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Survival of Liens: "Liens Pass through Bankruptcy Unaffected" — or Do They? *In Re Penrod — Challenging an Adage*

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NOTES

SURVIVAL OF LIENS: "LIENS PASS THROUGH BANKRUPTCY UNAFFECTED"—OR DO THEY? *IN RE PENROD*—CHALLENGING AN ADAGE: *In re Penrod*, 50 F.3d 459 (7th Cir. 1995)

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I. INTRODUCTION

The principle that a bankruptcy proceeding will not affect the existence of a valid prepetition lien can be found as early as 1886 in the landmark Supreme Court case *Long v. Bullard*.[1] For over 100 years and through two iterations of bankruptcy legislation, the long held tenet that *"liens pass through bankruptcy unaffected"* has been the presumed standard.

1. 117 U.S. 617 (1886).

The Seventh Circuit Court of Appeals, however, in *In re Penrod*[2] concluded that a secured creditor, indeed, may be divested of its lien by participating in a bankruptcy proceeding.[3] At first glance, *In re Penrod* only applies to situations where a secured creditor files a proof of claim and approves a plan of reorganization that does not expressly preserve its prepetition lien rights. Upon a closer examination, however, the decision demonstrates a conflict among the courts regarding a secured creditor's rights in a bankruptcy proceeding. Furthermore, *In re Penrod* reflects a conflict regarding the effect of confirmation of a plan of reorganization.[4]

By analyzing the rationale behind *In re Penrod* and the conflicting views regarding the effect of bankruptcy on creditors' liens, the *In re Penrod* decision offers insight into the manner by which judges attempt to balance the "fresh start" goal of the Bankruptcy Code and the protection of secured creditor's property rights during a bankruptcy proceeding.[5] This Note focuses on the implications of *In re Penrod* to creditors and debtors and examines how the tension between the divergent interests of these two groups influences judges' interpretations of the Bankruptcy Code.

Section II of this Note reviews the decision in *Long v. Bullard*, which is frequently credited with developing the adage that "liens pass through bankruptcy unaffected."[6] Next, Section II examines the impact of *Long v. Bullard* on the Bankruptcy Code of 1978.[7] Finally, Section II explores the different approaches to the effect of confirmation in a plan of reorganization.[8] Section III examines the facts of *In re Penrod* and the decisions of the bankruptcy court and court of appeals.[9] Section IV examines the issues raised by *In re Penrod* in light of the conflicting goals of bankruptcy.[10] Section IV also compares the *In re Penrod* court's approach to the approach taken by other courts in addressing the survival of a lien in a bankruptcy proceeding and the effect of confirmation.[11] Section V concludes that the balancing approach taken by Judge Posner in *In re Penrod* is fair to both debtors and creditors and is the best approach from a statutory, practical, and administrative sense.[12]

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2. *In re* Penrod, 50 F.3d 459 (7th Cir. 1995).
3. *Id.* at 461.
4. Confirmation is the process by which the bankruptcy court approves a debtor's plan for reorganization. For a general discussion of the procedure and requirements of confirmation, see 3 DANIEL R. COWANS, BANKRUPTCY LAW AND PRACTICE § 19.19 (6th ed. 1994) (discussing confirmation process in Chapter 13); 4 DANIEL R. COWANS, BANKRUPTCY LAW AND PRACTICE §§ 20.26, 20.28 (6th ed. 1994) (discussing confirmation process in chapter 11).
5. *See infra* notes 131-208 and accompanying text.
6. *See infra* notes 18-25 and accompanying text.
7. *See infra* notes 26-76 and accompanying text.
8. *See infra* notes 77-89 and accompanying text.
9. *See infra* notes 90-130 and accompanying text.
10. *See infra* notes 150-67, 182-86 and accompanying text.
11. *See infra* notes 168-208 and accompanying text.
12. *See infra* notes 209-10 and accompanying text.

II. BACKGROUND

Long v. Bullard is often cited for the adage that "liens pass through bankruptcy unaffected."[13] The relationship between this adage and the Bankruptcy Code of 1978 (the Code or the Bankruptcy Code) is of particular importance in understanding the impact of the *In re Penrod* decision. Unfortunately, there is little consensus among courts as to where and to what extent the principle that liens pass through bankruptcy unaffected is incorporated into the Bankruptcy Code.[14] As a prelude to an analysis of *In re Penrod*, therefore, this section first briefly reviews the facts and holding of *Long v. Bullard*.[15] Next, this section examines the differing approaches taken by courts in applying the concept that "liens pass through bankruptcy unaffected" with respect to the Bankruptcy Code.[16] This section concludes with a discussion of courts' differing views regarding the binding nature of confirmation in a plan of reorganization.[17]

A. Long v. Bullard

On November 18, 1872, Francis and Betsey Long borrowed $1,220 from Daniel Bullard, using their homestead as security.[18] Mr. Long entered into bankruptcy in 1873, including the debt and security interest to Mr. Bullard in the schedules.[19] Mr. Bullard did not participate in the bankruptcy proceedings.[20] Mr. Long was discharged from his obligations in 1874 and was permitted to retain the homestead as exempt property under state law.[21]

In 1878, Mr. Bullard brought a suit in the state court to enforce his obligation against the property.[22] The Longs responded that the obligation to Mr. Bullard was discharged in the bankruptcy proceeding and that Mr. Bullard was precluded from enforcing the obligation against the Longs' homestead.[23] The Supreme Court held that Mr. Bullard's lien was preserved as "the creditor neither proved his debt in bankruptcy nor released his lien. Consequently [Mr.

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13. *In re* Fischer, 91 B.R. 55, 57 n.5 (Bankr. D. Minn. 1988).
14. *See infra* notes 28-76 and accompanying text.
15. *See infra* notes 18-25 and accompanying text.
16. *See infra* notes 28-76 and accompanying text.
17. *See infra* notes 77-89 and accompanying text.
18. Long v. Bullard, 117 U.S. 617 (1886). Although the homestead was only in the name of Betsey Long, both Francis and Betsey Long executed the note and the deed securing the note with the homestead. *Id.* at 617-18.
19. *Id.* at 618.
20. *Id.*
21. *Id.* The Bankruptcy Act permitted a debtor to retain property which, pursuant to state law, was exempt from levy and sale upon execution. *Id.* For the counterpart of this provision in the Bankruptcy Code, see 11 U.S.C. § 522 (1994).
22. *Long*, 117 U.S. at 618.
23. *Id.*

Bullard's] security was preserved notwithstanding the bankruptcy of his debtor."[24] From this holding, courts have inferred the principle that "liens pass through bankruptcy unaffected."[25]

B. Survival of Liens and the Bankruptcy Code of 1978

The adage first enunciated in *Long v. Bullard*, that "liens pass through bankruptcy unaffected," remained a well-established principle in the Bankruptcy Act of 1898.[26] The Bankruptcy Act of 1898, however, was *replaced* by

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24. *Id.* at 620-21.

25. *See* Johnson v. Home State Bank, 501 U.S. 78, 83 (1991) ("Codifying the rule of *Long v. Bullard*, the Code provides that a creditor's right to foreclose on the mortgage survives or passes through the bankruptcy." (citation omitted)); *In re* Tarnow, 749 F.2d 464, 466 (7th Cir. 1984) ("One purpose of section 506(d)(1) is simply to codify the rule of *Long v. Bullard*—which previously had been purely a judge-made rule of bankruptcy law—permitting liens to pass through bankruptcy unaffected."); *In re* Fischer, 91 B.R. 55, 57 n.5 (Bankr. D. Minn. 1988) ("[T]he longstanding generalized principle that pre-petition liens survive discharge in bankruptcy . . . [is known] in bankruptcy parlance as 'the rule of *Long v. Bullard*.'"); *accord In re* Penrod, 50 F.3d 459, 461 (7th Cir. 1995); Southtrust Bank v. Thomas (*In re* Thomas), 883 F.2d 991, 996-97 (11th Cir. 1989); Simmons v. Savell (*In re* Simmons), 765 F.2d 547, 559 (5th Cir. 1985).

The Supreme Court's holding in *Long v. Bullard* also stated that both exempt and nonexempt property remain subject to the enforcement of a secured creditor's lien. This concept is codified in § 522 of the Bankruptcy Code of 1978 which provides that property that qualifies for exemption under § 522 is not subject to any prepetition debt, except debt that is secured by a lien that is not void or has not been avoided under specific sections of the Code. 11 U.S.C. § 522(c)(2)(A) (1994). *See* H.R. REP. No. 95-595, 95th Cong., 1st Sess. 361 (1977); S. REP. NO. 95-989, 95th Cong., 2d Sess. 76 (1978) ("The bankruptcy discharge will not prevent enforcement of valid liens. The rule of *Long v. Bullard* is accepted with respect to the enforcement of valid liens on nonexempt property as well as on exempt property." (citation omitted)); *see also* Estate of Lellock v. Prudential Ins. Co., 811 F.2d 186, 188 (3rd Cir. 1987); Chandler Bank v. Ray, 804 F.2d 577, 579 (10th Cir. 1986) (referring to the legislative history of § 522).

Thus, courts are in agreement that the mere exemption of property from the bankruptcy process does not invalidate a prepetition lien. *See* Owen v. Owen, 500 U.S. 305, 308-09 (1991) ("[T]he rule of *Long v. Bullard* [is] codified in § 522." (citation omitted)); *accord* Farrey v. Sanderfoot, 500 U.S. 291, 297 (1991); Riggs Nat'l Bank of Washington, D.C. v. Perry, 729 F.2d 982, 987-88 (4th Cir. 1984) (Widener, J., dissenting); *In re* Stauffer, No. CV S-95-281 GEB, 1995 U.S. Dist. LEXIS 8574, at *7-8 (E.D. Cal. June 1, 1995); United Pres. Life Ins. Co. v. Barker, 31 B.R. 145, 147 (Bankr. N.D. Tex. 1983).

26. Bankruptcy Act of 1898, ch. 541, 30 Stat. 544 (1898) (repealed 1978). The Bankruptcy Act of 1898 established a uniform system of bankruptcy throughout the United States. *Id.* The Bankruptcy Act of 1898 is commonly referred to as the "Bankruptcy Act" or simply the "Act." *See* DAVID G. EPSTEIN ET AL., BANKRUPTCY 4 (1993).

