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U.S. Bankruptcy Appellate Panel
of the Tenth Circuit
January 22, 1999
Barbara A. Schermerhorn
Clerk

NOT FOR PUBLICATION

UNITED STATES BANKRUPTCY APPELLATE PANEL

OF THE TENTH CIRCUIT

IN RE CARLTON W. PARSONS and RENEE PARSONS, also known as Theresa R. Parsons, Debtors.	BAP No. NM-98-038
CARLTON W. PARSONS and RENEE PARSONS, also known as Theresa R. Parsons, Appellants, v. INVESTMENT COMPANY OF THE SOUTHWEST, Appellee.	Bankr. No. 95-10118 Chapter 7 ORDER AND JUDGMENT*

Appeal from the United States Bankruptcy Court
for the District of New Mexico

Before CLARK, BOHANON, and PEARSON, Bankruptcy Judges.

BOHANON, Bankruptcy Judge.

After examining the briefs and appellate record, the Court has determined unanimously that oral argument would not materially assist in the determination of this appeal. See Fed. R. Bankr. P. 8012; 10th Cir. BAP L.R. 8012-1(a). The case is therefore ordered submitted without oral argument.

* This order and judgment has no precedential value and may not be cited, except for the purposes of establishing the doctrines of law of the case, res judicata, or collateral estoppel. 10th Cir. BAP L.R. 8010-2.

APPELLATE JURISDICTION

The Bankruptcy Appellate Panel, with the consent of the parties, has jurisdiction to hear timely appeals from final judgments, orders, and decrees of the bankruptcy courts. 28 U.S.C. § 158. See also Fed. R. Bankr. P. 8001-8002; 10th Cir. BAP L.R. 8001-1. In this matter, the parties have consented to jurisdiction by not opting to have the appeal heard by the district court, the appeal was timely filed, and the order of the bankruptcy court is final within the meaning of the statute. Thus, this court has jurisdiction.

BACKGROUND

The debtors-appellants purchased an unimproved lot in 1989. At that time, they executed a mortgage on the property in the amount of $26,300.14, and the mortgagee, Sunwest Bank, perfected its lien on the same day.

The Federal Deposit Insurance Corporation obtained a judgment against the debtors-appellants in the amount of $107,343.42 in January, 1990, which was recorded in the same month. The FDIC subsequently assigned the judgment to the appellee, Investment Company of the Southwest ("ICS"), which, in June, 1993, filed a Notice of Assignment in the appropriate state clerk's office. In October, 1993, ICS filed a foreclosure action against the debtors-appellants, and it recorded a notice of lis pendens in the clerk's office in November, 1993.

The first mortgage was assigned to David J. Ensor and Becky Ensor in July, 1994. Ensor knew of ICS's lien at the time of this assignment. Also, Ensor had been a friend of the debtors-appellants for eighteen years.

The debtors-appellants contracted with Ensor to build a house on the lot. Between July, 1994, and October, 1994, Ensor advanced approximately $58,594.54 for associated construction costs and expenses. Construction on the house was stopped prior to the bankruptcy petition filing date and the debtor-

appellants moved into the uncompleted house.

On January 13, 1995, the debtors-appellants filed for protection under Chapter 7. They listed the lot and the house as an asset on their schedules and claimed them as exempt under New Mexico law. No objection was made to the claimed exemption. A discharge was granted and the case was closed in September, 1995. Then the debtors-appellants resumed construction of the house and it was completed in April, 1996.

In January, 1996, the case was reopened. The debtors-appellants moved to avoid ICS's lien and to release the lis pendens and other recordings that clouded their title to the property. In April of 1998, the bankruptcy court held a final evidentiary hearing and denied the debtors-appellants' motion to avoid ICS's lien. The bankruptcy court concluded that:

1) the debtors-appellants were entitled to their claimed exemption in the amount of $60,000;

2) the property had a value of $150,701.72 (the lot was valued at $77,000 and the house was valued at $73,701.72);

3) Ensor had a first mortgage on the property for $26,300.14;

4) amounts owed to Ensor in excess of the $26,300.14 were not secured by a mortgage; and

5) ICS's judgment lien did not impair the debtors-appellants' exemption, and therefore was not avoidable.

Subsequently, the debtors-appellants moved to clarify the order, arguing that ICS's lien should be partially avoided by reducing the amount. The bankruptcy court denied the motion and this appeal followed.

ISSUES

The debtors-appellants raise three issues on appeal:

1) whether the bankruptcy court erred, as a matter of law, in failing to avoid ICS's judgment lien by finding that it did not impair any exemptions to which the debtor-appellants are entitled;

2) whether the bankruptcy court erred in fixing the amount of Ensor's lien at $26,300.14; and

3) whether the bankruptcy court erred in determining the value of the property to be $150,701.72.

