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Plan Confirmation and Lien Extinguishment in Greater American Land Resources

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In the chapter 11 reorganization context, the Bankruptcy Code does not wholly protect the interests of secured creditors. Secured creditors should be mindful of the disposition of property for which they hold a security interest because liens can be (and often are) extinguished under the terms of a chapter 11 plan. In *In re Greater American Land Resources Inc.*,¹ the bankruptcy court was presented with the issue of whether a secured tax lien passed through the bankruptcy proceeding and survived a confirmed chapter 11 plan. The court ultimately found that the tax lien at issue passed through the plan and was not extinguished.



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The decision is helpful for secured creditors to understand how lien rights can be protected and/or treated in the plan context and the potential dangers that can arise, depending on their level of involvement in any particular case. Conversely, it is instructive where debtors seek to address a security in anticipation of reorganization, and shows that the debtor must, among other things, clearly address the lienholders' interest in the plan and include language that specifically deals with and extinguishes the lien.

Background

On March 18, 2008, Greater American Land Resources Inc. (the debtor) filed for chapter 11 relief in the U.S. Bankruptcy Court for the District of

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New Jersey. By way of background, the debtor operated a real estate business and owned, acquired and sold real property. As of the petition date, the debtor had less than a dozen unsecured creditors, and an official committee of unsecured creditors was not formed in the case, presumably because of lack of interest. According to the debtor's schedules, in relevant part, the debtor listed the following:

- Schedule A—Real Property:
 - Lot 5, Block 701, in Brick Township, N.J. (Lot 5)
 - Lot 17, Block 701 in Brick Township, N.J. (Lot 17)

Lien on Me

- Schedule B—Personal Property: suit against Plymouth Park Tax Services (Plymouth) to recover real estate taken without due process
- Schedule D—Creditors Holding Secured Claims:
 - Brick Township (Brick) lien on Lot 17
 - Plymouth tax sale certificate for Lot 5

The Plymouth tax sale certificate was apparently one of the reasons for the debtor's chapter 11 filing because in May 2008, during the pendency of the chapter 11 case, the debtor initiated an adversary proceeding by filing a complaint against Plymouth to vacate the tax foreclosure judgment and to avoid the transfer as fraudulent and from

other related relief, all relating to Lot 5. Quickly, in July 2008, the debtor resolved the adversary proceeding under the terms of a consent order, whereby the debtor agreed to redeem the tax sale certificate held by Plymouth by paying \$90,000, with \$9,000 being paid within five days of the entry of the consent order and the balance of \$81,000 to be paid within 90 days from entry of the consent order. Interestingly, no notice of the debtor's settlement of the litigation nor the consent order was provided to creditors under Rule 9019 of the Federal Rules of Bankruptcy Procedure. Thereafter, the payment terms were modified by written agreement between the parties; however, this modification is not disclosed in the decision. As of the date of the opinion, the debtor had satisfied the terms of the consent order and was, again, the owner of Lot 5.

The claims bar date established in the case was July 15, 2008. On April 23, 2008, Brick filed a proof of claim in the amount of \$30,504.08 (plus any accrued interest and penalties) for unpaid real estate taxes with respect to Lot 17. Brick was the only creditor to file a proof of claim in the case.

On Dec. 24, 2009, the debtor filed its initial chapter 11 plan and disclosure statement, which were subsequently amended in May 2010 by the filing of the first modified reorganization plan and the first modified disclosure statement. Both the initial and modified plans as well as the initial and modified disclosure statements identified the debtor rather than Plymouth as the owner of Lot 5, and described the Lot 5 litigation and settle-

¹ 452 B.R. 532 (Bankr. D. N.J. 2011).

ment as set forth above. With respect to Brick's claim, the modified plan was classified and provided as follows:

Secured Claims are Claims secured by liens on property of the Debtor's estate. The following represents all classes containing the Debtor's secured pre-petition Secured Claims and their treatment under this Plan:

Class 1—The Secured Claim of the Township of Brick. The Class One Claim shall be paid its Allowed Claim on the later of (i) the Effective Date or (ii) such date that the Claim becomes an Allowed Claim. This Class is not impaired, and therefore is not entitled to vote on the Plan.