The concept that bankruptcy does not affect the liens of creditors was codified in § 67d of the Bankruptcy Act. *See* City of Richmond v. Bird, 249 U.S. 174 (1919) (holding that the statutory priority of tax claims established in § 64a could not take preference over a valid creditor's lien as § 67d expressly protected such liens in the bankruptcy process); *see also* Dewsnup v. Timm, 502 U.S. 410, 418 (1992) (discussing *City of Richmond v. Bird*); John Miles, Book Note, 46 ARK. L. REV. 689, 695 (1993-94) (reviewing *Dewnsup v. Timm*).

The Bankruptcy Act of 1898 was amended in 1938 and the initial language of § 67d was removed. Nonetheless, courts continued to uphold the principle that "liens pass through bankruptcy unaffected." *See* Oppenheimer v. Oldham, 178 F.2d 386, 389 (5th Cir. 1949); *In re* Unidraft Homes, Inc., 370 F. Supp. 667, 672 (W.D. Va. 1974); *In re* John S. Goff, Inc., 141 F. Supp. 862, 863-64 (D. Me. 1955); *In re* Wordon, 107 F. Supp. 496, 498 (W.D. Ky. 1952); *In re* Van Winkle, 49 F. Supp. 711, 713-14 (W.D. Ky. 1943) (fundamental principle of § 67d was not changed by the 1938 Chandler Act revisions of that section); *see also Dewsnup*, 502 U.S. at 418 ("A respected bankruptcy authority convincingly explained that this was done not

the Bankruptcy Reform Act of 1978.[27] Subsequently, courts have disagreed as to the extent the principle is applicable under the Bankruptcy Code of 1978.[28] The conflict is based upon the courts' differing perceptions regarding the scope of the debtor's discharge under the applicable provisions of the Bankruptcy Code.

1. Debtor's Discharge in General

One of the fundamental goals of bankruptcy is to enable the debtor to obtain an economic "fresh start."[29] This goal is primarily realized by discharging a debtor from liability for certain debts.[30] Section 524 of the Bankruptcy Code[31] discusses the general effect of discharge and is applicable to Chapters 7, 9, 11, 12, and 13 of the Bankruptcy Code.[32]

Section 524 provides that a discharge under one of the aforementioned chapters of the Bankruptcy Code voids any judgments of personal liability of the debtor and operates as an injunction against attempts by creditors to collect debts as a personal liability of the debtor.[33] It is important to note that section 524(a) applies only to the debtor's *personal* liability.[34] Accordingly, a valid prepetition lien that is not paid or otherwise eliminated during the bankruptcy process is not affected by discharge.[35] This in personam-in rem distinction takes on further significance in determining the scope of the discharge within the specific provisions of the various chapters.[36]

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to remove the rule of validity but because the draftsmen of the 1938 Act desired generally to specify only what should be invalid." (citing JAMES W. MOORE ET AL., 4B COLLIER ON BANKRUPTCY ¶ 70.70, at 771 (James W. Moore & Lawrence P. King eds., 14th ed. 1979)); Miles, *supra*, at 695.

27. Bankruptcy Reform Act of 1978, Pub. L. No. 96-598, 92 Stat. 2549 (1978) (codified as amended at 11 U.S.C. §§ 101-1330 (1994)). The Bankruptcy Reform Act is commonly referred to as the "Bankruptcy Code" or simply the "Code." *See, e.g.*, Miles, *supra* note 26, at 696 ("[T]he Bankruptcy Act was repealed and replaced by the Bankruptcy Code of 1978. The Code was intended as a comprehensive overhaul of the entire bankruptcy system and included many substantive changes from the Act."). The majority of the Code's substantive changes are beyond the scope of this Note and will not be discussed.

28. *See infra* notes 42-76 and accompanying text.

29. *See infra* notes 135-50 and accompanying text.

30. *See* WILLIAM L. NORTON, JR., NORTON BANKRUPTCY LAW AND PRACTICE 2d ch. § 48.1 (2d ed. 1994); Charles L. Green, *Recent Development in Bankruptcy Law: Effect of Discharge*, 1 BANKR. DEV. J. 323, 323 (1984).

31. 11 U.S.C. § 524(a)(1) (1994).

32. *See generally* 11 U.S.C. §§ 701-766 (1994) (Chapter 7—Liquidation); 11 U.S.C. §§ 901-946 (1994) (Chapter 9—Adjustments of Debts of a Municipality); 11 U.S.C. §§ 1101-1174 (1994) (Chapter 11—Reorganization); 11 U.S.C. §§ 1201-1231 (1994) (Chapter 12—Adjustments of Debts of a Family Farmer with Regular Annual Income); 11 U.S.C. §§ 1301-1330 (1994) (Chapter 13—Adjustments of Debts of an Individual with Regular Annual Income).

33. 11 U.S.C. § 524.

34. *See* KENNETH N. CLEE ET AL., 2 COLLIER ON BANKRUPTCY ¶ 524.02[1], at 524-17 (Lawrence P. King et al. eds., 15th ed. 1995).

35. *See id.* ¶ 524.02[1], at 524-17, ¶ 524.02[2], at 524-23 to -25.

36. *See infra* notes 42-76 and accompanying text.

2. Discharge in the Context of Chapter 7, 11, and 13 Cases

The in personam-in rem distinction with respect to discharge is widely recognized in cases under Chapter 7[37] of the Bankruptcy Code.[38] The Supreme Court, in *Johnson v. Home State Bank*,[39] specifically acknowledged that it is only the personal liability of the debtor that is discharged within the context of Chapter 7.[40] Consequently, courts in a Chapter 7 case find that a valid creditor's lien is unaffected by the bankruptcy, unless specifically disallowed.[41]

This is not the situation, however, with respect to discharge under the various reorganization chapters of the Bankruptcy Code.[42] Although section 524 is applicable to cases filed under Chapters 11 and 13, some courts view certain provisions of these chapters as overriding or limiting the applicability of section 524.[43] Thus, the reorganization chapters contain the greatest conflict regarding the survival of liens in the bankruptcy process.

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37. Chapter 7 of the Bankruptcy Code is a liquidation provision. Debtors who liquidate their assets to satisfy the claims of their creditors are granted discharge pursuant to § 727 of the Bankruptcy Code.

38. *See* Johnson v. Home State Bank, 501 U.S. 78, 84 (1991) ("[D]ischarge extinguishes only one mode of enforcing a claim—namely, an action against the debtor *in personam*—while leaving intact another—namely, an action against the debtor *in rem*."); Chandler Bank v. Ray, 804 F.2d 577, 579 (10th Cir. 1986) (holding *in rem* action survives bankruptcy (Chapter 7)); *accord* Connor v. United States, 27 F.3d 365, 366 (9th Cir. 1994) (Chapter 7); Isom v. United States, 901 F.2d 744, 745 (9th Cir. 1990) (Chapter 7); Estate of Lellock v. Prudential Ins. Co., 811 F.2d 186, 189 (3rd Cir. 1987) (Chapter 7); Terio v. Great W. Bank, 93 Civ. 4377 (VLB) (MDF), 1994 U.S. Dist. LEXIS 4821, at *11 (S.D.N.Y. Mar. 22, 1994), *approved*, 166 B.R. 213 (S.D.N.Y. 1994), *aff'd*, 52 F.3d 310 (2d Cir. 1995) (Chapter 7); *In re* Eakin, 153 B.R. 59, 60 (Bankr. D. Idaho 1993) (Chapter 7); Polk County Fed. Sav. & Loan Ass'n v. Weathers (*In re* Weathers), 15 B.R. 945, 949 (Bankr. D. Kan. 1981) (Chapter 7); *see also* Dale C. Schian, *Section 1111(b)(2): Preserving the In Rem Claim*, 67 AM. BANK. L. J. 479, 487-89 (1993); *cf.* Dewsnup v. Timm, 502 U.S. 410, 418 (1992) (prohibiting the reduction of creditor's lien prior to payment to creditor from foreclosure (Chapter 7)); Owen v. Owen, 500 U.S. 305, 308-309 (1991) (holding property of debtor does not include equitable interest of the creditor (Chapter 7)); Farrey v. Sanderfoot, 500 U.S. 291, 297 (1991) (permitting enforcement of lien on exempt property subsequent to discharge (Chapter 7)).

39. 501 U.S. at 78.

40. *Id.* at 83-84.

41. *See Chandler Bank*, 804 F.2d at 577 (holding lien not extinguished where creditor filed a secured proof of claim (Chapter 7)); *Terio*, 1994 U.S. Dist. LEXIS 4821, at *10 (holding lien not extinguished where creditor did not file a proof of claim and debtor listed credit's debt in schedules as secured (Chapter 7)); *In re Eakin*, 153 B.R. at 59 (holding lien not extinguished where creditor did not file a proof of claim and debtor listed debt in schedules as unsecured (Chapter 7)); Samorajczyk v. United States (*In re* Atoka Agric. Sys.), 39 B.R. 474 (Bankr. E.D. Va. 1984) (holding lien not extinguished for failure to file a proof of claim (Chapter 7)); United Pres. Life Ins. Co. v. Barker, 31 B.R. 145 (Bankr. N.D. Tex. 1983) (holding lien not extinguished where creditor did not file proof of claim and debtor did not list creditor in schedules (Chapter 7)); *In re Weathers*, 15 B.R. at 945 (holding lien not extinguished where creditor did not file proof of claim and debtor stopped payments pursuant to a nonbinding reaffirmation agreement (Chapter 7)); *see also* John J. Rapisardi, *Attention Lenders: Liens May Not Be as Secure as You Thought*, N.Y.L.J., July 24, 1995, at 10.

42. Chapters 11, 12, and 13 are the reorganization chapters of the Bankruptcy Code. In reorganization, debtors generally do not liquidate all of their assets to satisfy the claims of their creditors. Instead, creditors are paid pursuant to a court approved plan of reorganization, and debtors are permitted to retain their assets. Chapter 12, a reorganization chapter for family farmers, is beyond the scope of this Note.

43. *See infra* notes 44-76 and accompanying text.

