Liens That Survive Bankruptcy:
Is There a Better Way to Get That Message to Debtor Clients?

by F. Lewis Biggs

Real estate lawyers report that they frequently run into situations in which a lien survives bankruptcy. Property owners enter into a contract for the sale or refinance of their land which has (or had) judgment liens attached to it. The homeowner confidently (but incorrectly) believes that prior bankruptcy proceedings have discharged those liens. Unfortunately, once it is determined that these liens were not in fact discharged, problems arise which may include the failure to perform the sales contract for sale or financing falling through.[1]

As a general rule, deeds of trust, judgment liens, and tax liens, among others, survive bankruptcy. A bankruptcy discharge may release a debtor from many *personal* liabilities, but it will not clear the lien from the property. Thus, a creditor may still enforce the lien against the *property* in an *in rem* proceeding.[2]

There are, of course, exceptions to the rule. Certain liens that are partially or fully "underwater" on the date of the bankruptcy filing may, in some circumstances, be avoided, "stripped-down," or "stripped-off." Those circumstances and their limitations[3] are beyond the scope of this article, but recent articles by other Virginia lawyers, mentioned below, explore that aspect of the law.[4]

Whether or not lien stripping or avoidance is (or was) available in bankruptcy, many debtors do not know that pre-bankruptcy liens survive discharge. This problem could arise from any of a number of possible sources, including (i) the abstract, confusing nature of lien survival vs. debt survival, (ii) an understandable tendency by debtors to focus on short term, pressing threats, (iii) a lack of effective communication between lawyers

and clients, and/or (iv) a failure of debtors to disclose (and their lawyers to identify) liens against real estate.

The purpose of this article is to highlight the long-term, sometimes devastating, impact of lien survival on individual debtors — and to urge bankruptcy lawyers who represent individuals to consider if there are ways to improve their clients' understanding and expectations.

The idea that liens exist independently from the underlying debts (and can survive the debts) is very a difficult concept for even the most sophisticated clients to grasp. Individual debtors facing bankruptcy are probably not going to study or understand complex disclaimers and warnings, no matter how well-crafted. Thus, I think it is fair to say that, *in an ideal world*, best practice would be to both (i) present clients with detailed written disclaimers and (ii) have specific and direct conversations with clients about the potential future impacts of lien survival. The former would protect the lawyer; the latter would help clients achieve understanding (and manage expectations). Even in situations where lien stripping or avoidance is not an option, better knowledge and understanding could help clients plan better and may prevent them from entering into sales contracts that they cannot perform because of the extent of liens against the property.

The issue of whether bankruptcy lawyers must or should run title searches is tricky. Debtors may not be able to accurately disclose liens, especially given the financial stress driving them to file. *In an ideal world*, obtaining current lien searches on all owned real estate would be best practice; many debtors, however, may not be willing or able to pay for those searches.

One possibility could be to try to reduce the cost of lien searches as much as possible. Some bankruptcy lawyers report that they send clients to the record room to search for judgments themselves. Other (more reliable?) options may be to order a "current owner search" (about $150 in the Richmond area), or a mere "judgment lien search" (about $75). High-volume bankruptcy offices may be able to negotiate discounts, perhaps by contracting directly with an independent title examiner certified by the Virginia Land Title Association. Search orders should specify and limit what copies are to be pulled (e.g., the source deed and any deeds of trust, for accurate scheduling, and docketed judgment liens).

Several practitioners identified what may be the most vexing problem concerning lien survival. If a judgment lien is known, the lawyer has a duty to analyze lien stripping or avoidance options. If any options are viable, the lawyer then has a duty to bring a motion or adversary proceeding seeking a remedy. The real cost to the debtor in the latter case is not the $150 title search but a substantial increase in legal fees because of the time and process involved in what in essence is an additional proceeding within the bankruptcy proceeding.

