ALERTS AND UPDATES

Third Circuit's Credit-Bid Decision's Impact upon Secured Lenders

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The U.S. Court of Appeals for the Third Circuit, in *In re Philadelphia Newspapers LLC*,[1] has ruled that secured creditors do not have a right, as a matter of law, to credit bid their claims when their collateral is sold under a plan of reorganization. The Third Circuit held that secured creditors may be barred from credit bidding where a debtor's reorganization plan provides secured creditors with the "indubitable equivalent" of their secured interest in the assets. The court's ruling follows a similar ruling last year by the U.S. Court of Appeals for the Fifth Circuit in *In re Pacific Lumber Co*.[2] The Third Circuit decision interprets away a significant protection for secured creditors in the context of sales under plans of reorganization.

In *In re Philadelphia Newspapers LLC*, the debtors' chapter 11 plan proposed the liquidation of substantially all of the debtors' assets, and the cram-down of the secured creditors. The debtors' motion for approval of bid procedures sought to prevent the secured creditors from making credit bids at the auction. Secured creditors were owed more than $300 million, and the assets were valued at substantially less than the loan amounts.

The bankruptcy court denied the preclusion of credit bids, concluding that there was no "cause" to deny secured creditors' their credit-bid right under section 363(k). The debtors appealed, and the district court reversed the bankruptcy court, holding that the debtors' proposed bid procedures precluding credit bids were allowed by section 1129(b)(2)(A)(iii). The district court reasoned that section 1129(b)(2) requires that a plan be fair and equitable to the secured creditors, and provides three alternative ways for the "fair and equitable" standard to be met. The third alternative, set forth in section 1129(b)(2)(A)(iii), provides only that the secured creditor receive the "indubitable equivalent" of its claims and contains no reference to the section 363(k) right to credit bid (whereas in the second alternative, the secured creditor expressly retains the right to its credit bid). The district court focused on the "plain meaning" of section 1129(b)(2)(A), which is phrased in the disjunctive.

The Third Circuit Court of Appeals affirmed, holding "[a]ccordingly, we agree with the District Court and the Fifth Circuit that § 1129(b)(2)(A) is unambiguous and that a plain reading of its provisions permits the Debtors to proceed under subsection (iii) without allowing the Lenders to credit bid. Because we are directed to cease our inquiry when we are satisfied that the applicable statutory language is unambiguous, we will affirm the District Court on those grounds."[3] The court recognized that there may be cases where credit bidding is required, stating "our holding here only precludes a lender from asserting that it has an absolute right to credit bid when its collateral is being sold pursuant to a plan of reorganization." The holding is further limited to the pre-confirmation process, and a secured creditor can still object to plan confirmation on a variety of bases, including that the absence of a credit bid did not provide it with the "indubitable equivalent" of its collateral.[4] Objections by secured creditors to confirmation of a plan based on credit-bid preclusion may include: the restriction of credit bidding failed to generate fair market value at the auction; a foreclosure auction would have generated greater value than the plan sale; or adequate marketing was impossible due to the speed of the confirmation process.[5]

Circuit Judge Ambro wrote a lengthy dissenting opinion. In his dissent, he argued that subsection 1129(b)(2)(A)(ii) (which acknowledges a secured creditor's right to credit bid) is the exclusive subsection of 1129(b)(2)(A) applicable to sales under plans of reorganization. He emphasized the importance of a secured creditor's right to credit bid at any sale, including a sale under a plan of reorganization, as a means to permit secured creditors to protect against the undervaluation of secured

assets at a sale. He also identified practical concerns related to the majority's decision. Secured creditors rely on their ability to credit bid in extending credit to debtors. Eliminating that right in certain situations may increase the cost of credit. In addition, although the *In re Philadelphia Newspapers LLC* decision does not preclude a secured creditor from participating in any sale under a plan of reorganization by making a cash bid, that situation may present administrative difficulties for secured creditors when they are part of a large, widely syndicated loan.

Conclusion

The *In re Philadelphia Newspapers LLC* decision may give debtors new leverage in negotiating with lenders and in structuring sales in chapter 11 cases. In pre-bankruptcy negotiations with debtors, secured creditors should consider conditioning debtor-in-possession financing or the use of cash collateral on the debtor's agreement to include the right to credit bid at any sales (including sales under plans of reorganization) of their collateral.

For Further Information

If you have any questions regarding this *Alert*, please contact any member of the Business Reorganization and Financial Restructuring Practice Group or the attorney in the firm with whom you are regularly in contact.

Notes

1. *In re Philadelphia Newspapers LLC*, 2010 WL 1006647 (3d Cir. Pa. Mar 22, 2010).
2. *In re Pacific Lumber Co*., 584 F.3d 229 (5th Cir. 2009).
3. 2010 WL 1006647, at *16.
4. *Id*. at *16 (citing *In re Pacific Lumber Co*., 584 F.3d 229, 247).
5. *See Id*.; *In re Pacific Lumber Co*., 584 F.3d 229, 247.