3. The Controversy Regarding the Interpretation of Sections 1141 and 1327 of the Bankruptcy Code

In a Chapter 11 case, a debtor is discharged upon confirmation of the plan of reorganization.[44] In a Chapter 13 case, a debtor is discharged upon completion of all payments under the plan.[45] The effect of discharge under Chapter 11 or 13, however, is dependent upon the court's interpretation of sections 1141 and 1327.

Sections 1141(b) and (c) provide that upon confirmation the debtor is vested of all property of the estate free and clear of all claims and interests of creditors "dealt with" by the plan "[e]xcept as otherwise provided in the plan or the order confirming the plan."[46] Similarly, sub-sections 1327(b) and (c) state that upon confirmation, all property of the estate vests in the debtor free and clear of all claims and interests "provided for" by the plan "except as otherwise provided in the plan or in the order confirming the plan."[47] The manner in which the terms of these two provisions are defined and the way courts view the relationship of these sections are a significant source of controversy.

Courts differ on precisely what property interest is vested in the debtor upon confirmation of a plan.[48] Property of the estate encompasses all legal or equitable interests of the debtor acquired prior to filing a case.[49] Under Chapter

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44. Section 1141(d) states: "Except as otherwise provided in this subsection, in the plan, or in the order confirming the plan, the confirmation of a plan—(A) discharges the debtor . . . ." 11 U.S.C. § 1141(d)(1)(A) (1994).

45. Section 1328(a) states: "As soon as practicable after completion by the debtor of all payments under the plan . . . the court shall grant the debtor a discharge . . . ." 11 U.S.C. § 1328(a) (1994).

46. 11 U.S.C. § 1141(b), (c) (1994). Section 1141(b) states: "Except as otherwise provided in the plan or the order confirming the plan, the confirmation of a plan vests all of the property of the estate in the debtor." *Id.* § 1141 (b). Section 1141(c) states:

> 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 security holders, and of general partners in the debtor.

Id. § 1141(c).

47. 11 U.S.C. § 1327(b), (c) (1994). Section 1327(b) states: "Except as otherwise provided in the plan or the order confirming the plan, the confirmation of a plan vests all of the property of the estate in the debtor." *Id.* § 1327(b). Section 1327(c) states: "Except as otherwise provided in the plan or in the order confirming the plan, the property vesting in the debtor under subsection (b) of this section is free and clear of any claim or interest of any creditor provided for by the plan." *Id.* § 1327(c).

48. *See infra* notes 51-54 and accompanying text.

49. *See* 11 U.S.C. § 541 (1994). Section 541(a) states:

> (a) The commencement of a case under section 301, 302, or 303 of this title creates an estate. Such estate is comprised of all the following property, wherever located and by whomever held:
> (1) Except as provided in subsections (b) and (c)(2) of this section, all legal or equitable interests of the debtor in property as of the commencement of the case.

Id. § 541(a)(1).

13, property of the estate also includes all legal and equitable interests of the debtor acquired prior to the closing of the case.[50]

Some courts conclude that sections 1141 and 1327 vest in the debtor the same interest the debtor had in the property at the commencement of the case.[51] Thus, if the debtor's property entered the bankruptcy estate subject to a lien, and the lien was not voided or avoided during the bankruptcy process, the property remains subject to the lien when the property vests in the debtor's name upon confirmation.[52] Courts that follow this approach conclude that the mere passing of property through the bankruptcy estate is insufficient to extinguish a lien.[53] Consequently, under this interpretation of sections 1141 and 1327, the creditor maintains its in rem rights, and the creditor's lien, therefore, passes through bankruptcy unaffected.

Other courts, however, conclude that if the creditor's claim or interest is dealt with or provided for in the plan, then sections 1141(c) and 1327(c) vest that property in the debtor free and clear of the creditor's claim or interest.[54] Courts following this approach base their interpretation on the statutory language of the provisions. The issue for these courts is twofold: Is a lien a claim or interest and, what are the requirements to "deal with" or "provide for" a creditor's claim or interest?

The terms "claim" and "lien" are defined in section 101 of the Bankruptcy Code.[55] The Bankruptcy Code, however, does not define the term

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50. *See* 11 U.S.C. § 1306 (1994). Section 1306(a) states:

(a) Property of the estate includes, in addition to the property specified in section 541 of this title—

(1) all property of the kind specified in such section that the debtor acquires after the commencement of the case but before the case is closed, dismissed, or converted to a case under chapter 7, 11, or 12 of this title, whichever occurs first . . . .

Id. § 1306(a)(1).

51. *See* Second Nat'l Bank v. Honaker (*In re* Honaker), 4 B.R. 415, 416-17 (Bankr. E.D. Mich. 1980) (holding that the same interest the debtor held in the property at the commencement of the case is shifted back to debtor upon confirmation); *accord* Cen-Pen Corp. v. Hanson, 58 F.3d 89, 92-93 (4th Cir. 1995); Simmons v. Savell (*In re* Simmons), 765 F.2d 547, 555 (5th Cir. 1985); Southtrust Bank v. Thomas (*In re* Thomas), 883 F.2d 991, 998 (11th Cir. 1989); Relihan v. Exchange Bank, 69 B.R. 122, 127 (Bankr. S.D. Ga. 1985).

52. *See In re Honaker*, 4 B.R. at 416-17 (holding that where no action has been taken to void or avoid a lien, the property is revested in the debtor subject to the lien); *accord Cen-Pen Corp.*, 58 F.3d at 92-93; *In re Thomas*, 883 F.2d at 998; *In re Simmons*, 765 F.2d at 555; *Relihan*, 69 B.R. at 127.

53. *See Cen-Pen Corp.*, 58 F.3d at 92-93; *In re Thomas*, 883 F.2d at 998; *In re Simmons*, 765 F.2d at 555; *Relihan*, 69 B.R. at 127; *In re Honaker*, 4 B.R. at 416-17.

54. *In re* Penrod, 50 F.3d 459 (7th Cir. 1995) (holding lien is extinguished where creditor files a proof of claim and debtor provides for creditor's claim in the plan); Board of County Comm'rs v. Coleman Am. Prop., Inc. (*In re* American Prop., Inc.), 30 B.R. 239 (Bankr. D. Kan. 1983) (holding lien is extinguished where creditor's claim is listed in debtor's schedules); *accord In re* Danks, 123 B.R. 652 (Bankr. W.D. Okla. 1991); *In re* Henderberg, 108 B.R. 407 (Bankr. N.D.N.Y. 1989); *In re* Fischer, 91 B.R. 55 (Bankr. D. Minn. 1988); *In re* Arctic Enter., Inc., 68 B.R. 71 (D. Minn. 1986).

55. 11 U.S.C. § 101 (1994). A "claim" is defined as:

(A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured; or

(B) right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent,

"interest." Some courts conclude that a "lien" is not an "interest" for purposes of sections 1141(c) and 1327(c).[56] These courts find it anomalous that Congress chose the term "interest" if Congress intended liens to be subject to this provision since the term "lien" was already defined in the Bankruptcy Code.[57] Thus, courts adopting this view conclude sections 1141(c) and 1327(c) do not affect a valid prepetition lien that is not void or avoided during the bankruptcy process because a "lien" is not a "claim" or "interest."

Other courts, however, conclude that the meaning of "interest" as used in sections 1141(c) and 1327(c) includes liens.[58] These courts note that the term "interest" as used elsewhere in the Bankruptcy Code is frequently understood to encompass the term "lien."[59] Further, the word "interest" is used to define "lien" for purposes of the Bankruptcy Code.[60] Accordingly, these courts conclude a lien may be extinguished if it is "dealt with" or "provided for" by the plan.

The issue thus becomes, what is required to "deal with" or "provide for" property within a plan such that a creditor's lien will be extinguished upon confirmation? Since section 506(d) expressly permits a creditor to ignore the bankruptcy process and look solely to its lien for satisfaction of its claim, it is clear that some affirmative action on the part of the debtor is required in order for a lien to be extinguished.[61] Beyond the limited situation where a creditor does not participate in the reorganization process and the debtor does not file a proof of claim on the creditor's behalf, or make any reference to the creditor's claim in its schedules or plan, courts differ on what type of action is necessary to "deal with" or "provide for" property such that a creditor's lien will be extinguished.

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matured, unmatured, disputed, undisputed, secured or unsecured.

Id. § 101(5). A "lien" is defined as a "charge against or interest in property to secure payment of a debt or performance of an obligation." *Id.* § 101(37).

56. *In re Honaker*, 4 B.R. at 417 (finding that a lien is not a "claim" or "interest"); *accord In re Simmons*, 765 F.2d at 555; *Relihan*, 69 B.R. at 127.

57. *In re Honaker*, 4 B.R. at 417 ("The term 'interest' is nowhere defined in the Code, but it would be odd if Congress had chosen that undefined term to mean 'lien,' when they could have used the defined term 'lien' and avoided uncertainty."); *accord In re Simmons*, 765 F.2d at 555; *Relihan*, 69 B.R. at 127.

58. *See In re Penrod*, 50 F.3d at 463 (holding that "claims and interests" as used in § 1141(c) encompasses liens); *In re Arctic Enter.*, 68 B.R. at 79 ("[T]he term 'interests' as used in section 1141(c) subsumes the term 'lien.'"). Other courts' concurrence with this definition of "interest" is implied by these courts' holdings that a creditor's lien is extinguished if the debtor lists the creditor's claim in the debtor's schedules and the creditor fails to object to confirmation of the debtor's Chapter 11 plan. *In re American Prop.*, 30 B.R. at 239 (holding lien is extinguished where creditor's claim is listed in debtor's schedules and creditor fails to object to confirmation of debtor's plan); *accord In re Danks*, 123 B.R. at 652; *In re Henderberg*, 108 B.R. at 407; *In re Fischer*, 91 B.R. at 55.

59. *See In re Penrod*, 50 F.3d at 463; *In re* Penrod, 169 B.R. 910, 915-16 (Bankr. N.D. Ind. 1994), *appeal decided*, 50 F.3d 459 (7th Cir. 1995); *In re Arctic Enter.*, 68 B.R. at 79.

60. *See In re Penrod*, 50 F.3d at 463.

