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Feature

BY IRVE J. GOLDMAN

The Effect of Bankruptcy on a Prejudgment Attachment Lien

Irve J. Goldman
Pullman & Comley LLC
Bridgeport, Conn.

Irve Goldman is a member of the Bankruptcy Practice Group at Pullman & Comley LLC in Bridgeport, Conn. He has been a board-certified business bankruptcy specialist since 1993 and is a member of ABI's Business Reorganization and Asset Sales Committees.

Most states provide creditors with some form of prejudgment remedy[1] that allows them to attach a debtor's assets, prior to judgment, in order to secure a future judgment.[2] When such an attachment is procured by a creditor within the 90 days prior to a bankruptcy filing, it will be considered an avoidable preference under § 547(b).[3] In comparison, when a prejudgment attachment lien is created outside the preference period but the creditor obtains a judgment within the preference period, the judgment will not be voidable as a preference if, under applicable state law, it relates back, in terms of priority, to the prejudgment attachment.[4] However, more difficult issues are presented when a prejudgment attachment is obtained outside the 90-day preference period and the debtor files for bankruptcy protection before a final judgment can be rendered for the attaching creditor.

Is a Prejudgment Attachment Considered a Lien and Secured Claim under the Bankruptcy Code?

The terms "lien" and "judicial lien" are specifically defined under the Bankruptcy Code. A "lien" is defined as a "charge against or interest in property to secure payment of a debt or performance of an obligation,"[5] and a "judicial lien" is defined as a "lien [that is] obtained by judgment, levy, sequestration, or other legal or equitable process or proceeding."[6] Whether a lien is enforceable in bankruptcy is determined by applicable state law.[7]

The prevailing view among courts that have addressed this issue is that a prejudgment attachment is a lien that secures the attaching creditor's debt contingent on entry of a judgment and gives rise to a secured claim in bankruptcy.[8] There is authority to the contrary, which appears to rest on the theory that after a discharge is entered, the attaching creditor may not proceed to perfect the attachment by pursuing a judgment and, as

1 *Connecticut v. Doehr*, 501 U.S. 1, 111 S. Ct. 2105 (1991) (appendix surveying state prejudgment attachment statutes). The U.S. Supreme Court in *Doehr* invalidated Connecticut's prejudgment remedy statute on constitutional grounds, but it has since been amended to address the infirmities that led to its downfall.

2 *Hartford Provision Co. v. U.S.*, 579 F.2d 7, 9 (2d Cir. 1978) (prejudgment attachment "permits the plaintiff to obtain security for the satisfaction of any judgment [that] he may finally recover").

3 *Benoit v. Lund*, 330 B.R. 105, 110 (D. Vt. 2004); *Turner v. Emmons & Wilson Inc. (In re Minton Group Inc.)*, 28 B.R. 789, 792-93 (Bankr. S.D.N.Y. 1983). *Compare with Republic Supply Co. of Calif. v. J. H. Welsh & Son Contracting Co. (In re J. H. Welsh & Son Contracting Co.)*, 68 B.R. 520, 523 (Bankr. D. Ariz. 1986) (writ of prejudgment attachment for which levy was made outside of 90-day preference period could not be avoided as preference).

4 *Harpley v. Hines (In re Cooper)*, 153 B.R. 925, 926 (Bankr. M.D. Fla. 1993) (judgment obtained within preference period, and lien created thereby, was not avoidable as preference because under Florida law, it related back to prejudgment writ of garnishment obtained in pre-preference period); *Coston v. Coston (In re Coston)*, 65 B.R. 224, 226-27 (Bankr. D.N.M. 1986) (Kentucky judgment obtained within preference period related back to prejudgment attachment lien effectuated outside of preference period and therefore, could not be avoided as preference); *In re McNeely*, 51 B.R. 816, 819-20 (Bankr. D. Utah 1985) (judgment perfecting attachment liens may be rendered within preference period without constituting avoidable preference if it relates back under state law.) *Compare Wind Power Sys. Inc. v. Cannon Fin. Grp. Inc. (In re Wind Power Sys. Inc.)*, 841 F.2d 288, 291 (9th Cir. 1988) (levy made on California prejudgment attachment within preference period could not be avoided as preference because under California law, it relates back to date that prejudgment attachment was granted, which was outside of preference period).

