BANKRUPTCY

"Well, You Can Always Credit Bid . . ." Still True For Lenders In 2010?

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Historically, one of the primary protections afforded a secured creditor in a bankruptcy proceeding was the right to "credit bid" some or all of its secured debt in connection with a debtor's proposed sale of the secured creditor's collateral. Indeed, this right is expressly codified in Section 363(k) of the Bankruptcy Code. In a typical "credit bid" scenario, the secured lender's debt is functionally substituted for cash that a competing bidder would offer in its bid, and provides the secured creditor with a form of safeguard against the debtor's sale of the assets for lower than what the secured lender believes to be market value.

However, the United States Court of Appeals for the Third Circuit recently ruled that despite the language of Section 363(k), a secured creditor does not have the right to make a credit bid in *every* sale of a secured creditor's collateral that might take place in a Chapter 11 case. The true impact of this ruling, and a determination of whether it will in fact pose serious problems for secured lenders remains to be seen—but with the increase in chapter 11 sales that the past few years have seen, it presents the potential for an increase in sale related litigation, and for cramdown fights in contested chapter 11 cases.

Background

The case, *In re Philadelphia Newspapers, LLC,* 599 F. 3d 298, 2010 U.S. App. Lexis 5805, (3rd Cir. 2010), involved a media holding company ("Debtor"), that sought court approval of the sale of its newspapers as part of its plan of reorganization. The Debtor's proposed sale included sale procedures that expressly prohibited its secured lenders from making a credit bid at the sale. The secured lenders were a group of institutions that had loaned the Debtor more than $300 million to originally acquire the newspapers.

In affirming a decision of the United States District Court for the Eastern District of Pennsylvania, the Third Circuit held, over the objection of the secured lenders, that the Debtor could prohibit the secured lenders from credit bidding in the particular context of the sale that was presented in the case. In determining how the court did so in the face of the language of Section 363(k) of the Bankruptcy Code, it is important to first understand the types of sale that most often occur in bankruptcy cases today.

Sales in chapter 11 cases typically occur in one of two contexts. The first is a sale under Section 363 of the Bankruptcy Code, in which the debtor seeks, typically through an auction type procedure, to sell some or all of its assets. These sales, which occur "outside the ordinary course of business" usually occur well in advance of any plan of reorganization, and are not tied directly to a particular plan of reorganization. Indeed, in many instances, after such a sale, the case does not proceed to reorganization, and is instead converted to a proceeding under Chapter 7 of the Bankruptcy Code, with unsold assets liquidated for the benefit of creditors.

The second is a sale that forms a part of a chapter 11 plan of reorganization, and is conducted pursuant to, and in conjunction with the confirmation of a plan of reorganization under Section 1129 of the Bankruptcy Code. In such a circumstance, the anticipated sale may be the functional funding mechanism for the plan of reorganization. The question before the Third Circuit was impacted by the distinction between these two types of sales, and it was a sale under Section 1129 of the Bankruptcy Code—more particularly pursuant to Section 1129(b)(2), that was at issue in the *Philadelphia Newspapers* decision.

To understand the ruling also requires a bit of background in how Section 1129(b) of the Bankruptcy Code works. Section 1129(b) is the so-called "cramdown" provision of the Bankruptcy Code, which allows the Bankruptcy Court to confirm a plan of reorganization over the dissenting vote of a class of creditors (i.e., to "cram the plan down" over a "no" vote). Section 1129(b), viewed broadly, requires that for a plan to be "crammed down" the Bankruptcy Court must conclude that the plan is nonetheless "fair and equitable" in its treatment of the dissenting class. It goes on, in the provisions of Section 1129(b)(2)(b), to delineate more precisely what is considered "fair and equitable" treatment for dissenting secured creditors, unsecured creditors, and equity holders. For secured creditors (to paraphrase somewhat) a plan can be found fair and equitable if it does one of three things: (i) provides the secured creditor with a stream of payments equal to the present value of its claim, and leaves the secured creditor's lien in place, (ii) provides for a sale of the collateral, subject to the secured creditors' right to credit bid, or (iii) provides the secured creditor with the "indubitable equivalent" of its claim. The decision by the Third Circuit turned on this last alternative.