61. *See* Cen-Pen Corp. v. Hanson, 58 F.3d 89, 92-93 (4th Cir. 1995); *In re Penrod*, 50 F.3d at 461; *In re* Tarnow, 749 F.2d 464, 465 (7th Cir. 1984); Terio v. Great W. Bank, 166 B.R. 213 (S.D.N.Y. 1994), *aff'd*, 52 F.3d 310 (2d Cir. 1995); Lee Serv. Co. v. Wolf (*In re* Wolf), 162 B.R. 98, 105-06 (Bankr. D. N.J. 1993). See *infra* notes 65-72 and accompanying text for a discussion of § 506(d) of the Bankruptcy Code.

Some courts find that it is sufficient for the debtor to list the creditor's claim in the schedules of its petition or make some provision for the creditor's claim in the debtor's plan.[62] Other courts, however, find that a creditor's lien is not properly "dealt with" or "provided for" unless the debtor takes action specifically directed at voiding the creditor's lien.[63] These courts place greater emphasis on the general provisions of sections 502 and 506 of the Bankruptcy Code than the specific provisions of sections 1141(c) and 1327(c).[64]

Section 506(d) describes when a secured creditor's lien is void.[65] Prior to its amendment in 1984, the language of section 506(d)(1) provided that a lien securing a claim was not void if action had not been taken to allow or disallow the claim.[66] Thus, some courts prior to 1984 interpreted this provision to require the debtor to take action specifically directed at allowing or disallowing the creditor's lien.[67]

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62. *Cen-Pen*, 58 F.3d at 96 (Heaney, J., dissenting) (concluding that unambiguous language in plan extinguishing lien should have been sufficient affirmative action to avoid the lien); *In re* Pence, 905 F.2d 1107 (7th Cir. 1990) (allowing extinguishment of lien where plan specifically stated lien would be extinguished); *In re Wolf*, 162 B.R. at 98 (allowing extinguishment of lien where plan provided for "cram down" of creditor's lien); *In re Arctic Enter.*, 68 B.R. at 71 (allowing extinguishment of lien where debtor listed as unsecured in plan and creditor did not object); *In re American Prop.*, 30 B.R. at 239 (allowing extinguishment of lien where debtor listed creditor's claim in schedules as "unliquidated" and creditor did not file a proof of claim or did not object to plan).

63. *See infra* notes 73-76 and accompanying text.

64. *Id.*

65. 11 U.S.C. § 506 (1994). Section 506(d) states in pertinent part:

(d) To the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void, unless—

(1) such claim was disallowed only under section 502(b)(5) or 502(e) of this title; or

(2) such claim is not an allowed secured claim due only to the failure of any entity to file a proof of such claim under section 501 of this title.

Id. § 506(d).

Even though § 103(a) makes this provision applicable to cases filed under Chapters 7, 11, and 13 of the Bankruptcy Code, courts differ on the extent and circumstances in which § 506(d) is applicable within the various chapters. *See* Rapisardi, *supra* note 41, at 10 (discussing differing treatment of §§ 506(d)(2) and 1141(c) concerning survival of liens in Chapter 11).

66. Prior to amendment in 1984, § 506(d)(1) stated in pertinent part:

(d) To the extent that a lien secures a claim against the debtor that is not an allowed secured claim such lien is void, unless --

(1) a party in interest has not requested that the court determine and allow or disallow such claim under section 502 of this title.

11 U.S.C. § 506 (1976).

67. *See* Estate of Lellock v. Prudential Ins. Co., 811 F.2d 186, 188-89 (3rd Cir. 1987) (considering Chapter 7 case filed prior to amendment of § 506(d)); Samorajczyk v. United States (*In re* Atoka Agric. Sys., Inc.), 39 B.R. 474, 476-77 (Bankr. E.D. Va. 1984); United Pres. Life Ins. Co. v. Barker, 31 B.R. 145, 147-48 (N.D. Tex. 1983); Polk County Fed. Sav. & Loan Ass'n v. Weathers (*In re* Weathers), 15 B.R. 945, 948-50 (Bankr. D. Kan. 1981).

The legislative history of the *original* version of § 506(d) states that this subsection allows liens to pass through bankruptcy unaffected except as restricted by § 506(d). *See* H. REP. NO. 95-595, 95th Cong., 1st Sess. 357 (1977); *cf.* S. REP. NO. 95-989, 95th Cong., 2d Sess. 68 (1978). Accordingly, many courts see this provision as the codification of the general principle that liens pass through bankruptcy unaffected as espoused in Long v. Bullard, 117 U.S. 617 (1886). *See, e.g.*, Dewsnup v. Timm, 502 U.S. 410, 419 (1992) (Chapter 7) and *infra* notes 69-72.

The amended version of section 506(d) no longer specifically requires a party to take action to allow or disallow a secured claim in order for the lien to be void; nevertheless, section 506(d)(2) states that a lien will not be void merely because a proof of claim was not filed.[68] Thus, some courts still interpret section 506(d) to require more than a listing of a creditor's claim in the schedules or addressing the claim in the plan where a creditor has not filed a proof of claim.[69] These courts note that the filing of a proof of claim pursuant to section 501 is permissive, not mandatory.[70] The debtor, therefore, must either initiate an adversary proceeding to void the creditor's lien[71] or file a proof of claim on behalf of the creditor[72] before a bankruptcy plan may extinguish the creditor's lien.

Conversely, some courts hold that the creditor's lien cannot be extinguished within the provisions of the debtor's plan even where the creditor has filed a proof of claim.[73] These courts require the debtor to object to the creditor's proof of claim in order for the lien to be extinguished.[74] In support of this conclusion, these courts note that section 502[75] provides that a proof of claim is allowed unless a party in interest objects to the claim.[76] The extent of the action necessary to extinguish a creditor's lien, therefore, will depend on whether the court places the most emphasis on the specific provisions of sections 1141(c) and 1327(c) or the general provisions of sections 502 and 506 of the Bankruptcy Code.

C. The Effect of Confirmation of a Plan of Reorganization

A bankruptcy court will "confirm" a debtor's plan of reorganization if the plan meets the requirements of section 1129[77] in a Chapter 11 case, or section 1325 in a Chapter 13 case.[78] Prior to confirmation, the bankruptcy

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68. *See supra* note 65 and accompanying text.

69. *See infra* notes 72-75 and accompanying text.

70. *See In re* Bisch, 159 B.R. 546, 549 (Bankr. 9th Cir. 1993) (finding filing of proof of claim is permissive); *accord* Cen-Pen Corp. v. Hanson, 58 F.3d 89, 94 (4th Cir. 1995); Southtrust Bank v. Thomas (*In re* Thomas), 883 F.2d 991, 996 (11th Cir. 1989); Simmons v. Savell (*In re* Simmons), 765 F.2d 547, 551 (5th Cir. 1985); Terio v. Great W. Bank, 93 Civ. 4377 (VLB) (MDF), 1994 U.S. Dist. LEXIS 4821, at *10 (S.D.N.Y. Mar. 22, 1994), *approved*, 166 B.R. 213 (S.D.N.Y. 1994), *aff'd*, 52 F.3d 310 (2d Cir. 1995).

71. *See Cen-Pen Corp.*, 58 F.3d at 93; *In re* Eakin, 153 B.R. 59, 60 (Bankr. D. Idaho 1993); *In re* Beard, 112 B.R. 951, 955 (Bankr. N.D. Ind. 1990).

72. *See* Relihan v. Exchange Bank, 69 B.R. 122, 127 (S.D. Ga. 1985).

73. *See In re* Howard, 972 F.2d 639, 639-40 (5th Cir. 1992); *In re Simmons*, 765 F.2d at 551-52.

74. *See In re Howard*, 972 F.2d at 639-40; *In re Simmons*, 765 F.2d at 551-52.

75. *See* 11 U.S.C. § 502 (1994). Section 502(a) states: "A claim or interest, proof of which is filed under section 501 of this title, is deemed allowed, unless a party in interest, including a creditor of a general partner in a partnership that is a debtor in a case under chapter 7 of this title, objects." *Id.*

76. *See In re Howard*, 972 F.2d at 639; *In re Simmons*, 765 F.2d at 547.

77. *See* 11 U.S.C. § 1129 (1994) (discussing requirements for confirmation of a Chapter 11 plan of reorganization).

78. *See* 11 U.S.C. § 1325 (1994) (discussing requirements for confirmation of a Chapter 13 plan of reorganization).

court will hold a confirmation hearing at which time a party in interest is permitted to object to the confirmation.[79] Upon confirmation, the plan of reorganization is binding on all parties regardless of whether they participated in the bankruptcy process.[80] Thus, the confirmation of a plan of reorganization has a res judicata effect regarding matters covered by a plan of reorganization.[81]

Courts, however, are divided as to whether the confirmation of a debtor's plan of reorganization is res judicata as to issues regarding the survival of a creditor's lien.[82] The approach taken by courts in addressing this issue is similar to the approach taken by courts in addressing whether a creditor's lien has been "dealt with" or "provided for" by the plan.[83] Those courts which place greater emphasis on the specific provisions of sections 1141 and 1327 conclude that "a creditor's lien rights are only those granted in the confirmed plan."[84] Thus, if a plan of reorganization "deals with" or "provides for" the creditor's lien, the lien is extinguished upon confirmation unless otherwise stated in the plan.[85] Under this approach, therefore, a creditor is estopped from asserting rights that are inconsistent with the plan of reorganization.[86]

On the other hand, courts placing greater emphasis on the general provisions of sections 502 and 506(d) find that the creditor is not estopped from asserting lien rights subsequent to confirmation if the issue regarding the

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79. *See* 11 U.S.C. §§ 1128, 1324 (1994) (addressing confirmation hearings in Chapters 11 and 13 respectively).

80. *See* 11 U.S.C. §§ 1141(a), 1327(a) (1994). Section 1141(a) states:

> (a) Except as provided in subsections (d)(2) and (d)(3) of this section, the provisions of a confirmed plan bind the debtor, any entity issuing securities under the plan, any entity acquiring property under the plan, and any creditor, equity security holder, or general partner in the debtor, whether or not the claim or interest of such creditor, equity security holder, or general partner is impaired under the plan and whether or not such creditor, equity security holder, or general partner has accepted the plan.

Id. § 1141(a).

Section 1327(a) states: "The provisions of a confirmed plan bind the debtor and each creditor, whether or not the claim of such creditor is provided for by the plan, and whether or not such creditor has objected to, has accepted, or has rejected the plan." *Id.* § 1327(a).