5 11 U.S.C. § 101(37).

6 11 U.S.C. § 101(36).

7 *Travelers Casualty & Surety Co. of America v. Pacific Gas & Electric Co.*, 549 U.S. 443, 451, 127 S. Ct., 1199, 1205 (2007) (quoting *Butner v. U.S.*, 440 U.S. 48, 55 (1979), for the proposition that "'property interests are created and defined by state law' and 'unless some federal interest requires a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in bankruptcy proceeding'"). *See also Drake v. Franklin Equipment Co. (In re Franklin Equip. Co.)*, 418 B.R. 176, 210-11 (Bankr. E.D. Va. 2009) ("The legal requirements of a lien, the priority of a lien, and the extent of property interests encumbered by a lien are determined by state law.").

8 *In re Giordano*, 188 B.R. 84, 89 (D.R.I. 1995) (Rhode Island prejudgment writ of attachment considered secured claim); *In re Int'l Banking Corp.*, 439 B.R. 614, 621-22 (Bankr. S.D.N.Y. 2010) (surveying authorities holding New York prejudgment attachment to be lien on property attached to secure future judgment); *Montano Cigarette Candy & Tobacco Inc. (In re Shivani)*, 2004 WL 484549, at *3-4 (Bankr. D. Conn. March 11, 2004) (Connecticut prejudgment attachment is lien and secured claim that survives discharge, enabling creditor to proceed to judgment post-discharge); *In re Schalebaum*, 263 B.R. 684, 687-88 (Bankr. D.N.H. 2001) (New Hampshire prejudgment order placing funds in escrow pending future judgment was judicial lien and secured claim); *In re Flynn*, 238 B.R. 742, 747 (Bankr. N.D. Ohio 1999) (Ohio prejudgment garnishment lien against debtor's bank account effectively secured funds in account and defeated debtor's claim to exemption); *In re McNeely*, 51 B.R. 816, 819-20 (Bankr. D. Utah 1985) (Utah prejudgment writ of attachment considered secured claim entitled to adequate protection).

a consequence, loses its lien.[9] The courts that are in disagreement with this theory point to the familiar rule in bankruptcy that liens pass through bankruptcy unaffected by discharge and may be enforced *in rem*, but not as a personal liability, post-discharge.[10]

Yet another perspective on this issue is provided by the Ninth Circuit's decision in *Diamant v. Kasparian (In re Southern California Plastics Inc.)*.[11] In this case, the Ninth Circuit reversed a decision by the Bankruptcy Appellate Panel (BAP) that a creditor with a prejudgment attachment lien under California law could perfect its lien and thereby become secured by having its claim "allowed" under the claims-allowance process, as opposed to obtaining a state court judgment.[12] Thus, in the Ninth Circuit, a creditor with only a prejudgment attachment lien at the time of bankruptcy filing will be considered unsecured.[13]

Is a Prejudgment Attachment Voidable under a Trustee's Strong-Arm Powers?

Under § 544(a), a trustee or debtor-in-possession is given the rights of a hypothetical lien and execution creditor as of the date of the bankruptcy filing. It is well established, however, that the trustee's § 544 powers will not permit avoidance of a prejudgment attachment lien if, under applicable state law, a subsequent judgment could "relate back" to the prejudgment attachment lien, thereby giving it priority over a judgment-lien creditor that perfected its lien after the prejudgment attachment lien was acquired.[14]

However, the result is different where applicable state law does not establish a prejudgment attachment's priority in relation to subsequent lien creditors based on the date that the property is attached, but rather creates the lien only upon execution on a judgment. In that case, if a judgment has not been obtained prior to a bankruptcy filing, the attachment lien will be vulnerable to the trustee's § 544 powers.[15] Thus, the antidote to avoidability under § 544 in this context is the relation back of a judgment to the prejudgment attachment lien under applicable state law.