The modified plan was approved and confirmed by the court by entry of a confirmation order on July 30, 2010.

After entry of the confirmation order, Brick filed a motion seeking the following: (1) relief from the automatic stay of § 362 of the Bankruptcy Code because its secured claim on Lot 17 had not been paid; (2) permission to amend its proof of claim to include taxes due on Lot 5; and (3) payment of the following amounts: (a) \$30,504.08 (pre-petition taxes) plus \$13,497.69 (post-petition taxes) for Lot 17, and (b) \$59,180.47 (pre-petition taxes) plus \$84,394.51 for Lot 5. According to the court, the basis for the relief requested was characterized by Brick as newly discovered evidence.² To this end, Brick relied on the certification of the Brick tax collector filed with the motion (as required by local rule), which provided in relevant part as follows:

[I]n regard to Block 701/Lot 5, it was [Brick]'s understanding that this property was foreclosed by Plymouth Park Tax Services LLC on August 25, 2006. However, upon receipt of debtor's Modified Disclosure Statement and Modified Plan, [Brick] first became aware that debtor's property was not foreclosed, but was still owned by debtor. Being that it was [Brick]'s understanding that the aforementioned property has been foreclosed, [Brick] did not file a proof of claim in regard to taxes owed. The amount owed on this property at the time of

[Brick]'s original proof of claim was \$59,180.47.³

The debtor did not dispute Brick's demand for payment of its secured claim with respect to Lot 17, including the post-petition tax obligations, and stated that it would make payment accordingly before the hearing on the motion. However, the debtor disputed that Brick was entitled to any relief with respect to Lot 5. The debtor disagreed that the facts could be considered newly discovered evidence, or even excusable neglect, and pointed out several relevant facts in support of its disagreement. Brick was regularly served with notices in the case, including notice of the hearing on the initial disclosure statement, a copy of which Brick could have obtained prior to the hearing date. If Brick had obtained a copy, it would have discovered that the adversary proceeding had commenced and that it was consensually resolved resulting in payment to Plymouth and recovery of ownership of Lot 5 by the debtor. The debtor further asserted that all of the facts regarding the resolution of the adversary proceeding were set forth clearly in the modified disclosure statement and modified plan, which were served on Brick prior to the confirmation hearing. Finally, the debtor noted that Brick did not seek to amend its proof of claim prior to confirmation to include any Lot 5 tax obligations and Brick did not object to the modified plan or appear at the hearing on confirmation of the modified plan.

In addition to disputing that the facts supported Brick's motion, the debtor further argued that Brick's rights are governed exclusively by the terms of the modified plan because it was confirmed and that Brick's failure to assert a tax claim for Lot 5 prior to confirmation barred it from doing so after the fact. Specifically, the debtor relied on Article IV of the modified plan, which contained this standard vesting language: "[T]he Confirmation vests all of the property of the estate in the Debtor, free and clear of all Claims and Equity Interests."⁴

The court noted the following definitions contained in the modified plan as relevant in order to understand the vesting provisions: (1) "claim" is "any right to payment from the Debtor whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured or unsecured"; (2) "equity interest" is

defined as "any interest of ownership in the Debtor"; and (3) the "effective date" of the modified plan is the day the confirmation order becomes final, which occurred on Aug. 14, 2010.⁵

Finally, the court observed that pursuant to the confirmation order, (1) the debtor was discharged from all pre-petition debts and claims, (2) all creditors were permanently enjoined from pursuing collection efforts against the debtor relating to any debt due and owing, and (3) the modified plan was binding on the debtor, each creditor of the debtor, each holder in interest (as that term was defined in the confirmation order), and each other party in interest in the chapter 11 case.⁶ In addition, and importantly, the court noted that the confirmation order also dissolved the automatic stay on the effective date.⁷

The court effectively framed the issues raised by Brick's motion as two-fold: (1) what the effect was of confirmation of the modified plan and whether Brick's lien on Lot 5 survived confirmation, and (2) if so, whether the automatic stay applied necessitating relief therefrom in order for Brick to commence collection efforts for accrued taxes on Lot 5. Due to the court's ultimate decision, it was not necessary for the court to determine the issue as to whether Brick should be allowed to amend its proof of claim.