The literal language of Section 1129(b) says that if the debtor is conducting a sale of the secured creditor's collateral under Section 1129(b)(2)(ii) that the right to credit bid is preserved. But, could a sale be conducted under Section 1129(b)(2)(iii) (which says nothing about a credit bid right)? What if the secured creditor received whatever the sale generates? Would such a secured creditor thus receive the "indubitable equivalent" of its secured claim—which is what Section 1129(b)(2)(iii) requires? The Debtor in the *Philadelphia Newspaper* decision argued the answer to this last question was "yes". And, it argued, because Section 1129(b(2)(iii) says *nothing* about preserving a credit bid right for a secured lender, it didn't have to provide such a right for its secured lenders in the sale it conducted under that provision of the Code.

The Third Circuit concluded the debtor was right--from a statutory construction standpoint--because Section 1129(b)(2)(iii) contains no

language expressly referring to a credit bid right Thus, in theory, a sale which is properly advertised, managed and conducted would generate a reasonably determined sale price that constitutes the "unquestionable value" of the secured creditors' collateral--and such a sale price, if it were turned over completely to the secured creditor, would therefore constitute the "indubitable equivalent" of the secured creditors claim--i.e., the same thing that the secured creditor would itself be able to obtain on account of its collateral. As a consequence, such a sale could proceed, without a mandated credit bid right for the secured lenders.

Impact on Secured Creditors

So, what should a secured lender take away from this? In the first instance, as a practical matter, the decision gives debtors some support if they wish to try to craft a plan that is based on a sale, and potentially some leverage against secured lenders who oppose such a sale, because it arguably removes an arrow from the quiver traditionally held by the secured lender. And, because the Third Circuit is binding authority on the Bankruptcy Courts from the District of Delaware (itself an influential jurisdiction), the precedential effect of the decision might be magnified. However, there are other aspects to the ruling to consider that offset these concerns somewhat.

Initially, it is important to note that the Third Circuit never held that secured lenders will always be deemed to receive the "indubitable equivalent" of their claim by receiving proceeds from an asset sale. Indeed, the Court remanded the case back to the Bankruptcy Court for a determination of whether that had in fact occurred in the particular sale. Thus the decision should not be read to suggest that *any* sale conducted under the banner of Section 1129(b)(2)(iii) will necessarily or automatically result in secured lenders receiving the "indubitable equivalent" of their claims. Even without a credit bid right, secured lenders are not deprived of their ability to object to other aspects of the sale, or their right to insist that all of the other requirements of Section 1129 of the Code are met by a debtor in conjunction with the confirmation of a plan of reorganization. Each sale will have to be carefully monitored on its own terms.

It is notable that there was also a very vigorous dissent in the 2-1 decision of the Third Circuit, which, amongst other things, noted that notwithstanding the pure statutory construction argument made by the Debtor, the decision seemed to contradict some 30 years of bankruptcy practice and jurisprudence by taking away the credit bid right that had been so widely recognized. By leaving it to the bankruptcy court to determine whether a particular sale provides the "indubitable equivalent" of a lenders claim the Third Circuit left a big door open for this issue to be considered going forward. It is foreseeable that many bankruptcy courts will be sympathetic to the dissent's points. Further, there are "workarounds" for the secured creditor, even if they might not be particularly elegant, or even particularly practical. For example, while perhaps the lender could be disenfranchised as a "credit bidder", couldn't it just bid cash if it was really concerned that the assets were being undersold in the sale process? The cash would seem to just come back around to the lender on account of its secured claim, with everyone winding up in the same economic place. Finally, there is always the possibility that it will be possible to "draft around" this decision, and it seems likely that future cash collateral or DIP financing arrangements will contain limitations on a debtor's ability to propose a plan that purports to deprive a lender of its credit bid rights.

A chink in the armor of a secured creditor? Perhaps at some level. A worrisome development? Its probably too soon to draw that conclusion. But almost certainly, there is more case law to come on this issue.

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