BUSINESS REORGANIZATION AND CREDITORS' RIGHTS

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Seventh Circuit Disagrees with Third on Selling Collateral Without Credit Bidding in a Cramdown: Rule of Philly Papers Rejected

The Bankruptcy Code provides that a Chapter 11 plan of reorganization may be confirmed over the opposition of a class of secured creditors whose secured claims are not being paid in full only if it provides one of the following[1]--

(a) the secured creditors shall retain their liens to secure a right to receive a future stream of payments in an aggregate amount of at least the value of their secured claims and a present value of at least the value of their collateral;[2]

(b) the secured creditors' collateral is sold, free and clear of their liens but subject to their right to "credit bid" at the resulting auction, with their liens transferred to the proceeds of sale;[3] or

(c) realization by the secured creditors of the "indubitable equivalent" of their secured claims.[4]

Could a plan be confirmed over the opposition of a class of secured creditors under the "indubitable equivalent" test if it provides for a sale of their collateral that does not allow for secured creditor credit bidding? In a controversial split decision last year, the U.S. Court of Appeals for the Third Circuit in Philadelphia held that it could.[5] Earlier this summer, a unanimous panel of the U.S. Court of Appeals for the Seventh Circuit in Chicago, in a well-reasoned decision that largely echoed the dissent in *Philadelphia Newspapers*, held that it could not.[6] To allow such a plan to be confirmed, the court said, would "nullify" the requirement for credit bidding when a collateral sale is the basis for a cramdown[7] and "ignore the protections for secured creditors recognized in other [Bankruptcy] Code provisions."[8] It held that "the Code requires that cramdown plans that contemplate selling encumbered assets free and clear of liens at an auction" must provide for secured party credit bidding.[9]

Usually when the Courts of Appeals for two or more circuits disagree on an important issue of federal law, the way is open for the Supreme Court to eventually resolve the disagreement. However, in our view, *River Road* is so clearly the correct interpretation of the applicable Bankruptcy Code provisions that this disagreement is likely to be resolved without the intervention of the Supreme Court. ◆

Endnotes

1 The confirmation of a plan over the opposition of a class of creditors or equity holders has long been referred to by bankruptcy lawyers as a "cramdown." In the absence of a permissible cramdown, the Bankruptcy Code normally requires the acceptance of the plan by every impaired class of claims and equity interests. Bankruptcy Code § 1129(a)(8).

2 Bankruptcy Code § 1129(b)(2)(A)(i).

3 *Id*. § 1129(b)(2)(A)(ii). When a secured creditor credit-bids at an auction of collateral, it bids using its secured claim as auction currency. Credit bidding in bankruptcy is generally protected by Bankruptcy Code § 363(k). It is generally thought to provide a "crucial check against undervaluation." *River Road Hotel Partners, LLC v. Amalgamated Bank*, 2011 WL 2547615, at *7 (7th Cir. June 28, 2011).

4 Bankruptcy Code § 1129(b)(2)(A)(iii). The phrase "indubitable equivalent" is also used in Bankruptcy Code § 361(3), the Code's illustration of permissible types of "adequate protection," and has its roots in a decision that long antedates the Bankruptcy Code, *In re Murel Holding Corp*., 75 F.2d 941 (2d Cir. 1935).

5 *In re Philadelphia Newspapers, LLC*, 599 F.3d 298 (3rd Cir. 2010). The decision had some tangential support in a prior Fifth Circuit decision, *In re Pacific Lumber Co.*, 584 F.3d 229 (5th Cir. 2009).

6 *River Road Hotel Partners, LLC v. Amalgamated Bank*, *supra*.

7 Bankruptcy Code § 1129(b)(2)(A)(ii).

8 *River Road Hotel Partners, LLC v. Amalgamated Bank* at *9.

9 *Id*.

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