81. *See* Stoll v. Gottlieb, 305 U.S. 165, 171-72 (1938); *see also* CONRAD K. CYR ET AL., 5 COLLIER ON BANKRUPTCY ¶ 1114.01[1], at 1141-9, ¶ 1327.01[1], at 1327-2 (Lawrence P. King et al. eds., 15th ed. 1995) (discussing the binding effect of confirmation in plans of reorganization).

82. *See infra* notes 84-89 and accompanying text; *see also* H. Gray Burks, IV, *Obtaining the Release of Liens Through Reorganization Plans: The Circuit Courts Sharpen the Debate with* Penrod *and* Cen-Pen, NORTON BANKR. L. ADVISOR, Sept. 1995, at 1, 5 (discussing courts' differing approaches to confirmation).

83. *See supra* notes 62-76 and accompanying text.

84. Board of County Comm'rs v. Coleman Am. Prop., Inc. (*In re* American Prop., Inc.), 30 B.R. 239, 246 (Bankr. D. Kan. 1983); *accord* Green Tree Fin. Corp. v. Garrett (*In re* Garrett), 185 B.R. 670, 672 (Bankr. N.D. Ala. 1995); *In re* Wrenn Ins. Agency, 178 B.R. 792, 795-96 (Bankr. W.D. Mo. 1995); Lee Serv. Co. v. Wolf (*In re* Wolf), 162 B.R. 98, 106 (Bankr. D.N.J. 1993); *In re* Johnson, 139 B.R. 208, 216-17 (Bankr. D. Minn. 1992); *In re* Danks, 123 B.R. 652, 654 (Bankr. W.D. Okla. 1991); *In re* Henderberg, 108 B.R. 407, 411 (Bankr. N.D.N.Y. 1989); *In re* Fischer, 91 B.R. 55, 56-57 (Bankr. D. Minn. 1988); *In re* Arctic Enter., Inc., 68 B.R. 71, 80 (D. Minn. 1988); *cf.* Michael L. Molinaro, *Lender Liability Claims Can Be Barred After Confirmation of a Bankruptcy Plan*, LAW NEWS FIN., CREDITORS' RIGHTS & BANKR., Sept. 1995, at 1-2 (discussing res judicata effect regarding lender liability claims that were or could have been raised prior to confirmation).

85. *In re American Prop.*, 30 B.R. at 246.

86. *Id.*

survival of the creditor's lien was not properly addressed prior to confirmation.[87] These courts require some specific action on the debtor's part to extinguish the creditor's lien, such as the initiation of an adversary proceeding, the filing of a proof of claim, or the objection to a proof of claim.[88] Absent such actions, the issue regarding the survival of the creditor's lien has not been determined by the court. Thus, these courts conclude that a creditor is not precluded from raising the issue post-confirmation.[89] Accordingly, the effect of confirmation on the survival of a creditor's lien once again depends upon whether the court places greater emphasis on the specific provisions of sections 1141 and 1327 or the general provisions of sections 502 and 506.

III. FACTS AND HOLDING

In re Penrod addresses the situation where a secured creditor files a proof of claim but the debtor's plan of reorganization is silent with respect to the preservation of the creditor's lien.[90] The issue thus becomes whether the secured creditor's lien "pass through bankruptcy unaffected" or is extinguished pursuant to section 1141(c).[91]

A. Facts

John Lee and Alyce Jean Penrod (the Penrods) are hog farmers in Indiana.[92] On February 13, 1986, the Penrods borrowed $150,000 from Mutual Guaranty Corporation (Mutual Guaranty),[93]granting Mutual Guaranty a "security interest in, *inter alia*, all of the Penrods' hog livestock and the proceeds and products thereof."[94] Thereafter, on March 27, 1987, the Penrods filed for relief under Chapter 11 of the United States Bankruptcy Code.[95] Mutual Guaranty filed a proof of claim as a secured creditor in the amount of $154,625.13.[96] The Penrods did not object to Mutual Guaranty's claim, nor did the Penrod's challenge the validity of the lien.[97] The Penrods' Chapter 11 plan

87. *See supra* notes 69-76 and accompanying text.

88. *See supra* notes 71-76 and accompanying text.

89. *See* Cen-Pen Corp. v. Hanson, 58 F.3d 89, 92 (4th Cir. 1993) (holding confirmed Chapter 13 plan is only res judicata if debtor takes some affirmative action to avoid the creditor's lien); *accord In re* Howard, 972 F.2d 639 (5th Cir. 1992); Southtrust Bank v. Thomas (*In re* Thomas), 883 F.2d 991, 998 (11th Cir. 1989); Simmons v. Savell (*In re* Simmons), 765 F.2d 547, 557-59 (5th Cir. 1985).

90. *In re* Penrod, 50 F.3d 459, 461 (7th Cir. 1995).

91. See *supra* note 46 regarding § 1141(c) of the Bankruptcy Code.

92. *In re* Penrod, 169 B.R. 910, 913 (Bankr. N.D. Ind. 1994).

93. Mutual Guaranty Corporation, now known as Financial Institutions Liquidation, was the successor in interest to the Clinton County Farm Bureau Cooperative Association Credit Union from whom the Penrods borrowed money in 1986. *Id.*

94. *Id.*

95. *Id.*

96. *Id.* The Seventh Circuit Court of Appeals opinion states the amount owed to Mutual Guaranty as $132,000. *In re* Penrod, 50 F.3d 459, 461 (7th Cir. 1995). The difference is immaterial to this discussion.

97. *In re Penrod*, 50 F.3d at 461.

proposed to pay Mutual Guaranty's claim in full, plus interest, on a monthly basis over a seven year period.[98] Mutual Guaranty voted to accept the Penrods' plan, which was subsequently confirmed by the bankruptcy court on June 21, 1990.[99]

Prior to the confirmation of the plan, the hogs became diseased, forcing the Penrods to liquidate the entire herd.[100] The Penrods refused to provide replacement collateral[101] or to remit the proceeds from the sale of the hogs.[102] Accordingly, Mutual Guaranty brought a state court action against the Penrods to enforce its lien.[103] The Penrods maintained that Mutual Guaranty's lien was extinguished when the plan was confirmed and responded by requesting the bankruptcy court to find Mutual Guaranty in contempt for violating the order confirming the plan.[104]

B. The Bankruptcy Court Decision

The bankruptcy court held that Mutual Guaranty's lien was extinguished upon confirmation of the Penrods' Chapter 11 plan.[105] In reaching this conclusion, the bankruptcy court began its analysis with section 1141 of the Bankruptcy Code.[106] The bankruptcy court placed particular emphasis on "[t]he language of § 1141(c) which states '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 . . . .'"[107] Noting that the term "interest" is not defined in the Bankruptcy Code,[108] the bankruptcy court nevertheless concluded that "the definition of the term 'lien'[109] coupled with the many instances under the Code in which the term 'interest' is used coextensively with the term 'lien'[110] persuade this court that § 1141(c) does, in fact, cover liens."[111]

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98. Mutual Guaranty was designated as the only "Class 3 creditor" in the Penrods' plan of reorganization. *Id.* The plan provided, in its entirety, that Class 3 creditors "will be paid in full, with interest at the rate of eleven percent (11%) per annum. Payments to this Class shall be paid on a monthly basis commencing sixty (60) days after Confirmation. Furthermore, said payments shall be based upon a seven (7) year amortization." *Id.*

99. *In re Penrod*, 169 B.R. at 913.

100. *Id.* The hogs were liquidated between June 1, 1990 and July 1, 1991. *Id.*

101. *Id.* at 914.

102. *In re Penrod*, 50 F.3d at 461.

103. *Id.*

104. *Id.*

105. *In re Penrod*, 169 B.R. at 916.

106. *Id.* at 914.

107. *Id.* at 915.

108. *Id.*

109. See *supra* note 55 regarding the definition of the term "lien."

110. The *In re Penrod* bankruptcy court cited *In re* Arctic Enter., Inc., which suggests "the word 'interest' is commonly understood to mean all property rights including lien rights." *In re Penrod*, 169 B.R. at 915 (quoting *In re* Artic Enter., Inc., 68 B.R. 71, 79 (D. Minn. 1986)).

111. *Id.* at 916.

The bankruptcy court rejected Mutual Guaranty's argument that a creditor's prebankruptcy liens are preserved absent an affirmative action on the debtor's part to extinguish the lien.[112] To the contrary, the bankruptcy court held that unless the lien is "expressly preserved by the terms of the Plan of Reorganization [the lien is] voided by the confirmation of that Plan."[113] The bankruptcy court analogized the provisions of a Chapter 11 plan of reorganization to a contract between a debtor and creditor that is binding on both parties upon the confirmation of the plan.[114] The bankruptcy court concluded that a confirmed plan of reorganization is a binding contract between a debtor and creditor. The rights and obligations of the parties, therefore, are only those rights and obligations stipulated in the plan.[115] The bankruptcy court concluded that Mutual Guaranty had ample opportunity to expressly provide for the retention of its lien in the plan of reorganization, just as four other classes of creditors had done in their provisions under the plan.[116] Having failed to expressly provide for the retention of its lien in the plan of reorganization, the Penrods were vested with possession of the hog herd free and clear of Mutual Guaranty's prepetition lien.[117] Accordingly, the bankruptcy court held that Mutual Guaranty was "precluded from asserting or enforcing any pre-confirmation lien that [it] may have had in Penrods' hog herd."[118]

C. The Seventh Circuit Court of Appeals Decision

In an opinion written by Judge Posner, the court of appeals affirmed the bankruptcy court's decision.[119] The court acknowledged the existence of the principle that "liens pass through bankruptcy unaffected" but noted that the principle is applicable only to situations where the secured creditor did not, nor was it forced to, participate in the bankruptcy proceeding.[120] The court illustrated numerous situations where a secured creditor may chose to, or be

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112. *Id.* at 915. The bankruptcy court recognized that there is a split of authority over the issue of survival of liens in a bankruptcy proceeding. *Id.* at 919. For the reasoning of these courts, see *supra* notes 44-76 and accompanying text.

113. *In re Penrod*, 169 B.R. at 916.

114. *Id.* at 916-17.

115. *Id.*

116. *Id.* at 917-18.