Discussion Automatic Stay

The court first discussed the more straightforward automatic-stay issue and examined the modified plan and the language of §§ 1141 and 362 of the Code. The court held that the automatic stay did not apply because all property of the estate vested in the debtor, the debtor was discharged of all pre-confirmation debts and the automatic stay terminates when such a discharge is granted.⁸ To the extent that Brick's lien on Lot 5 survived the plan process, the automatic stay did not apply with respect to Brick's rights as to enforcement. Thus, the primary issue remained: Was Brick's lien on Lot 5 extinguished?

Effect of Confirmation

The debtor contended that under § 1146(c) of the Code, Brick's lien was extinguished just the same as the debtor's other pre-petition and pre-confirmation debts. Brick maintained that its lien

⁵ *Id.*

⁶ *Id.*

⁷ *Id.*

⁸ *Id.* at 538.

² *Greater American Land Resources*, 452 B.R. at 536.

³ *Id.*

⁴ *Id.* at 537.

on Lot 5 was unaffected by confirmation. The court was thus posed with reconciling §§ 1146(c) and 506(d). Section 1146(c) provides:

(c) Except as provided in subsections (d)(2) and (d)(3) of this section and 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, equity securityholders, and of general partners in the debtor.⁹

The debtor argued that § 1146(c) provides a claim preclusion effect stemming from the modified plan and confirmation order and that Brick was bound thereunder. However, § 506(d) permits a secured creditor's lien to survive confirmation and continue through bankruptcy unaffected.¹⁰ The court noted that several circuit courts had addressed the present issue and the effect of a confirmed chapter 11 plan on a secured creditor's lien and looked to such decisions for the court's analysis of Brick's lien on Lot 5. The court focused in particular on two decisions, *In re Penrod*¹¹ and *In re Ahern Inc.*,¹² and adopted the factors enunciated in *Ahern*.

Penrod involved the effect of a confirmed plan on a secured creditor's lien when the plan was silent as to such lien (as in the present case). The Seventh Circuit defined the issue as, "What is the default rule when neither the plan nor the confirmation order mentions preexisting liens?"¹³ *Penrod* provides that unless the chapter 11 plan, or order confirming the plan, says that a lien is preserved, it is extinguished by plan confirmation, provided, however, that the lienholder participated in the reorganization.¹⁴ If the lienholder did not participate, "his lien would not be 'property dealt with by the plan,' and so section [1141(c)] would not apply."¹⁵

The court ultimately turned to *Ahern*, which analyzed the holdings from the various circuits and set forth the follow-

ing factors for determining whether a lien can be extinguished under § 1141(c): "(1) the plan must be confirmed; (2) the property that is subject to the lien must be dealt with by the plan; (3) the lienholder must participate in the reorganization; and (4) the plan must not preserve the lien."¹⁶ Importantly, *Ahern* also took up the problematic issue that had split courts interpreting and applying *Penrod*: What exactly must be "dealt with" in a plan; the lien itself or the property that is subject to the plan? *Ahern* decided that "because liens constitute one of the interests that section 1141(c) extinguishes, it is sensible to interpret 'property dealt with by the plan' as the property subject to the lien."¹⁷

The court then applied the *Ahern* factors to Brick's lien and Lot 5. First, it determined that Brick did not participate in the chapter 11 case with regard to its tax lien on Lot 5.¹⁸ Brick did not file a claim for taxes due on Lot 5, most likely due to the fact that it understood Plymouth to be the owner of Lot 5.¹⁹ However, even after Brick learned that the debtor had reacquired Lot 5, Brick did not take any action to participate—either by filing a claim or participating in the confirmation process.²⁰

Second, the court found that Brick's tax lien with respect to Lot 5 was not "dealt with" for purposes of § 1141(c).²¹ The court noted that the debtor surely knew that Brick held a tax lien for unpaid taxes on Lot 5, yet the modified plan did not have any provisions for the Lot 5 tax lien as it did for Brick's lien with respect to Lot 17.²² The debtor neither provided for payment of the secured creditor's claim nor did it provide for any treatment for its lien.²³ The modified plan and modified disclosure statement were therefore completely silent as to Brick's unpaid taxes and lien on Lot 5.

