the Trustee sought clarification regarding the status of Mehlhaf's lien. Following responses by interested parties, this Court concluded, by decision and order entered March 3, 1997, that Mehlhaf's lien on the house sale proceeds was valid.

On April 7, 1997, Debtor filed a motion to discharge Mehlhaf's judgment under S.D.C.L. § 15-16-20. On April 14, 1997, the Trustee[1] sought further direction since he did not have sufficient funds to pay the balance of Debtor's homestead exemption, Mehlhaf's lien, and Attorney Collier's mortgages. Debtor's § 15-16-20 motion was

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[1] A. Thomas Pokela was the original trustee. He was succeeded by John S. Lovald on December 13, 1996.

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granted without objection on May 2, 1997. A hearing on the Trustee's April 14, 1997 motion led Debtor to file her motion to avoid Mehlhaf's lien under § 522(f) on July 1, 1997. It also led Mehlhaf to file an adversary complaint against Attorney Collier on August 20, 1997 seeking a declaration that his lien on the homestead is superior to her mortgages. These three related matters are thus pending and are decided herein.

Two payment sources are involved: the remaining sale proceeds balance of $13,799.00 held by the Trustee and the $20,000.00 in homestead exemption proceeds held by Debtor. Debtor's § 522(f) motion applies only to Debtor's homestead share of the sale proceeds. Regarding the lien held by Mehlhaf and the mortgages held by Attorney Collier, this Court has jurisdiction to determine their priorities only as to the bankruptcy estate funds. The priority of any liens on the exempt homestead proceeds is more appropriately decided by a state court who has jurisdiction over those proceeds.

II.
DEBTOR'S § 522(f) MOTION

In *Farrey v. Sanderfoot*, 111 S.Ct. 1825 (1991), the United States Supreme Court was presented with a similar § 522(f) motion regarding a debtor's homestead. The Court concluded that a debtor may avoid a lien under § 522(f) only if the debtor had an interest in the property before the lien attached. *Id.* at 1829-30. The Court looked to state law to determine when the debtor's interest

arose and when the subject lien attached. *Id.* at 1830-31.

The parties in *Farrey* were divorced under Wisconsin state law, which presumes that marital property will be equally divided upon divorce. *Id.* The Court found that the divorce decree gave fee simple title to Sanderfoot at the same time that it placed a lien on the property for Farrey's benefit. *Id.* Therefore, Sanderfoot did not have this interest in the property before Farrey's lien attached and under § 522(f), Sanderfoot could not avoid Farrey's lien. *Id.* at 1831. The Court noted that it did not matter whether Sanderfoot's interest in the homestead was extinguished by the divorce decree and then recreated with a lien or whether Sanderfoot simply was given Farrey's interest in the property subject to the lien. Either way, the new interest that Sanderfoot received was encumbered simultaneously with Farrey's lien. *Id.*

The same situation exists here under similar state statutes and case law. Hofer and Mehlhaf held the marital residence jointly. The Court awarded the home to Hofer and directed Mehlhaf to quit claim his interest to Hofer. That new interest was simultaneously encumbered with Hofer's lien as provided by S.D.C.L. § 25-4-42. Accordingly, Hofer did not obtain her new interest in the property without the lien encumbrance of Mehlhaf's. Under § 522(f), as interpreted in *Farrey*, this lien cannot be avoided.

Debtor argues that Mehlhaf's lien attached after her fee simple interest because the quit claim deed was filed six months

before the judgment lien was docketed by the clerk of court. She relies on S.D.C.L. § 15-16-7, which states that a judgment becomes a lien on non homestead real property only after it has been docketed by the clerk.