117. *Id.* at 919. The bankruptcy court stated:

> The filing of the Penrods' bankruptcy petition had the effect of divesting them of all legal or equitable interests they possessed in property at the time of filing. 11 U.S.C. § 541(a)(1). Upon confirmation of their Plan, all of the property of the estate vested in the possession of the Penrods. 11 U.S.C. § 1141(b). The Penrods' Plan did not attempt to restrain them from selling their hog livestock. Therefore, upon confirmation of their Plan, the Penrods had transferrable rights in the hog livestock.

Id. (footnote omitted).

118. *Id.* at 920. The bankruptcy court, however, did not find Mutual Guaranty in contempt based on the split of authority regarding the issue of survival of liens in a bankruptcy proceeding. *Id.*

119. *In re* Penrod, 50 F.3d 459 (7th Cir. 1995).

120. *Id.* at 461.

forced to, participate in bankruptcy proceeding,[121] and the potential effect such participation may have on the secured creditor's lien.[122] The court used this analysis to refute an all encompassing interpretation of the adage that "liens pass through bankruptcy unaffected."[123]

Turning its attention to the case at bar, the court of appeals concluded that the "default rule" was the extinction of the lien in situations where the secured creditor participated in the plan of reorganization, but where the plan was silent with respect to the secured creditor's lien.[124] Like the bankruptcy court, the court of appeals based it decision on section 1141(c) of the Bankruptcy Code.[125] The court also concluded that a "lien" is an "interest" as used in the statute and accordingly is extinguished upon confirmation absent some express provision to the contrary.[126] The court was careful to limit its decision to those situations where a secured creditor "participate[s] in the reorganization," otherwise, the "lien would not be 'properly dealt with by the plan,' and so [section 1141(c)] would not apply."[127]

The court reasoned that its "interpretation reconciles the language of section 1141(c) with the principle . . . that liens pass through bankruptcy unaffected" and also provides practical benefits to the reorganized firm and prospective creditors and investors.[128] Further, the court concluded that other courts have been "mesmerized" by the tenet that "liens pass through bankruptcy unaffected" when reaching a contrary conclusion.[129] Consequently, the court of appeals held that Mutual Guaranty's lien was extinguished upon

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121. For example, the secured creditor may voluntarily choose to participate in the plan and file a proof of claim. *Id.* Alternatively, the secured creditor may be forced to participate in the plan where the debtor or another party in interest files a claim on the secured creditor's behalf. *Id.* at 462. The secured creditor may participate in order to get relief from the statutorily imposed stay such that it may enforce its lien. *Id.* Alternatively, the secured creditor may choose to participate in order to ensure the value of its lien is not diminished by the manner in which the estate is administered. *Id.*

122. *Id.* For example:

> If the secured creditor's claim is challenged in the bankruptcy proceeding and the court denies the claim, the creditor will lose the lien by operation of the doctrine of collateral estoppel. [The secured creditor] may be forced in the plan of reorganization to swap [its] lien for an interest that is an "indubitable equivalent" of the lien. And in some circumstances [the secured creditor] may even be compelled to surrender [its] lien without receiving *anything* in return. And, of course, [the secured creditor] can consent to its discharge.

Id. (citations omitted).

123. *Id.* at 461-62.

124. *Id.* at 462.

125. *Id.* at 462-63.

126. *Id.* at 463.

127. *Id.*

128. *Id.* Explaining the benefits of its interpretation, the court stated its decision:

> [L]owers the costs of transacting with the reorganized firm, thus boosting the chances that the reorganization will succeed. By studying the plan of reorganization a prospective creditor of or investor in the reorganized firm can tell whether any liens that creditors whose interest in the new entity are defined in the plan may have against its bankrupt predecessor survive as encumbrances on the assets of the new firm.

Id.

129. *Id.*

confirmation of the plan as Mutual Guaranty had ample opportunity to preserve its lien, yet it failed to do so.[130]

IV. ANALYSIS

The issues raised in *In re Penrod* reflect the court's attempt to balance the competing goals of bankruptcy. This section first discusses the dual competing goals of bankruptcy: protecting creditors' rights while providing debtors a "fresh start."[131] Next, this section examines how the balancing of these competing goals of bankruptcy influenced the court in *In re Penrod* and other courts' interpretation of the language of the Bankruptcy Code with respect to survival of liens[132] and the effect of confirmation.[133]

A. The Competing Goals of Bankruptcy

The United States Constitution grants Congress the authority to establish federal law on the subject of bankruptcy.[134] The early bankruptcy legislation focused solely on the protection of creditor's rights upon the insolvency of a debtor.[135] For example, the initial Bankruptcy Act, enacted in 1800,[136] was based on the English version of bankruptcy law that was mainly concerned with liquidating the assets of business debtors for the benefit of the business' creditors.[137] Bankruptcy legislation subsequent to the initial Bankruptcy Act gradually evolved[138] to include a second purpose: to provide debtors with sufficient protection to enable debtors to obtain a "fresh start" absent the burden of prior obligations.[139]

Various rationales exist for granting a debtor a "fresh start." First, the "fresh start" goal serves various fundamental, moral, and social purposes. Granting the debtor a "fresh start" serves both a public and a private interest by

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130. *Id.* at 464.

131. *See infra* notes 134-49 and accompanying text.

132. *See infra* notes 150-74 and accompanying text.

133. *See infra* notes 175-208 and accompanying text.

134. U.S. CONST. art. I, § 8, cl. 4. Article I, section 8, clause 4 states in pertinent part that Congress shall have the power to "establish . . . uniform Laws on the subject of Bankruptcies throughout the United States." *Id.*

135. *See* Louisville Joint Stock Land Bank v. Radford, 295 U.S. 555, 587-88 (1935).

136. Bankruptcy Act of 1800, ch. XIX, 2 Stat. 19 (repealed 1803).

137. *See* Doug Rendleman, *The Bankruptcy Discharge: Toward a Fresher Start*, 58 N.C. L. REV. 723, 724 (1980); Charles Jordan Tabb, *The Scope of the Fresh Start in Bankruptcy: Collateral Conversions and the Dischargability Debate*, 59 GEO. WASH. L. REV. 56, 63 (1990).

138. *See* Tabb, *supra* note 137, at 63-65 (discussing the evolution from the Bankruptcy Act of 1800 through the Bankruptcy Act of 1898).

139. *See* Local Loan Co. v. Hunt, 292 U.S. 234, 244 (1934) ("One of the primary purposes of the bankruptcy act is to 'relieve the honest debtor from the weight of oppressive indebtedness and permit him to start afresh free from the obligations and responsibilities consequent upon business misfortunes.'" (citation omitted)); *accord In re* Krohn, 78 B.R. 829, 833 (Bankr. N.D. Ohio 1987), *aff'd*, 87 B.R. 926 (N.D. Ohio 1988), *aff'd*, 886 F.2d 123 (6th Cir. 1989).

enabling the debtor to once again become a productive member of society.[140] The opportunity for a "fresh start" relieves the debtor of the "hopelessness" associated with the burden of excessive debts.[141] Further, some view the ability to earn a living as a personal liberty, if not a property right, worthy of particular protection.[142]

There are also economic reasons for providing a debtor with a "fresh start." Granting the debtor a "fresh start" reduces the administrative costs of bankruptcy by providing the debtor with incentive to cooperate in the distribution of the debtor's assets.[143] Additionally, a "fresh start" encourages economic activity by shifting resources to their most productive use and by eliminating some of the risks of business failure.[144]

The scope of a debtor's "fresh start," however, is not unlimited. The relief from debt must be balanced against the protection of creditors' rights in a bankruptcy proceeding. This balancing takes on particular significance where the creditor is a secured creditor because a lien is a property right,[145] and the law does not favor the forfeiture of a property right.[146] Additionally, the scope of a debtor's "fresh start" may be limited by lingering notions that bankruptcy is "antisocial." Arguably, bankruptcy discourages people from paying their debts, and, therefore, should be limited to those in "extreme difficulty."[147]

In summary, the Bankruptcy Code seeks to balance two goals: (1) providing a debtor with a "fresh start;" and (2) treating creditors equitably.[148] The manner in which a court views these competing goals will influence the court's interpretation of the provisions of the Bankruptcy Code.[149]

B. Balancing the Competing Goals of Bankruptcy: Survival of Liens

The holding of *In re Penrod* is expressly limited to situations where a secured creditor has participated in a Chapter 11 plan of reorganization, and the plan does not specifically provide for the preservation of the creditor's lien.[150] Under these circumstances, a court following the Seventh Circuit's rationale

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140. *See Local Loan Co.*, 292 U.S. at 244-45; Tabb, *supra* note 137, at 90, 94.

141. Rendleman, *supra* note 137, at 726; Tabb, *supra* note 137, at 94.

142. *See Local Loan Co.*, 292 U.S. at 245.

143. *See* Tabb, *supra* note 137, at 90.

144. *See* Rendleman, *supra* note 137, at 726.

145. *See In re* Penrod, 50 F.3d 459, 464 (7th Cir. 1995) (citing United States v. Security Indus. Bank, 459 U.S. 70, 76-77 (1982)); *accord In re* Tarnow, 749 F.2d 464, 466 (7th Cir. 1984).

146. *In re Penrod*, 50 F.3d at 462.

147. *Cf.* Rendleman, *supra* note 137, at 725; Tabb, *supra* note 137, at 98.

148. *See In re* B.D. Int'l Discount Corp., 701 F.2d 1071, 1075 n.8 (2d Cir.) ("[T]he two major purposes of bankruptcy [are] achieving equality among creditors and giving the debtor a fresh start."), *cert denied*, 464 U.S. 830 (1983); *accord In re* Krohn, 886 F.2d 123, 127-28 (6th Cir. 1989); *In re* Martha Washington Hosp., 157 B.R. 392, 394 (N.D. Ill. 1993).

149. *See* Miles, *supra* note 26, at 712.

150. *In re Penrod*, 50 F.3d at 462-64.

will deem the lien extinguished upon the confirmation of the plan.[151] Although the *In re Penrod* holding is factually limited, the Seventh Circuit's reasoning provides a useful basis for comparing the effect of the conflicting goals of bankruptcy.