Obtaining Relief from the Automatic Stay to "Perfect" the Prejudgment Attachment

The approach that courts have taken to requests to lift the automatic stay in order to "perfect"[16] a prejudgment attachment has not been uniform. In jurisdictions that consider the prejudgment-attachment lien to qualify as a secured claim, relief from the automatic stay has been granted on the grounds of there being a lack of adequate protection[17] or a lack of equity in the property attached.[18]

> **In most jurisdictions, a creditor with a prejudgment attachment that was obtained outside the preference period will be considered to have a secured claim that is not avoidable under § 544 and survives a bankruptcy discharge.**

Where the prejudgment attachment is considered unsecured, courts have focused the inquiry on whether there is "cause" for relief from the automatic stay under § 362(d)(1).[19] Cause for this purpose has been held to exist to allow the attaching creditor to proceed to judgment based on a multitude of factors: the unavoidability of the attachment lien, the public policy in favor of allowing pre-preference creditors to proceed to judgment, and the judicial economy that would be served by liquidating the claim in its place of origin.[20] It has been held that relief from the automatic stay to the prejudgment attachment creditor should not be denied solely to block perfection of the attachment lien.[21]

It would appear that even in jurisdictions where the prejudgment attachment lien gives rise to a secured claim, a bankruptcy court could still consider whether "cause" exists to permit the creditor to proceed to judgment for purposes of liquidating its claim.[22] As courts have recognized, the legislative history to §362(d)(1) itself contemplates that

> [i]t will often be more appropriate to permit proceedings to continue in their place of origin, when no great prejudice to the bankruptcy estate would result, in order to leave the parties to their chosen forum and to relieve the bankruptcy court from any duties that may be handled elsewhere.[23]

9 *Sciarrino v. Mendoza*, 201 B.R. 541, 544-45 (E.D. Cal. 1996) (holding that creditor with prejudgment attachment could not proceed to judgment post-discharge and suggested that proper course of action would have been to seek relief from automatic stay or object to dischargeability under § 523 or 727); *In re Savidge*, 57 B.R. 389, 390 (D. Del. 1986) (prejudgment attachment of real estate under Delaware law that had not been "perfected" by judgment prior to debtor's discharge was not "a sufficient lien to create a secured status"). *Cf. In re DeLancy*, 94 B.R. 311, 314 (Bankr. S.D.N.Y. 1988) (citing approvingly to *Savidge* but distinguishing case before it on grounds that bankruptcy court had denied debtor a discharge).

10 *Shivani* at *4; *FDIC v. Debtor & Trustee (In re Moscoso Villaronga)*, 111 B.R. 13, 17-18 (Bankr. D.P.R. 1989); *Shawmut Bank v. Brooks Dev. Corp.*, 46 Conn. App. 399, 411-12, 699 A.2d 283, 289-90 (Conn. App. 1997); *Zammitto v. Guarnotta*, 2008 WL 5780817, at *2 (Mass. Super. Ct. Oct. 15, 2008).

11 165 F.3d 1243 (9th Cir. 1999).

12 *Id.* at 1248 ("Permitting an allowance of claim to substitute for a judgment perfecting an attachment lien undermines the rights and protections created by the California Legislature.").

13 *In re Aquarius Disk Services Inc.*, 254 B.R. 253, 258 (Bankr. N.D. Cal. 2000).

14 *Wind Power Sys. Inc. v. Cannon Fin. Grp. Inc. (In re Wind Power Sys. Inc.)*, 841 F.2d 288, 292-93 (9th Cir. 1988); *In re Giordano*, 188 B.R. 84, 87-88 (D.R.I. 1995); *Liscinski v. Bobilin (In re Bobilin)*, 83 B.R. 258, 263 (Bankr. D.N.J. 1988).

15 *Ivester v. Miller*, 398 B.R. 408, 420-21 (M.D.N.C. 2008) (under North Carolina law, effective date of priority for prejudgment attachment lien against bank account is date of entry of judgment, and thus, it could be avoided under § 544).

