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MEMORANDUM

To: All Massachusetts Agents and Approved Attorneys

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COMMON MISTAKES IN BANKRUPTCY

On October 17, 2005, major amendments to the United States Bankruptcy Code will go into effect making it more difficult for debtors to obtain relief in bankruptcy courts. As a result of this impending change, there has been a noticeable increase in bankruptcy filings. It is anticipated that this larger volume of filings will continue until the effective date of the new law. With this increase in filings, we expect to be dealing with more bankruptcy issues in the months ahead. Thus, it is a good opportunity to review some of the common title mistakes in dealing with bankruptcies.

The most common mistakes, which have been the basis of several recent title claims, are based on two fundamental misconceptions about bankruptcy law. The first misconception is that a discharge in bankruptcy removes recorded liens from the title. The second misconception is that a discharge in bankruptcy closes the bankruptcy case and allows the debtor to sell or mortgage his property without permission of the bankruptcy court. The fact is:

A discharge in bankruptcy has no effect on record title.

Consequently, both of these assumptions are false. Taking each in turn:

1. Liens on title are not automatically released by bankruptcy.

A discharge in bankruptcy does not, in and of itself, remove any liens from the title to real estate. A discharge in bankruptcy is personal to the debtor and relieves him from personal liability for his debts. However, any liens that have been recorded against the property of the debtor, whether voluntary or involuntary, remain on the title. These liens

are only removed in bankruptcy if the bankruptcy court specifically orders that the liens be voided or, in the alternative, the court orders property sold free and clear of liens.

If the bankruptcy case is closed and there are pre-bankruptcy liens that have not been voided by the court, then those liens are still valid and on title. Consequently, the only way to remove these liens is by recording a discharge or release. The other option would be to reopen the bankruptcy case and have the liens voided by the court.

In cases where the liens are voided by the bankruptcy court, a certified copy of the judge's order voiding the liens should be recorded in the Registry of Deeds. In such a case, the order of the court acts as a release, and if you do not see a recorded order of the bankruptcy court, then the liens are still outstanding.

2. A discharge in bankruptcy does not vest title back in the debtor.

While it is true that a discharge in bankruptcy has no effect on record title, this does not mean that the filing of the bankruptcy does not affect title. In fact, the bankruptcy filing effectively freezes the title. No new liens can be put on the title nor can the debtor sell or mortgage his or her property. It is as if the debtor is under a disability, comparable to a ward under a guardianship. Once subject to a guardianship, the ward no longer has the power to deal with his or her own property. Similarly, once a bankruptcy is filed, the debtor is unable to sell or mortgage his property. All property of the debtor now becomes property of the bankruptcy estate. The effect of the foregoing is that the property can only be sold out of the bankruptcy estate by the trustee, or by a debtor-in-possession when appropriate, pursuant to an order of the court.

Another manner in which property of the debtor can be sold after the filing of a bankruptcy is by an abandonment, the effect of which is to release the realty from the bankruptcy estate. A debtor can personally convey or mortgage property if it has been formally abandoned by the bankruptcy trustee. The process of abandonment requires an order of the court, and property sold or mortgaged after an abandonment remains subject to any liens of record as discussed above.

Similarly when a bankruptcy case is closed, any property not otherwise dealt with by the trustee is abandoned back to the debtor. After closure of the case, the debtor is free to sell or mortgage his property, again, subject to any liens of record. It is important to note that closure of the case and discharge in bankruptcy are not the same thing. A debtor is often given a discharge before the case is closed. In fact, in larger bankruptcy cases, the discharge can occur years before the actual closure of the case. So again, in this situation a discharge in bankruptcy has no effect on the title. It is not until the case is actually closed that the debtor can treat property as his own.

Reorganization plans can affect title.

The outline above applies in large part to Chapter 7 liquidations. In Chapter 11 or Chapter 13 reorganizations, things can be different. While the above principles still apply, they can be varied by a reorganization plan. A plan of reorganization approved by the court can vest title in the debtor individually. In addition, the provisions of the plan may also void liens, or alternatively, the plan may specifically allow the debtor to sell or mortgage property. In all of these cases, the plan must be carefully scrutinized to be sure that the action proposed by the debtor is specifically allowed under the plan.

If an action by the debtor is controlled by a reorganization plan, then a full copy of the plan must be recorded in order to show debtor's authority. Sometimes these plans can be quite lengthy. Nevertheless, if the debtor's authority is derived under the plan, there really is not an alternative to recording the entire plan.

Checking for bankruptcies.

As most examiners note on their abstracts, the bankruptcy indices in the Registries of Deeds are not reliable. With the increase in bankruptcy filings, it may be a good idea to do some additional checking. The best way to do this, of course, is through Pacer (http://pacer.psc.uscourts.gov). Pacer is the approved internet-based system for the United States Court system. There is no cost to subscribe. You only pay use charges which are 60 cents per minute plus 8 cents per page for any documents printed off of the system. Checking names for bankruptcy filings does not require printing any documents.

If you do not wish to subscribe to Pacer, another method of checking is to simply ask the seller or borrower if they have filed bankruptcy. Most people are honest, and they will tell you the truth. In fact, they may simply believe the common mistakes that are discussed here. Having received a discharge in bankruptcy, they think that they are all set. In their minds, they have no reason to mention a previous bankruptcy filing. It never hurts to ask if the seller or borrower has ever filed for bankruptcy.

There is no doubt that bankruptcy can be tricky. The interplay of bankruptcy law and real estate can make for difficult title issues. As always, if you have any questions in regard to bankruptcy or any other issue, please call the local office.