The holding in *In re Penrod* illustrates how this court balanced the "fresh start" goal of the Bankruptcy Code with the need to provide equitable treatment to creditors. The *In re Penrod* court interpreted the Bankruptcy Code as placing burdens on both parties to protect their own interests. In this case, the court interpreted section 1141(c) of the Bankruptcy Code as placing a burden on the Penrods to "deal with" Mutual Guaranty's claim in its plan of reorganization.[152] The court very likely found it significant that the Penrods provided for full repayment of Mutual Guaranty's claim plus interest in their plan.[153] Having so provided, the court found that the Penrods met the burden of "dealing with" Mutual Guaranty's claim.[154] Accordingly, the court concluded that Mutual Guaranty's lien was extinguished upon the confirmation of the plan based on the specific language of section 1141(c) of the Bankruptcy Code.[155]

There are several factors that the court considered in viewing the protection of Mutual Guaranty's interest in the bankruptcy proceeding. First, the court acknowledged that Mutual Guaranty had a property right in its lien, and the law disfavors the forfeiture of that property right.[156] In balancing this interest, however, the *In re Penrod* court weighed the fact that Mutual Guaranty *voluntarily* participated in the plan, and, in doing so, was aware that its lien may be affected.[157] The court interpreted section 1141 of the Bankruptcy Code as expressly extinguishing the creditor's lien upon confirmation of a plan dealing with the creditor's claim, unless otherwise provided in the plan.[158] This interpretation placed a burden on Mutual Guaranty to ensure that the plan protected its lien right.

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151. *See id.* at 463.

152. *Id.* This burden is implied from the court's reliance on § 1141(c). *Id.* If the Penrods had not included Mutual Guaranty's claim in their plan, the lien could not have been "dealt with by the plan." *Id.*

153. *Id.* at 463-64.

154. *Id.* The *In re Penrod* court specifically limited its holding to situations where the *creditor* participates in the plan. *Id.* The *Penrod* court did not reach the issue of whether it is sufficient for the debtor to merely include the secured creditor's claim in its schedules or plan of reorganization. See *supra* notes 61-76 and accompanying text discussing what is sufficient to "deal with" or "provide for" a creditor's claim or interest. At least one commentator has criticized the *Penrod* court's limitation on the scope of § 1141(c) to creditors who participate in the reorganization as being "inconsistent with the language of the statute." James C. Olson, *Liens: Now You See 'Em, Now You Don't*, 27 BANKR. CT. DEC., Issue 10 (Weekly News and Comment), July 25, 1995, at A3 ("As the Seventh Circuit recognized, a plan which requires a secured creditor to give up preexisting liens for other interests in the reorganized debtor 'deals with' the liens. Thus, it would appear to be immaterial to the Seventh Circuit's analysis whether the secured creditor participated in the reorganization." (citation omitted)).

155. *In re Penrod*, 50 F.3d at 463.

156. *Id.*

157. *Id.* at 462.

158. *Id.* at 463.

The *In re Penrod* court clearly concluded that Mutual Guaranty's actions fell short of meeting this burden. Several facts exist in which the *In re Penrod* court most likely found significant in reaching this determination.[159] First, the treatment of Mutual Guaranty's claim within the plan was clear and unambiguous.[160] The plan did not expressly provide for the preservation of Mutual Guaranty's lien.[161] It merely provided for full repayment of its claim.[162] This is significant in light of the fact that the plan *did* expressly provide for the preservation of four other secured creditors' liens.[163]

Second, Mutual Guaranty was represented by counsel who actively participated in the formation of the plan and ultimately voted to accept the plan.[164] If Mutual Guaranty was not satisfied with its treatment within the plan, Mutual Guaranty had the opportunity to object to the confirmation of the plan.[165] A Chapter 11 plan cannot be confirmed if a secured creditor objects to its treatment in the plan, unless the plan provides for the retention of the creditor's lien.[166] Thus, the Bankruptcy Code provided Mutual Guaranty with the opportunity to protect its interest in the bankruptcy proceeding. By failing to protect its interest, the court held Mutual Guaranty's lien was extinguished upon confirmation of the plan.[167] Thus, *In re Penrod* can be interpreted as rewarding those who actively participate in a bankruptcy proceeding to protect their respective interests.

This balancing approach is evident in other courts' opinions regarding the survival of liens in a bankruptcy proceeding. Courts that have a broad view of the scope of the "fresh start" goal of the Bankruptcy Code conclude that sections 1141(c) and 1327(c) of the Bankruptcy Code merely require a debtor to include a secured creditor's claim in the debtors schedules or plan.[168] These courts find that requiring an adversarial proceeding to extinguish a lien places

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159. The bankruptcy court's decision contains greater detail regarding the specific facts surrounding the formation of the Penrods' plan of reorganization. These facts most likely influenced the court of appeals decision, even though the court did not reiterate all of these facts in its decision. *See In re* Penrod, 169 B.R. 910, 913-14 (Bankr. N.D. Ind. 1994).

160. *Id.* at 917.

161. *Id.* at 916.

162. *Id.* at 917-18.

163. *Id.* at 918.

164. *Id.* at 917.

165. *See* 11 U.S.C. § 1128 (1994). Section 1128(b) states "[a] party in interest may object to confirmation of a plan." *Id.*

166. *See* 11 U.S.C. § 1129(b) (1994). Section 1129(b) is known as the "cram down" provision. Section 1129(b)(1) provides that a court may confirm a plan even if all classes have not accepted the plan "if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan." *Id.* Section 1129(b)(2)(A)(i)(I) provides in pertinent part that a plan is "fair and equitable" with respect to secured creditors' claims if "the holders of such claims retain the liens securing such claims . . . to the extent of the allowed amount of such claims." *Id.*

167. *In re* Penrod, 50 F.3d 459, 463 (7th Cir. 1995).

168. *See supra* note 62 and accompanying text.

too high a burden on the debtor.[169] Further, courts focusing on a debtor's "fresh start" conclude that a plan that addresses a creditor's claim provides the creditor with sufficient notice such that a creditor is able to protect its rights by objecting to the plan prior to confirmation.[170]

Conversely, some courts take a more limited view of the scope of the "fresh start" goal of the Bankruptcy Code. Courts that focus on creditors' rights require the debtor to take action specifically directed at extinguishing the creditor's lien, placing a greater burden on the debtor to protect its "fresh start" interest.[171] Accordingly, by focusing on the in personam-in rem distinction, these courts limit the debtor's "fresh start" to relief from personal obligation.[172] According to these courts, the extinguishment of the creditor's lien by simply providing for the creditor's claim in a plan results in a "material improvement" of the debtor's position. Such a material improvement is beyond the "fresh start" goal of the Bankruptcy Code.[173] Rather, these courts are concerned with protecting creditors' rights by requiring specific notice of the abrogation of the creditors' property right.[174]

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169. *Cf. In re* Ruti-Sweetwater, Inc., 836 F.2d 1263, 1267 (10th Cir. 1988) (stating that where a creditor does not object to its treatment in a plan, it places the debtor "in the unique position of anticipating . . . creditors' objections to the plan" if the debtor is required to take action directed at these "hypothetical objections" (quoting *In re* Sweetwater, Inc., 57 B.R. 748 (D. Utah 1985)); *In re* Arctic Enter., 68 B.R. 71, 80 (D. Minn. 1986) (stating that Chapter 11 reorganizations would be "greatly complicated" if debtors were required to challenge the claims of each lienholder).

170. *See In re Penrod*, 50 F.3d at 464 (concluding that Mutual Guaranty could have protected its lien interest by appealing the order confirming the plan of reorganization); *In re* Wrenn Ins. Agency, Inc., 178 B.R. 792 (Bankr. W.D. Mo. 1995) (concluding that creditor had sufficient notice of its treatment in the plan and could have objected to the confirmation of the plan); Lee Serv. Co. v. Wolf (*In re* Wolf), 162 B.R. 98, 108 (Bankr. D.N.J. 1993) (holding that summary of plan's terms provided to creditors provides sufficient notice and opportunity for creditors to object at the confirmation hearing in order to protect their lien rights); *In re* Henderberg, 108 B.R. 407, 414 (Bankr. N.D.N.Y. 1989) (holding that lienholders had sufficient notice regarding their treatment in the plan and had sufficient opportunity to object); *In re Arctic Enter.*, 68 B.R. at 80 ("[R]ights of lienholders are preserved, because creditors are given an opportunity to object to the plan.").

171. *See supra* notes 69-76 and accompanying text.

172. *See* Estate of Lellock v. Prudential Ins. Co., 811 F.2d 186, 189 (3rd Cir. 1987) (holding that unless a creditor's lien is void or avoided, the debtor is only discharged from any personal liability; further stating that extinguishing prepetition liens that are not disallowed or avoided in the bankruptcy "is clearly repugnant to bankruptcy policy"); Simmons v. Savell (*In re* Simmons), 765 F.2d 547, 555 (5th Cir. 1985) (concurring with reasoning of *In re Honaker*); Second Nat'l Bank v. Honaker (*In re* Honaker), 4 B.R. 415, 416-17 (Bankr. E.D. Mich. 1980) (concluding that absent some affirmative action on the part of the debtor to void or avoid a lien, that upon confirmation the debtor is revested with the property subject to the lien).

173. *See In re Honaker*, 4 B.R. at 417 ("The reading of Section 1327 urged by Defendant would have the debtor materially improve his financial position, by unencumbering pledged assets, through the simple expedient of passing his property through the estate. This result has little to recommend it."); *see also* Cen-Pen Corp. v. Hanson, 58 F.3d 89, 92-93 (4th Cir. 1995) (concurring with the reasoning of *In re Honaker*); *In re Simmons*, 765 F.2d at 559 (concurring with the reasoning of *In re Honaker* and stating that this interpretation "does not frustrate Chapter 13's fresh start policy" and to hold otherwise would grant the debtor a windfall).