Her reliance on § 15-16-7 is misplaced. The divorce judgment was entered on February 24, 1995. From that date, Debtor had an enforceable interest in the property and Mehlhaf had a valid lien on that property. *Lien v. Lien*, 278 N.W.2d 436, 444 (S.D. 1979); *Agard v. Menagh*, 244 N.W. 379, 379 (S.D. 1932). That the quit claim deed was not recorded until March 20, 1995, that the supplemental judgment was not entered until August 25, 1995, or that the divorce judgment was not docketed on the clerk's judgment roll until September 7, 1995, are not determinative in this case. The *validity* of a lien imposed by a divorce court in South Dakota *on specific property* is not governed by § 15-16-7. That section applies to general liens imposed on non homestead real property. Mehlhaf's lien was a special lien imposed pursuant to S.D.C.L. § 25-42-4 on certain real property. S.D.C.L. § 44-1-2; *Muhlenkort v. Union County Land Trust*, 530 N.W.2d 658, 662 (S.D. 1995); *see also* S.D.C.L. § 15-16-26 (recognizing distinction between specific and general liens). Moreover, among the parties and their counsel when the original divorce judgment was entered February 24, 1995, there was no confusion or misunderstanding regarding what the subject property was or what Mehlhaf's lien protected. The

supplemental judgment with the legal description added nothing for these parties.

In *Muhlenkort*, the court held that S.D.C.L. § 15-6-7, in the absence of any other applicable law, governs how *long* a divorce-related judgment on specific property is effective. The court also concluded that a divorce-related judgment must be docketed in a clerk's judgment book to be effective *as to third parties*. *Id.* at 661. However, the facts are different in this case. First, it was exclusively homestead property, which is not governed by § 15-6-7, that was subjected to the special divorce-related lien. Second, the sufficiency of notice to an innocent third party based on the judgment roll entry is not at issue in this case. Finally, as noted in *Muhlenkort*, a substandard docket entry does not affect the validity of the lien itself. *Id.* at 661.

Debtor also cannot successfully argue that Mehlhaf's lien is voidable under § 522(f) because it is not excluded under § 522(f)(1)(A). Since Mehlhaf's lien arose simultaneously with Debtor's interest in the property, it does not meet the general requirements of § 522(f)(1). The exclusions under § 522(f)(1)(A) are not reached. Moreover, there is nothing in *Farrey* that limits its application to family support debts. Instead, the Court in *Farrey* looked to the dates when the property interest arose and when the lien was created to determine whether the lien could be

avoided. *Farrey*, 111 S.Ct. at 1828-30.

Finally, Debtor is correct that her personal liability to Mehlhaf for the divorce judgment was discharged under 11 U.S.C. § 524(a)(1) and S.D.C.L. § 15-16-20. An order under that statute, however, has no impact on Mehlhaf's specific lien on the homestead. S.D.C.L. § 15-16-26.

III.

PRIORITY OF MEHLHAF'S LIEN AND ATTORNEY COLLIER'S MORTGAGE

There is no statute or case law that supports Attorney Collier's theory that her mortgage interest is superior to Mehlhaf's lien. Debtor could not unilaterally convey an interest in the homestead until the divorce was granted and the home was awarded to her. S.D.C.L. § 43-31-17. Until February 24, 1995, Debtor and Mehlhaf were married and neither could convey an interest in the homestead without the other's written consent. *Id.* Accordingly, Attorney Collier's first mortgage did not attach until Debtor received sole title. S.D.C.L. § 44-1-6. It is of little relevance here whether the transfer of interest occurred on February 24, 1995 when the JUDGMENT AND DECREE OF DIVORCE was entered or on March 20, 1995 when the quit claim deed was recorded. No interest was conveyed to Debtor that was not already encumbered by Mehlhaf's lien.

Further, under the facts of this case, it would be inequitable to place Attorney Collier's first mortgage ahead of Mehlhaf's lien. Once the divorce judgment was entered, the clerk was obligated to

"immediately" record it on the judgment roll. S.D.C.L. § 15-6-58. The clerk's unexplained delay should not benefit Attorney Collier to Mehlhaf's detriment, especially where Attorney Collier had actual notice that Debtor's interest was encumbered by Mehlhaf's lien. The state's recording statutes protect only those who act in good faith without actual knowledge. Attorney Collier cannot rely on them where she had knowledge of the divorce court's lien for Mehlhaf's behalf before she had her mortgage recorded. S.D.C.L. §§ 43-25-3, 43-28-14, and 44-2-1.