Finally, the court was not persuaded that the modified plan's plain language extinguished Brick's tax lien on Lot 5. The court looked to the revesting language in Article IV of the modified plan relied on by the debtor and found that the language did not extend to an "interest" such as Brick's lien on Lot 5 for purposes of § 1141(c). Instead, Article IV provided that "all of the property of the

estate [which included Lot 5] revested in the Debtor, free and clear of all Claims and Equity Interests"²⁴ as those terms were specifically defined in the plan. Thus, as the court pointed out, the debtor actually modified the effect of § 1141(c) by limiting "interests" under the plan to include only the defined term "equity interests."²⁵ Accordingly, the court determined that because Brick did not participate in the bankruptcy with respect to its lien on Lot 5 sufficiently to permit Brick's lien on Lot 5 to be extinguished and such lien was not dealt with in the modified plan, the lien survived *in rem* pursuant to § 506(d).²⁶

Conclusion

If a secured lienholder participates in a bankruptcy proceeding with respect to its security interest and fails to object to the treatment of its lien in a plan, the lienholder's interest may be extinguished despite any protection lienholders may be entitled to under § 506(d). Lienholders should involve themselves in the plan-confirmation process and object to the plan if necessary to enforce their rights. Further, lienholders should always file proofs of claim for their secured interests to ensure that the claim will be addressed by the debtor under its plan and as a prophylactic measure for any potential deficiency claims. In the case of *Greater American*, the secured creditor should not have assumed that the debtor no longer had an interest in the real property and should have filed a claim in the case. In contrast, debtors seeking to extinguish secured claims by a plan must expressly address the lienholder's claim and provide adequate notice to the lienholder of the treatment and disposition of the security interest. ■

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⁹ *Id.* at 538-39; 11 U.S.C. § 1146(c).

¹⁰ *Greater American*, 452 B.R. at 539; 11 U.S.C. § 506(d); *Long v. Bullard*, 117 U.S. 617, 620-21, 6 S.Ct. 917, 29 L.Ed. 1004 (1886) (providing that liens pass through bankruptcy unaffected and serving as basis for § 506(d)); *FDIC v. Union Entities (In re Be-Mac Transp. Co. Inc.)*, 83 F.3d 1020, 1025 (8th Cir. 1996).

¹¹ 50 F.3d 459 (7th Cir. 1995).

¹² 507 F.3d 817 (5th Cir. 1997).

¹³ *Id.* at 540. See also *Airadigm Communs. Inc. v. FCC (In re Airadigm Communs. Inc.)*, 519 F.3d 640 (7th Cir. 2008) (discussing and explaining *Penrod* decision).

¹⁴ *Greater American*, 452 B.R. at 540; *Penrod*, 50 F.3d. at 463.

¹⁵ *Id.* See also *Airadigm*, 519 F.3d at 649 (explaining that if property is dealt with under plan, then property is free and clear under § 1141(c), but in order to be "dealt with," plan must provide that lienholder has been compensated or otherwise impliedly affected its interest).

¹⁶ *Greater American*, 452 B.R. at 542 (quoting *Ahern*, 507 F.3d at 822).

¹⁷ *Greater American*, 452 B.R. at 542 (quoting *Ahern*, 507 F.3d at 823) (noting that if lien is property that must be dealt with, then § 1141(c) would have to be read to say that "liens dealt with by the plan are free and clear of liens." *Id.*).

¹⁸ *Greater American*, 452 B.R. at 543.

¹⁹ *Id.*

²⁰ *Id.*

²¹ *Id.*

²² *Id.*

²³ *Id.*

²⁴ *Id.* at 544.

²⁵ *Id.*

²⁶ *Id.*