16 The term "perfection," as used in relation to a prejudgment attachment lien, means converting it to a choate lien by entry of a judgment. *First Fed. Bank of Calif. v. Robbins (In re Robbins)*, 310 B.R. 626, 630 n.4 (B.A.P. 9th Cir. 2004); *FDIC v. Debtor & Trustee (In re Moscoso Villaronga)*, 111 B.R. 13, 17 (Bankr. D.P.R. 1989) ("perfects," in relation to a prejudgment attachment lien, "is not used to denote an imperfect lien, but rather, it is used in the sense that the prejudgment attachment lien will relate back to the date of the presentation, and that it can only be enforced once a final judgment is obtained by claimant").

17 *In re McNeeley*, 51 B.R. 816, 820 (Bankr. D. Utah 1985).

18 *In re Giordano*, 188 B.R. 84, 89 (D.R.I. 1995); *Quadrel Leasing de Puerto Rico Inc. v. Carlos A. Rivera Inc. (In re Carlos A. Rivera Inc.)*, 130 B.R. 377, 383 (Bankr. D.P.R. 1991); *FDIC v. Debtor & Trustee (In re Moscoso Villaronga)*, 111 B.R. 13, 18 (Bankr. D.P.R. 1989). These decisions were rendered in the context of a chapter 7 case, where there was no dispute that the property was not necessary to an effective reorganization.

19 *In re Aquarius Disk Services Inc.*, 254 B.R. 253, 260 (Bankr. N.D. Cal. 2000).

20 *Id.* at 260-61.

21 *First Fed. Bank of Calif. v. Robbins (In re Robbins)*, 310 B.R. 626, 630-31 (B.A.P. 9th Cir. 2004). The BAP suggested that relief might be denied if there are senior liens that render the attachment lien without equity or if there is an objection to the creditor's claim. *Id.* at 630.

22 *Cf. In re 473 West End Realty Corp.*, 507 B.R. 496, 503 (Bankr. S.D.N.Y. April 3, 2014) ("A bankruptcy court can conduct both an adequate protection and an analysis of the *Sonnax* factors when considering whether to lift the automatic stay pursuant to § 362(d)(1)."). The *Sonnax* factors, so named based on the Second Circuit's decision in *Sonnax Indus. Inc. v. Tri Component Products Corp. (In re Sonnax Indus. Inc.)*, 907 F.2d 1280 (2d Cir. 1990), are a set of 12 factors that are frequently used by bankruptcy courts "in deciding whether litigation should be permitted to continue in another forum." *Id.* at 1286.

23 *See In re SCO Grp. Inc.*, 395 B.R. 852, 856 (Bankr. D. Del. 2007) (quoting H.R. Rep. No. 595, 95th Cong., 1st Sess., 341 (1977), *U.S. Code Con. & Admin. News* 1978, pp. 5787, 6297)).

When the nonbankruptcy action in question is at a more advanced stage, relief from the automatic stay to litigate it to conclusion will more likely be granted.[24] The analysis for determining whether "cause" exists to allow litigation to proceed in its place of origin should be no less applicable when a prejudgment attachment has been obtained in the litigation.

Conclusion

In most jurisdictions, a creditor with a prejudgment attachment that was obtained outside the preference period will be considered to have a secured claim that is not avoidable under § 544 and survives a bankruptcy discharge. During the bankruptcy case, relief from the automatic stay to proceed to judgment in order to "perfect" the attachment should be granted when there is a lack of adequate protection or no equity in the property attached and it is not necessary to an effective reorganization. Alternatively, relief might be granted for "cause" in order to "perfect" the attachment with a judgment or, with the same result, to establish liability and damages in the nonbankruptcy litigation and thereby liquidate the creditor's claim. abi

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24 *Id.* at 858 (granting stay relief to conclude case that was trial-ready when corporate defendant filed for chapter 11). *See also In re Fischer*, 202 B.R. 341, 355 (Bankr. E.D.N.Y. 1996) (stay relief granted to conclude case that was pending for four years and where discovery was nearly complete).