IV.
CLARIFYING THE TRUSTEE'S DISTRIBUTION

After paying the costs of sale, the agreed senior lien holder, and rent to the purchasers, the Trustee paid Debtor $20,000.00 of her $30,000.00 homestead. The balance of the homestead must also be paid to her before creditors' secured claims are paid. Accordingly, of the $13,799.00 held by the trustee, $10,000.00, less the $800.00 rent payment, goes directly to Debtor to complete her exemption. The rent is deducted from her exempt homestead proceeds in compliance with the ORDER APPROVING SALE OF REAL ESTATE & REQUIRING DEBTOR TO VACATE PREMISES entered June 18, 1996.

Attorney Collier and Mehlhaf will have secured claims only to the extent that estate funds are available to pay them and unsecured claims for the balance. 11 U.S.C. § 506(a). Here, the Trustee has only $4,599.00 to distribute to these secured claim holders. While the exempt homestead proceeds remain subject to an

unavoided lien and mortgages, the trustee does not serve as the disbursing agent. 11 U.S.C. § 522(c)(2). He can pay creditors only from estate funds. 11 U.S.C. §§ 522(b) and 704(1).

On the petition date, Debtor owed Attorney Collier $4,958.45, of which $3,958.45 was secured by the two mortgages and $1,000.00 was unsecured. The $1,000.00 unsecured claim represents that portion of the fee payment by Mehlhaf that Attorney Collier gave to her client. Neither mortgage secured this loan or gift. S.D.C.L. § 44-1-10.

Attorney Collier's total claim was reduced by Debtor's post-petition payment of $1,613.87 on August 16, 1996. The first $89.28 of that payment is appropriately applied to the post-petition fees and costs that existed on August 16, 1996. The $1,524.59 balance must be applied to the pre-petition claim (oldest debt first). S.D.C.L. § 54-1-5. This results in a secured claim of $2,433.86 and an unsecured claim of $1,000.00. Further, Attorney Collier has acknowledged (see letter to Trustee dated June 13, 1996) that her January 30, 1996 mortgage constituted a preference to the extent of $1,300.26. Accordingly, it is void under 11 U.S.C. § 547(b). Her remaining secured claim is thus $1,133.60 under the first mortgage and her unsecured claim is $2,300.26.

As discussed above, Mehlhaf has first priority over the $4,999.00 held by the Trustee. Mehlhaf will have to look to other estate funds and his lien on Debtor's exempt homestead proceeds to pay the balance of his claim. Likewise, Attorney Collier will have

to look to other estate funds and her mortgages on Debtor's exempt homestead proceeds to pay all her claim.

An order will be entered denying Debtor's § 522(f) motion in the main case. Summary judgment shall be entered for Plaintiff-Mehlhaf in the adversary. Trustee Lovald shall prepare his final report and account before distribution in accordance with these findings and conclusions.

Dated this 13 day of January 1998.

BY THE COURT:

Irvin N. Hoyt
Chief Bankruptcy Judge

ATTEST:
Charles L. Nail, Jr., Clerk

By: Sharon Thomas
Deputy Clerk

(SEAL)

NOTICE OF ENTRY
Under F.R.Bankr.P. 9022(a)
Entered

JAN 14 1998

Charles L. Nail, Jr., Clerk
U.S. Bankruptcy Court
District of South Dakota

[illegible] SERVICE
I hereby certify that a copy of this document was [illegible], I [illegible] delivered, [illegible] creditors and others, [illegible] identified [illegible]

[illegible] Clerk
[illegible] Court
[illegible] South Dakota

By: [illegible]
Date: 1-14-98

Case: 97-04045 Form id: 122 Ntc Date: 01/15/98 Off: 4 Page : 1
Total notices mailed: 6

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