174. *See Cen-Pen Corp.*, 58 F.3d at 93 (holding that adequate notice is required for confirmation to have a preclusive effect); *In re* Linkous, 990 F.2d 160 (4th Cir. 1993) (holding that specific notice regarding the

C. *Balancing the Competing Goals of Bankruptcy: Effect of Confirmation*

In addition to a balancing of burdens with respect to lien survival, the holding in *In re Penrod* illustrates the conflicting manner in which courts address the binding nature of a plan of reorganization. The reorganization chapters of the Bankruptcy Code expressly alter the contractual and legal rights of the parties.[175] A plan of reorganization represents a new and comprehensive agreement between the parties regarding their ongoing relationship. Thus, unlike a Chapter 7 case where there is no plan of reorganization, the parties in Chapters 11 and 13 "naturally look to the plan of reorganization as the final decree of the rights of the parties."[176]

As was the case when addressing the survival of liens, an inherent balancing of the competing goals of bankruptcy exists when addressing the binding nature of confirmation. Those courts that place greater emphasis on the "fresh start" aspect of the bankruptcy process tend to find an order confirming a plan of reorganization as binding to all parties;[177] whereas, those courts that stress the protection of creditors' rights will not.[178] Three cases—*In re Penrod*,[179] *In re Pence*,[180] and *In re Escobedo*[181]—illustrate the conflicting approaches within the Seventh Circuit regarding the binding nature of a plan of reorganization. *In re Penrod* placed greater emphasis on providing the debtors with a "fresh start" by concluding that the Penrods' confirmed plan extinguished Mutual Guaranty's lien.[182] In balancing the interests of the respective parties, the court emphasized that the potential success of the Penrods' "fresh start" was enhanced by the ability to rely on the confirmed plan as a binding agreement.[183] The court further observed that outside parties'

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impairment of the creditor's lien valuation was required); *In re Simmons*, 765 F.2d at 552 (requiring the debtor to object to the creditor's proof of secured claim as the "purpose of filing an objection is to . . . plac[e] the parties on notice that litigation is required to resolve an actual dispute between the parties").

175. *See In re* Henderberg, 108 B.R. 407, 412 (Bankr. N.D.N.Y. 1989) (holding that a "confirmed Chapter 11 plan defines the creditors' claims and any pre-confirmation rights of the creditors exist only to the extent that they are accounted for in the plan"); *In re* Fischer, 91 B.R. 55, 57 (Bankr. D. Minn. 1988) (noting that "the Bankruptcy Code allows the debtor to use the reorganization plan as a comprehensive and integrated restructuring of all creditors' claims and security rights"); Board of County Comm'rs v. Coleman Am. Prop., Inc. (*In re* American Prop., Inc.), 30 B.R. 239, 246 (Bankr. D. Kan. 1983) (holding that upon confirmation, "a creditor's lien rights are only those granted in the confirmed plan").

176. *In re* Arctic Enter., 68 B.R. 71, 80 (D. Minn. 1986); *accord In re Henderberg*, 108 B.R. at 413; *In re Fischer*, 91 B.R. at 56-57.

177. *See supra* notes 84-86 and accompanying text.

178. *See supra* notes 87-89 and accompanying text.

179. 50 F.3d 459 (7th Cir. 1995).

180. 905 F.2d 1107 (7th Cir. 1990).

181. 28 F.3d 34 (7th Cir. 1994).

182. *In re Penrod*, 50 F.3d at 462; *see also* Barry L. Zaretsky, *Survival of a Lien*, N.Y.L.J., July 20, 1995, at 3 (concluding that the *In re Penrod* court "seemed more concerned with giving effect to the terms of a confirmed plan, including the extinguishing of any pre-existing liens, in order to assure the debtor's fresh start").

183. *In re Penrod*, 50 F.3d at 463. The bankruptcy court also notes that the viability of the plan of

interests also should be considered since outside parties rely on the plan of reorganization to make decisions regarding their involvement with the debtor.[184] In considering Mutual Guaranty's interests, the court noted that Mutual Guaranty could have appealed the order confirming the plan to protect its interest.[185] Thus, *In re Penrod* established that a confirmed plan is binding with respect to a creditor's lien rights where a creditor has participated in the plan of reorganization.[186]

Similarly, *In re Pence*[187] involved the issue of the survival of a creditor's lien in a plan of reorganization. The debtor in *In re Pence*, however, specifically provided in her Chapter 13 plan for the extinguishment of the creditor's lien on her residence in exchange for the surrender of various commercial property.[188] The creditor did not object to its treatment prior to confirmation.[189] After confirmation, however, the creditor sought to enforce its lien against the debtor's residence when it discovered that the commercial property was worth significantly less than its appraisal prior to confirmation.[190] In reaching the conclusion that the creditor was bound by the terms of the confirmed plan, the court placed the burden on the creditor to protect its lien rights.[191] The court stated that the creditor "was not entitled to stick its head in the sand and pretend it would not lose any rights by not participating in the proceedings."[192] The court, however, did not go as far as *In re Penrod* since the court declined to find that a confirmed plan is "always binding on a secured creditor's lien."[193]

In re Escobedo,[194] while not involving creditors' lien rights in bankruptcy, involves a balancing of burdens to protect the respective interests of the parties. The debtor filed a Chapter 13 plan that did not provide for full repayment of certain priority claims.[195] The claimants received notice of the hearing regarding the confirmation of the debtor's plan, but failed to object to the plan.[196] Consequently, the court confirmed the debtor's plan.[197] Shortly thereafter, the trustee filed an objection to the confirmed plan requesting the

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reorganization was questionable absent the extinguishment of Mutual Guaranty's lien. *In re* Penrod, 169 B.R. 910, 919 (Bankr. N.D. Ind. 1994).

184. *In re Penrod*, 50 F.3d at 463.
185. *Id.* at 464.
186. *Id.* at 462.
187. 905 F.2d 1107 (7th Cir. 1990).
188. *Id.* at 1108.
189. *Id.*
190. *Id.* at 1108-09.
191. *Id.* at 1109.
192. *Id.*
193. *Id.* at 1110.
194. 28 F.3d 34 (7th Cir. 1994).
195. *Id.* at 35.
196. *Id.* at 34.
197. *Id.*

court to allow full repayment of various administrative and tax claims.[198] The court approved the trustee's motion to modify the plan since the debtor did not object to the modification.[199] The debtor, however, never modified her plan but continued to make the payments required by the original plan.[200] Nearly two years after the debtor made her last payment under the plan, the trustee moved to dismiss the confirmed plan stating that the plan did not provide for full repayment of the administrative and tax claims.[201] The Seventh Circuit affirmed the bankruptcy and district court decisions to dismiss the plan.[202]

Escobedo is similar to *In re Penrod* in that it involves the effect of a creditor's silence in a plan of reorganization. In *In re Penrod*, the court construed Mutual Guaranty's silence as tacit approval of the waiver of its lien right.[203] Mutual Guaranty could have objected to confirmation, and the plan would not have been approved without expressly preserving Mutual Guaranty's lien.[204] Since Mutual Guaranty did not take any action to preserve its lien, the lien was extinguished upon confirmation of the plan.[205]

In contrast, the *In re Escobedo* court reached a different conclusion when considering the claimant's silence in the confirmation of the debtor's plan. The claimant, like Mutual Guaranty, had notice of the content of the debtor's plan and the scheduled confirmation hearing. Nevertheless, the claimant chose to remain silent prior to the confirmation of the plan.[206] The *Escobedo* court, however, unlike the *In re Penrod* court, did not presume the claimant's silence to be a waiver of its rights under the plan.[207] Instead, the court rejected the debtor's *res judicata* argument and concluded the plan was facially defective.[208] By so concluding, the *Escobedo* court placed a greater burden on the debtor to ensure that her "fresh start" rights were protected. These conflicting approaches illustrate the difficulty in finding the proper balance between the competing goals of bankruptcy within the same circuit.

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198. *Id.* The court noted that full payment of these claims is required in order for a plan to be confirmed unless the claim holder agrees otherwise. *Id.* at 35; *see also* 11 U.S.C. § 1322(a)(2) (1994). Section 1322(a) states in pertinent part that a plan shall "provide for the full payment, in deferred cash payment of all claims entitled to priority under section 507 of this title, *unless* the holder of a particular claim agrees to a different treatment of such claim." *Id.* § 1322(a)(2) (emphasis added).

199. *In re Escobedo*, 28 F.3d at 34.

200. *Id.*

201. *Id.*

202. *Id.* at 35.

203. *In re* Penrod, 50 F.3d 459 (7th Cir. 1995).

204. *Id.* at 464.

205. *Id.*

206. *In re Escobedo*, 28 F.3d at 34.

207. The court could have concluded that the claimant agreed to its treatment in the plan as it did not object prior to the confirmation of the plan. *See supra* note 193.

208. *In re Escobedo*, 28 F.3d at 35.

V. CONCLUSION

In re Penrod, while factually limited, provides needed guidance regarding the survival of creditors' lien rights in a bankruptcy proceeding and the effect of confirmation on a plan of reorganization. The approach taken by the *In re Penrod* court balances the interests of all parties and rewards active participation in a bankruptcy proceeding.[209] The burdens placed on either side are not particularly onerous and will promote certainty and efficiency in the administration of a plan of reorganization. While Mutual Guaranty may have been unfairly surprised by the court's holding,[210] Mutual Guaranty will still receive full repayment of its claim through the plan. Further, the Penrods are provided with the necessary resources to successfully implement their "fresh start." Thus, the holding of *In re Penrod* adequately balances the competing goals of bankruptcy.

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209. *See also* Cen-Pen Corp. v. Hanson, 58 F.3d 89, 96 (4th Cir. 1995) (Heaney, J., dissenting) (stating that "parties opting to sit on their rights will lose their ability to later enforce such claims"); *In re* Pence, 905 F.2d 1107, 1109 (7th Cir. 1990) (concluding that creditor "was not entitled to stick its head in the sand and pretend it would not lose any rights by not participating in the proceedings"); *In re* Ruti-Sweetwater, Inc., 836 F.2d 1263, 1267 (10th Cir. 1988) (concluding that "creditors are obligated to take an active role in protecting their claims"); Lee Serv. Co. v. Wolf (*In re* Wolf), 162 B.R. 98, 104 (Bankr. D. N.J. 1993) (holding a creditor is deemed to have waived any objection to confirmation if the creditor does not object at the confirmation hearing).

210. *See In re* Penrod, 50 F.3d 459, 464 (7th Cir. 1995) ("We recognize that since the law was not clear with respect to the survival of the lien of a creditor who is provided for in the plan without mention of his lien, Mutual Guaranty may not have realized when the plan was adopted that its lien was in jeopardy.").