

LIEN ON REAL PROPERTY HELD IN TENANCY BY THE ENTIRETIES WAS AVOIDABLE

The U.S. Bankruptcy Appellate Panel for the Eighth Circuit recently affirmed a bankruptcy court's holding that a creditor held an unenforceable lien against a debtor's real property because the property was owned by the entireties and the lien was thus avoidable under Bankruptcy Code § 522(f)(1).

A copy of the opinion is available at: [Link to Opinion](#).

The debtor and his wife purchased real property in Missouri in 1995. A limited liability company obtained a judgment against the debtor in Missouri and recorded the judgment in the county where the debtor lived.

The debtor filed a Chapter 7 bankruptcy petition and claimed his home as exempt pursuant to Missouri's homestead statute and § 522(b)(3)(B) of the Bankruptcy Code because the home was titled in tenants by the entireties.

The debtor filed a motion to avoid the judgment lien under Bankruptcy Code § 522(f)(1) arguing that it impaired his homestead exemption. The creditor objected to the motion, "but it did not object to Debtor's claimed exemption or the discharge of the Debtor's debt. The bankruptcy court entered a Chapter 7 discharge order."

The bankruptcy court granted the debtor's motion to avoid the lien, reasoning that the judgment lien "affixed" to the debtor's home once judgment was recorded, but was unenforceable. The creditor appealed to the Bankruptcy Appellate Panel, which affirmed, and the creditor appealed to the U.S. Court of Appeals for the Eighth Circuit.

The Eighth Circuit reversed and remanded to the bankruptcy court "to determine whether [the creditor] has a judicial lien on the property (either enforceable or unenforceable)."

"On remand, the bankruptcy court held that [the creditor] holds an unenforceable judgment lien" and granted the debtor's motion to avoid the lien under § 522(f)(1). The creditor appealed again to the Appellate Panel.

The Appellate Panel reasoned that "[t]he Bankruptcy Code allows debtors to exempt certain property from their bankruptcy estates, which are otherwise

composed of all of the debtor's legal or equitable interests in property. ... Unless they are avoided, pre-petition judgment liens ordinarily survive a debtor's bankruptcy and can be enforced on exempt property.”

The creditor argued that while it “does not have a lien for § 522(f)(1) purposes because Debtor and his wife own the Property in a tenancy by the entirety[,] ... its lien (which it claims does not exist today) will spring into effect upon the death of the Debtor's wife and survive the bankruptcy estate.”

The Appellate Panel disagreed, reasoning that the debtor's home was not “real estate” as defined by Missouri law because it was owned by the entireties, and therefore “it was not ‘liable to be sold upon execution’ based on the judgment, which was against only the Debtor and not his wife.”

The Appellate Panel then addressed whether a lien existed “for the purpose of § 522(f)(1) by looking to state law in the context of the Bankruptcy Code's definitions of the terms ‘judicial lien’ and ‘lien.’ Pursuant to Bankruptcy Code § 101(36), ‘a judicial lien’ is a ‘lien obtained by judgment, levy, sequestration, or other legal or equitable process or proceeding.’ ... The Bankruptcy Code defines the term ‘lien’ as ‘a charge against or interest in property to secure payment of a debt or performance of an obligation.’ ... The legislative history of the Bankruptcy Reform Act states that the definition of ‘lien’ is ‘very broad’ and includes ‘inchoate liens.’ ... The purpose of avoidance under § 522 is to allow the debtor to ‘void any judicial lien on exempt property.’”

The Panel further explained that “[t]he Bankruptcy Code does not limit the avoidance of judicial liens to those liens that are enforceable ... [and] [t]he Eighth Circuit ‘conclude[d] that where a judgment gives rise to an unenforceable lien, a debtor may move to avoid that lien under § 522(f).’ ... Where a judgment does not give rise to a lien at all ‘§ 522(f) is superfluous and without application.’”

Because the recording of the judgment cast a cloud on the debtor's exempt homestead property and was a “judicial lien” under the Bankruptcy Code, but unenforceable under Missouri law, the Panel concluded that the creditor “holds an unenforceable lien for the purposes of §522(f)” and the “[a]pplication of § 522(f) will clear the cloud on title.”

The Panel stressed that its “decision is consistent with the purpose of § 522(f), which favors protecting exemptions at the cost of judicial lienholders as a party of a debtor’s fresh start ... [and] [t]he legislative history ... suggests that a principal reason Congress singled out judicial liens was because they are a device commonly used by creditors to defeat the protection bankruptcy law accords exempt property against debts.”

The Panel concluded that “[i]t would be unfair to allow [the judgment creditor] to defeat the Debtor’s fresh start because it has now devised a scheme whereby it believes it may avoid the protections afforded to the Debtor by § 522(f) and still reap the benefit of its lien upon the death of the Debtor’s spouse.”

Accordingly, the bankruptcy court’s ruling was affirmed.