STANDARD OF REVIEW

Conclusions of law by the trial court are reviewed by the appellate court de novo. Hollytex Carpet Mills, Inc. v. Oklahoma Employment Sec. Comm'n (In re Hollytex Carpet Mills, Inc.), 73 F.3d 1516, 1518 (10th Cir. 1996). The first issue raised by the debtors-appellants is a question of law and will be reviewed de novo.

Questions of fact are reviewed by the appellate court under the clearly erroneous standard. Findings of fact will only be disturbed if they are clearly erroneous. First Bank v. Reid (In re Reid), 757 F.2d 230, 233 (10th Cir. 1985). The second and third issues raised by the debtors-appellants are questions of fact and will be reviewed under this standard.

DISCUSSION

As a preliminary matter, the appellee claims that because the debtors-appellants first raised the issue of lien reduction in their Motion to Clarify, which was filed after the completion of the trial, the appeal should be denied because it was "not raised below." This argument is rejected. The debtors-appellants did

raise and argue the issue of lien avoidance at trial. The appellee's attempt to completely differentiate partial from total lien avoidance is not persuasive. Moreover, the appellee does not present any direct authority to support its contention.

The third issue raised by the debtors-appellants will be addressed first. The bankruptcy court valued the property at $150,701.72 (the lot was valued at $77,000 and the house was valued at $73,701.72). The bankruptcy court based its valuation of the lot on an appraisal conducted by an appraiser who was employed by ICS. No other valuation of the Lot had been completed as of the date of bankruptcy, and the record does not reflect any valuation of the uncompleted house as of the date of bankruptcy. The bankruptcy court based its valuation of the house on the appraisal of Jimmy Hufstedler conducted in August, 1995 and his testimony. Hufstedler was employed by the debtors-appellants.

The debtors-appellants argue that because of a statement by the bankruptcy court in its Findings of Fact, that there existed a long-term relationship between Hufstedler and the debtors-appellants and that as a result his credibility was questionable, the bankruptcy court's valuation of the house was clearly erroneous because it relied on Hufstedler's appraisal. However, the debtors-appellants correctly state in their appeal that there is nothing in the record to support the bankruptcy court's finding that there was a long-term relationship between the debtors-appellants and Hufstedler. In fact, as reflected in the record, the long-term relationship of the debtors-appellants was with Ensor. Thus, although it is apparent that the bankruptcy court erred as to the existence of a long-term relationship between the debtors-appellants and Hufstedler, it does not necessarily follow that the bankruptcy court's use of Hufstedler's appraisal was clearly erroneous. Indeed, in its comments, the bankruptcy court appeared to focus its questions of Hufstedler's credibility upon the marked difference between his

valuation of the lot before and after the filing of the debtors-appellants' bankruptcy petition.[1]

There were three sources of evidence concerning the value of the house before the bankruptcy court: The debtors-appellants', Ensor's, and Hufstedler's. The bankruptcy court discounted the debtors-appellants' and Ensor's estimates as not credible because they were extremely low and not supported by anything other than their opinions. Furthermore, the debtors-appellants' and Ensor's estimates of value concerned the property as a whole and did not separate the house from the lot. In contrast, Hufstedler's appraisal was based on a mathematical calculation using the square footage of the house as of the petition date multiplied by the estimated cost of construction, which yielded the valuation of the house adopted by the bankruptcy court: $73,701.72. Thus, the record indicates that the bankruptcy court relied upon the most credible, reliable, and objective evidence before it concerning the value of the house. Therefore, this court cannot conclude that the bankruptcy court clearly erred in its valuation of the property.

The second issue raised by the debtors-appellants is whether the bankruptcy court erred by fixing the amount of Ensor's lien at $26,300.14. It is evident from the record that the amount of the first mortgage was $26,300.14. It is also clear that Ensor assumed the first mortgage.[2] Thus, as a prima facie matter, it would seem that Ensor's security interest is limited to the original amount of the assigned note.

Surprisingly, the original mortgage is not part of the record before this

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[1] The bankruptcy court's comments on the lack of credibility did not seem to be addressed to the appraised valuation of the house at the time of the filing of the bankruptcy petition.

[2] At the time the note was assumed, only about $7500 was due. However, the original mortgagee advanced Ensor approximately $18,000, which was advanced by Ensor for the construction of the house. Thus, the total amount due on the note at the time of its assumption was almost exactly the amount that was originally due at the time of its making: $26,300.14.

court and was not entered into evidence before the bankruptcy court. However, the assignment of the first mortgage, a title report, and Ensor's recorded notice of advancement are in evidence and they appear to support the existence and amount of the first mortgage. Furthermore, the testimony of both the debtors-appellants and Ensor indicate that the first mortgage allowed for advances up to twice the original amount. However, the bankruptcy court did note that the testimony of the debtors-appellants and Ensor lacked credibility in certain aspects.

