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## The Second Circuit Establishes a Binding Standard For Lien Extinguishment Under a Plan of Reorganization

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The Second Circuit Court of Appeals recently issued an opinion, *City of Concord, N.H. v. N. New England Tel. Operations, LLC (In re N. New England Tel. Operations LLC)*, 795 F.3d 343 (2d Cir. 2015), addressing an issue of first impression and holding that a reorganization plan extinguishes a lien pursuant to §1141(c) if certain elements are present. The *New England Telephone* decision is important for secured creditors to understand in order to fully protect their liens in a reorganization case.

Northern New England Telephone Operations, LLC and its parent corporation, FairPoint Communications Inc. (the “Debtors”), filed chapter 11 voluntary petitions on October 26, 2009 (the “Petition Date”) in the United States Bankruptcy Court for the Southern District of New York. The Debtors owned real property in Concord, New Hampshire which required them to pay taxes to the City of Concord (the “City”). Real estate taxes in Concord, New Hampshire are paid quarterly. Payment obligations accrue for the year, however, on April 1<sup>st</sup>, with quarterly tax bills issuing in July for Q1, October for Q2, January for Q3, and March for Q4. After the Petition Date, the City filed secured proofs of claim for both the first and second quarter tax installments, but it failed to file proofs of claim for the third and fourth quarter taxes. Payment on the bills for the third and fourth quarter installments were due post-petition, on January 2, 2010, and March 31, 2010, respectively. On January 13, 2011, the Debtors confirmed their plan of reorganization (the “Plan”). Without addressing the City’s lien with any specificity in the Plan, it did state that the Debtors’ property was to be free and clear of all claims, liens and interests.

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Years after confirmation, the City filed a motion for allowance and payment of its secured claims for the third and fourth quarter taxes. The bankruptcy court held that the confirmed Plan extinguished the City's lien, explaining that the Plan declared all property of the Debtors to be free and clear of liens, including the City's liens, because the City asserted the tax liabilities for the first and second quarters by filing claims, but did not do so for the third and fourth quarters. The district court affirmed the bankruptcy court's decision and the City appealed to the Second Circuit Court of Appeals.

The Second Circuit affirmed the decision of the lower courts denying the City's motion for allowance of payment of its claims. The issue before the Second Circuit, which it had never before decided, was what standard it should apply in evaluating when a secured creditor's lien is extinguished. The Court held that "[a] lien is extinguished by a Chapter 11 plan if: (1) the text of the plan does not preserve the lien; (2) the plan is confirmed; (3) the property subject to the lien is 'dealt with' by the terms of the plan; and (4) the lienholder participated in the bankruptcy proceedings." The Court held that all four requirements had been satisfied as to the City's claimed liens for the third and fourth quarter taxes.

To articulate this standard, the Second Circuit first focused on the language set forth in section 1141(c) of the Bankruptcy Code that "after the confirmation of a plan, the 'property dealt with by the plan' is free and clear of all claims and interests of creditors...." The Court concluded that three of the four elements were expressly found in this statute. With regard to the fourth element, the Court explained that the property could not be 'dealt with' in the Plan in the absence of the interested parties, including the lienholder.

Applying the first two of the four elements, the Court found that it was undisputed that the Plan contained no language preserving the City's lien with respect to the third and fourth installments and that the plan was confirmed. With regard to the third factor, the Court found that the Plan provision stating "all property...shall be free and clear of all ...liens" included all of the Debtors' property, and as such, the property subject to the City's lien is dealt with by this provision. As to the fourth element concerning participation, the Court held that when the City filed proofs of claim for the first and second quarter property tax bills, it "participated" as to the property subject to this lien. The Court was careful to note that while the lien was converted from inchoate security into a full tax lien only after the City filed its proofs of claim, the City sufficiently participated because the single lien secured payment of the tax bills for which the City filed claims and for those which it did not. It may not be obvious, but should be noted that the City's lien was not extinguished with respect to the first two tax installments because the Plan provided "*except as specially provided in the Plan...all property...shall be free and clear of all ...liens.*" Since the City filed secured proofs of claim for the first and second installments, the City's claim for the first and second installments would have had to have been "*specially provided for in the Plan*" by being placed in a secured class with language that the City shall retain its lien securing the first and second installments.

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There are two important takeaways from this case for secured creditors, especially municipalities. The first is that secured creditors should be aware that while it is advisable to participate in a reorganization case by filing claims and reviewing the debtor's proposed plan to determine how their claims will be treated, just the filing of a single proof of claim with no further participation will be adequate participation for their liens to be extinguished if the other factors are satisfied. The second and implied takeaway is that a municipality should consider including all tax installments into a proof of claim even if some of the installments are due post-petition. Otherwise, if the four elements of the *New England Telephone* case are otherwise met, the lien, securing the tax installments that were not included in the claim, will be extinguished leaving the municipality no way to collect the debt that it failed to include in a proof of claim. This takeaway would likely apply to municipalities participating in Chapter 13 cases as well since, like section 1141(c) of the Bankruptcy Code, section 1327(c) similarly states "the property vesting in the debtor ...is free and clear of any claim or interest of any creditor provided for by the plan." See 11 U.S.C. §1327(c).

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