In preparation for writing this article, I spoke with bankruptcy practitioners about lien survival to account for their perspectives. One reported that his office requires that clients complete detailed paperwork that, among other things, discloses known liens. If the client discloses judgment liens, the office pulls records or has the client pull records. However, the office does not routinely order title searches. The office also provides clients a very detailed information packet disclosing that liens survive bankruptcy and offering, for a fee, to order title searches.[5] Several other bankruptcy practitioners confirm that the foregoing practice is typical.

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The easiest path for bankruptcy lawyers, it seems, may be to disclose but not really explain; and look for liens, but not look too diligently. This path may be prudent from a business standpoint, but it sometimes exacts a very heavy price from clients.

I hope this article highlights a frequent, yet not often thought about problem and

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invites consideration about ways to improve communications and subsequent long-term outcomes between bankruptcy attorneys and their debtor clients. ⚖

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Endnotes:

1 Consider the following real-life example: A former debtor was recently unable to close on a equity line of credit needed to send a son or daughter to college.

2 *See* 11 U.S.C. § 524 (Effect of Discharge). E.g., *In Re: Deutchman v. Internal Revenue*, 192 F.3d 457 (4th Cir., 1999) "As a general rule, liens pass through the bankruptcy process unaffected. This is because a bankruptcy discharge extinguishes only *in personam* claims against the debtor(s), but generally has no effect on an *in rem* claim against the debtor's property. In order to extinguish or modify a lien, the debtor must take some affirmative step toward that end." (citations omitted).

3 The following is a crude summary of the law related to lien stripping outside of the context of stripping/avoidance actions for preferences or fraudulent conveyances or under a trustee's strong-arm powers – Lien stripping is generally not available in Chapter 7 bankruptcies (*Dewsnup v. Timm*, 502 U.S. 410 (1992)), except to the extent certain judgment liens impair available homestead or other exemptions (11 U.S.C. § 522). It may be available in bankruptcies brought under Chapter 11 or 13 (11 U.S.C. § 506(a) and (d)), but the following broad exceptions apply: (a) Reorganization plans may not strip or otherwise "modify" a claim secured by a deed of trust on principal residence unless (at least in the 4th Circuit) such deed of trust is, on the date of filing, completely underwater; and (b) under Chapter 11, a creditor with some equity may be able to thwart efforts to strip by electing to have a its claim treated as fully-secured (11 U.S.C. § 111(b)(2)).

4 Recent articles covering lien-stripping in bankruptcy include *"Strip-Off" of Real Estate Liens in Bankruptcy*, by The Hon. Stephen S. Mitchell, THE FEE SIMPLE, Vol. XXXIV, No. 2 (Fall 2013) and *Stripping it Down – Real Estate Issues in Bankruptcy*, by Sarah Beckett Boehm, VIRGINIA LAWYER, Vol. 64 (February, 2016).

5 That information packet (reprinted with permission) contains the following excerpt related to liens on real estate, among others: "JUDGMENT LIENS – We do not obtain title examinations on your real property. Judgments may have been docketed as liens against your real property, and you may not know about it. A BANKRUPTCY DISCHARGE DOES NOT AUTOMATICALLY ELIMINATE JUDGMENT LIENS AGAINST YOUR REAL PROPERTY! GENERALLY, LIENS PASS THROUGH BANKRUPTCY AND ARE ENFORCEABLE AFTER BANKRUPTCY AGAINST THE PROPERTY THEY ARE ATTACHED TO! There are some limited circumstances where the lien may be modified by Court Order. But, it may be difficult, expensive and/or even impossible to have pre-Bankruptcy judgment liens removed or released. Please let us know if there are any judgment liens against your real property. If there are, please obtain a copy of the docketed lien from the Courthouse and bring it to us so, at your request, we can address this issue and advise you. If you don't know whether there are judgment liens, but suspect there may be, you should consider making arrangements to have a title examination done to determine lien existence and priorities. Remember, we do not do or arrange for title examinations unless special arrangements are made by you. They generally cost about $400.00 which you must pay for in advance."