The record also reflects that financial advances for the construction of the house were made by Ensor in approximately the amount of $59,000, which was recognized by the bankruptcy court. If, in fact, the first mortgage did allow for advances to be secured up to twice the amount of the original mortgage, then it would seem that the bankruptcy court erred in limiting the amount of Ensor's lien to $26,300.14. Although the record does not present the first mortgage, there is some testimony that indicates that it did contain such a provision.

In contrast, the appellee directs this court's attention to the timing of the start, hiatus, and completion of the construction of the house in conjunction with the filing of the bankruptcy petition. The appellee notes that the record contains explicit testimony that construction was halted to permit the debtors-appellants to file bankruptcy and that the halting of the construction at that particular time had favorable financial consequences to Ensor and/or the debtors-appellants within the context of the bankruptcy. This, of course, raises the question of whether the timing was improper and merely a device for avoiding the debt due ICS, although the order of the bankruptcy court does not specifically address this possibility.

Thus, given the bankruptcy court's questioning of the debtors-appellants' and Ensor's credibility, the lack of direct evidence of the purported provision of the first mortgage allowing the doubling of the secured amount of the note (i.e., the note itself), the suspicious timing of the halting of the construction of the

house and the filing of bankruptcy, this court cannot say that the bankruptcy court clearly erred in limiting the secured amount of the lien to $26,300.14. Indeed, it can rationally be concluded that the bankruptcy court took the middle ground between the two positions to prevent grave injustice to either party, and is affirmed on this issue.

Concerning the first issue raised on appeal by the debtors-appellants, whether the bankruptcy court erred, as a matter of law, in failing to avoid ICS's judgment lien by finding that it did not impair any exemptions to which the debtors-appellants are entitled, this court must agree with the debtors-appellants. The bankruptcy court summarily held, without stating its rationale, that ICS's lien did not impair the debtors-appellants' exemption.

11 U.S.C. § 522(f)(1) states that a debtor may avoid the fixing of a judicial lien if it impairs an exemption to which the debtor would be entitled. 11 U.S.C. § 522(f)(2) states that a lien shall be considered to impair an exemption if the sum of that lien and all other liens on the property and the amount of the exemption that could be claimed exceeds the value of the debtor's interest in the property in the absence of any liens. See also Zeigler Eng'g Sales, Inc. v. Cozad (In re Cozad), 208 B.R. 495 (10th Cir. BAP 1997).

In this matter, the debtors-appellants' interest in the property is $150,701.72. The total amount of liens on the property is $133,643.56 (the ICS lien amounts to $107,343.42), and the exemption allowed for the debtor-appellants is $60,000,[3] yielding a total of $193,643.56. Thus, it is apparent that the debtors-appellants' exemption is impaired in the amount of $42,941.84 ($193,643.56 - $150,701.72), and the ICS lien should be reduced by that amount. Therefore, concerning this question raised by the debtors-appellants, as a matter of law on de novo review, the bankruptcy court is reversed and this issue is

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[3] N.M.S.A. § 42-10-9.

remanded for further consideration consistent with this opinion.[4]

The appellee requests that if this court finds for the debtors-appellants on the first issue, that interest be awarded. However, the appellee presents no authority in support of its contention. In response, the debtors-appellants argue that any award of interest would impair the debtors-appellants' fresh start and would improperly deliver any post-petition appreciation in the property to the appellee. Bank of America Nat'l Trust and Sav. Ass'n v. Hanger (In re Hanger), 217 B.R. 592 (9th Cir. BAP 1997). We agree. Thus, the request for interest is denied.

[4] The appellee refers to the decision of David Dorsey Distrib., Inc. v. Sanders (In re Sanders), 39 F.3d 258 (10th Cir. 1994), in support of its position contrary to the debtors-appellants' argument. In response, the debtors-appellants note that the Sanders court was apparently interpreting 11 U.S.C. § 522(f) under the previous version. 11 U.S.C. § 522(f) had been modified by Congress just a short time prior to the publication of the Sanders decision. The legislative history strongly indicates that the Sanders decision has been negated by the changes to 11 U.S.C. § 522(f) enacted by Congress in October of 1994. See House Report on the Bankruptcy Reform Act of 1994, 140 Cong. Rec. H10752, 10769 (daily ed. Oct. 4, 1994). Thus, examining the plain language of the current version of 11 U.S.C. § 522(f) and the legislative history of the current version, it appears that Sanders is no longer binding.