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One Method to Protect Your Secured Position in Bankruptcy – Don't Participate

In a recent decision, the Fifth Circuit Court of Appeals addressed the impact of a confirmed plan of reorganization upon a secured creditor that does not participate in the case. In *Acceptance Loan Company, Inc. v. S. White Transportation, Inc. (In re S. White Transportation, Inc.)*, No. 12-60648, 2013 WL 3983343 (5th Cir. Aug. 5, 2013), the court held that the lien of a creditor that did not participate in the Chapter 11 proceeding survived the confirmation of a plan of reorganization that provided that the holder of the lien be paid nothing under the plan.

Acceptance Loan Company, Inc. perfected a security interest in the debtor's office building in 2004. The debtor contested the validity of Acceptance's lien in Mississippi state court for a number of years prior to filing Chapter 11 in May 2010. The debtor listed Acceptance's lien as "disputed" on its bankruptcy schedules, and it was uncontested that Acceptance received notice of the bankruptcy proceeding on numerous occasions. However, Acceptance never filed a proof of claim or otherwise involved itself in the bankruptcy case. The debtor filed a plan that contested the validity of Acceptance's lien and provided that Acceptance would receive nothing. The plan was confirmed by the bankruptcy court in December 2010. *On January 4, 2011, Acceptance moved the bankruptcy court for a declaratory judgment that its lien survived the confirmation of the plan, or alternatively, to amend the order of confirmation to provide for Acceptance's lien. The bankruptcy court denied the motion relying upon 11 U.S. C. § 1141(c), which provides that property dealt with in a confirmed plan is held "free and clear of all claims and interests." Although the Fifth Circuit had previously held that section 1141(c) voids only the liens of creditors that participate in the case, the bankruptcy court found that Acceptance had participated in the case by receiving notice of the bankruptcy. Acceptance appealed the bankruptcy court's order. The district court reversed, holding that mere notice did not constitute "participation." The debtor appealed to the Fifth Circuit.*

Citing prior Fifth Circuit decisions, the court began its analysis by noting that a lien creditor can ignore the bankruptcy proceeding and look to the lien for satisfaction of its debt, unless the lien is invalidated by some provision of the Code. Addressing section 1141(c), the court said that in *Elixer Industries, Inc. v. City Bank & Trust Co. (In re Ahern Enterprises, Inc.)* 507 F.3d 817, 822 (5th Cir. 2007), it had previously ruled that in addition to confirmation of a plan that dealt with the

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property subject to the lien (which lien was not preserved in the plan), the lien holder must participate in the reorganization. "Participation," said the court, "must be active and not mere nonfeasance." Two other Circuit Courts of Appeals addressing similar issues had reached the same conclusion. *See In re Penrod, 50 F.3d 459 (7th Cir. 1995)* and *FDIC v. Union Entities (In re Be-Mac Transp. Co.)*, 83 F. 3d 1020 (8th Cir. 1996). The court noted that it was unable to find any case voiding a lien in the face of no involvement by a secured creditor other than the receipt of notice. Passive receipt to notice is not enough to constitute participation by the creditor.

Upon being faced with a bankruptcy proceeding, a secured creditor's first reaction might be to immediately interject itself in the proceeding to vigorously protect its rights. The *S. White* decision suggests that strategically, the creditor should consider the ramifications of participating in the case as opposed to not participating at all and thereby preserving its lien.

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