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When Does a Chapter 11 Plan Extinguish a Secured Creditor's Lien?

On October 26, 2009, Northern New England Telephone Operations LLC (NNETO) filed a voluntary Chapter 11 petition in the United States Bankruptcy Court for the Southern District of New York. On January 13, 2011, the bankruptcy court confirmed NNETO's Chapter 11 plan.

As of the petition date, NNETO owned several parcels of real property in Concord, New Hampshire, and was billed on a quarterly basis by the City of Concord for property taxes relating to the property. Concord filed timely proofs of claim relating to the taxes against NNETO with respect to quarters of the 2009 tax year that had been billed pre-petition, but Concord did not file proofs of claim relating to taxes for later quarters that were billed post-petition.

During the course of NNETO's bankruptcy proceedings, the bankruptcy court allowed Concord's proofs of claim relating to the quarters of the 2009 tax year that were billed pre-petition. As to the quarters of the 2009 tax year that were billed by Concord post-petition and for which Concord did not file proofs of claim, Concord, after NNETO's Chapter 11 plan was confirmed, filed a motion to allow those tax bills on the basis that the bills were secured by a lien and that lien was not discharged by the plan. NNETO opposed the motion on the ground that the lien was extinguished by the plan. The bankruptcy court, citing the plan provision that provided that "all property" of NNETO be free and clear of creditors' liens, held that NNETO's tax lien was extinguished and denied the motion. Concord appealed the ruling to the district court, and the district court affirmed. Concord then challenged the district court's affirmance on further appeal to the Second Circuit.

Liens Pass Through Bankruptcy Unaffected . . .

At the outset of the opinion, the Second Circuit recognized the general principle that liens pass through bankruptcy unaffected and that the Bankruptcy Code, as a general matter, leaves that principle intact. However, as the Second Circuit noted, section 1141(c) of the Bankruptcy Code creates an important caveat to that general principle, providing, in pertinent part:

Except as . . . otherwise provided in the plan or in the order confirming the plan, after confirmation of a plan, the property dealt with by the plan is free and clear of all claims and interests of creditors. . . .

Accordingly, pursuant to the express requirements in section 1141(c), a lien is extinguished by a Chapter 11 plan if (i) the plan is confirmed, (ii) the property subject to the lien is "dealt with" by the plan, and (iii) neither the plan nor the confirmation order preserves the lien.

. . . But the Lienholder Must Participate in the Proceedings

In addition to the express requirements of section 1141(c), the Second Circuit inferred a fourth consideration: that the lienholder participated in the bankruptcy proceedings. According to the Second Circuit, that consideration is "located squarely within" section 1141(c). Specifically, the

Second Circuit noted that the Bankruptcy Code “allows a plan to extinguish a lien only if the underlying property is ‘dealt with,’ and that condition cannot be fairly satisfied in the absence of . . . the security holder.” According to the Second Circuit, that conclusion is reinforced by the interplay between section 1141(c) (which extinguishes liens) and section 506(d)(2) (which preserves liens of lienholders who do not file a proof of claim (i.e., do not participate in the bankruptcy proceedings)). Therefore, according to the Second Circuit, reading the “dealt with” limitation in section 1141(c) to include only lienholders who participated in the bankruptcy proceedings harmonizes the sections.

The Plan “Dealt With” the Property

Concord and NNETO stipulated that the plan was confirmed and that the plan and confirmation order did not preserve Concord’s liens. As a result, on appeal, the primary issues were whether the plan sufficiently “dealt with” the property subject to Concord’s lien and whether Concord sufficiently participated in the bankruptcy proceedings.

The Second Circuit held that the following plan language, even though it did not specifically mention the property at issue, “dealt with” the property that was subject to Concord’s lien sufficiently and with enough specificity: “As of the Effective Date, all property of [NNETO] shall be free and clear of all . . . Liens. . . .”

Concord argued that such language did not “deal with” the property subject to Concord’s lien because it did not specifically mention the property. The Second Circuit rejected that argument because, among other reasons, requiring a debtor to specifically mention each piece of property that is being “dealt with” by a plan is simply unworkable.

Filing a Proof of Claim Is Sufficient Participation

The Second Circuit also rejected Concord’s argument that its participation in NNETO’s bankruptcy proceedings was insufficient to support the extinguishment of its lien. Specifically, Concord argued that it did not participate in NNETO’s bankruptcy proceedings with respect to the tax bills for which it did not file proofs of claim. In rejecting that argument, the Second Circuit, citing applicable non-bankruptcy law, noted that the same statutory lien related to the tax bills for which proofs of claim were filed and were not filed. Therefore, when Concord filed proofs of claim, it participated in the bankruptcy proceedings as to the property subject to the lien.

The Second Circuit Rejected Alternative Challenges to the Lower Court’s Rulings

Finally, the Second Circuit rejected the alternative challenges raised by Concord on appeal. Specifically, Concord argued that its lien could be saved by section 506(d)(2). However, according to the Second Circuit, section 506(d)(2) is merely a complement to section 1141(c). In other words, according to the Second Circuit, once the conditions for the application of section 1141(c) are established, section 506(d)(2) does not apply.

The Second Circuit also rejected Concord’s argument that the doctrine of “excusable neglect” should save its lien. Applying an “abuse of discretion” standard, the Second Circuit affirmed the

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bankruptcy court's refusal to allow Concord to file proofs of claim more than two years after the plan was confirmed.

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