

Viewpoint

One of a series of opinion columns by bankruptcy professionals

Right To Credit Bid Denied In Philadelphia Newspapers

By Marshall S. Huebner and Kevin J. Coco

In a highly anticipated decision, on March 22 a split panel of the 3rd U.S. Court of Appeals affirmed the District Court by holding in *In re Philadelphia Newspapers, LLC* that a debtor may prohibit its secured creditors from credit bidding at a sale of substantially all of the debtor's assets conducted pursuant to a Chapter 11 plan of reorganization.

Credit bidding allows a secured creditor to use its secured claims as currency at certain sales of property of a debtor's estate, thus permitting the secured creditor to obtain possession of its collateral rather than receive the proceeds of a sale for consideration that it views as inadequate. Sales of property of the estate outside the ordinary course of business may be conducted pursuant to either section 363(b) of the Bankruptcy Code or a plan of reorganization. Section 363(k) expressly authorizes credit bidding in sales conducted pursuant to 363(b); the *Philadelphia Newspapers* court addressed whether a similar right exists when a secured creditor's collateral is sold pursuant to a plan.

A plan of reorganization may be approved over a dissenting class of creditors (i.e., crammed down) if, among other things, the plan is "fair and equitable" with respect to that class. For a dissenting secured creditor, under section 1129(b)(2)(A), a plan can meet the "fair and equitable" requirement by three methods: (i) allowing the secured creditor to retain the liens securing its claims and granting deferred payments having a present value equal to the value of the collateral; (ii) selling the collateral free and clear of the liens and attaching the liens to the sale proceeds, so long as the secured creditor is permitted to credit bid; or (iii) providing the secured creditor with the "indubitable equivalent" of its secured claim. The majority and dissent in *Philadelphia Newspapers* disagreed about whether an auction can take place under (iii), without the protections of (ii).

The 3rd Circuit's ruling approved the debtors' proposed bid procedures barring holders of liens on the debtors' assets from credit bidding at an auction of those assets, concluding that "subsection (iii) of Section 1129(b)(2)(A) unambiguously permits a debtor to proceed with any plan that provides secured lenders with the 'indubitable equivalent' of their secured interest in the assets and contains no statutory right to credit bidding." The court also emphasized that the plan must subsequently and

separately meet the "fair and equitable" standard articulated in section 1129(b)(2)(A), governing the cramdown of secured creditors.

In granting the debtors' request to preclude credit bidding, the court found that section 1129(b)(2)(A)(ii) was not the exclusive means for conducting a "fair and equitable" plan sale of assets free and clear of liens, but that such a sale pursuant to subsection (iii), which, unlike subsection (ii), does not expressly address credit bidding, was also permissible. Grounding its primary holding in the plain meaning of the statute, the court opined that section 1129(b)(2)(A) was disjunctive and unambiguous on its face and permitted the debtor to auction off its assets under subsection (iii), without credit bidding. The court determined that although subsection (ii) "may reflect 'a special congressional concern' about the free and clear transfer of collateral that secures a loan...it is apparent here that Congress' inclusion of the indubitable equivalence prong intentionally left open the potential for yet other methods of conducting asset sales, so long as those methods sufficiently protected the secured creditor's interests."

While the 3rd Circuit's opinion makes clear that, when seeking to cram down secured creditors in a sale pursuant to a plan, a debtor may prohibit credit bidding and proceed under subsection (iii) by granting secured creditors the "indubitable equivalent" of their claims, the court also recognized that the bankruptcy court must find the plan "fair and equitable." The court highlighted the prematurity of drawing any conclusions with respect to the "fair and equitable" requirement. Rejecting the dissent's contention that allowing a free and clear sale of assets under the "indubitable equivalent" prong would deny secured lenders the "fair and equitable" treatment to which they are entitled under subsection (ii), the Court reasoned that a "fair and equitable" analysis is properly left "for plan confirmation and cannot be answered at this stage by manufacturing extratextual statutory constraints." Consequently, the court declined to conclude whether the prospective auction could produce the "indubitable equivalent" of the secured lenders' claims, and indicated further that while the debtors may preclude credit bids, the lenders may argue at confirmation that the plan did not generate the "indubitable equivalent" of their claims and, therefore, is not "fair and equitable" and should not be confirmed.

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In a lengthy dissent rejecting the majority's plain meaning analysis, Judge Thomas L. Ambro opined that section 1129(b)(2)(A) is ambiguous and therefore "more than one reasonable reading of the statute" is permissible. He reasoned that the issue must be considered with respect to "long-established canons of statutory interpretation to § 1129(b)(2)(A),...the context of the entire Bankruptcy Code [as well as] the section's legislative history and the comments of Code drafters[.]" Ambro concluded that the Bankruptcy Code requires that Chapter 11 asset sales free and clear of liens be subject to the specific requirements of section 1129(b)(2)(A)(ii) instead of the general requirement of subsection (iii), thus mandating that secured creditors be allowed to credit bid the value of their collateral.

Ambro's dissent also focused on the practical consequences of the court's decision in this case (and the arguably unsavory facts), noting that debtors will likely seek confirmation under subsection (ii) only if granting their secured creditors the right to credit bid somehow provided more advantages than denying such a right. Moreover, he observed that precluding secured creditors from credit bidding runs contrary to the parties' established expectations and denies secured creditors the benefit of their pre-petition bargain.

This ruling deals an unwelcome blow to secured creditors by opening the door to debtors evading statutory credit bidding rights by proposing auctions under plans of reorganization that bar credit bidding. But the secured

lenders' rights in *Philadelphia Newspapers* have not yet been definitely extinguished. As the majority noted, the holding only forecloses lenders' absolute right to credit bid. Indeed, "in some instances, credit bidding may be required" and, significantly, lenders retain the statutory right to object to confirmation, including by asserting that the plan fails to meet the "indubitable equivalent" and "fair and equitable" requirements. Nevertheless, the decision suggests that some debtors that have reason to be averse to the prospect of secured lenders receiving their collateral will attempt to effectuate asset sales through the longer and more expensive plan of reorganization route rather than pursuant to section 363(b) of the Bankruptcy Code.

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Over on the West coast in California, Essex recently announced the acquisitions of the 115-unit DuPont Lofts in Irvine and the 349-unit Skyline at MacArthur Place in Santa Ana. The prices were reported at \$27 million and \$128 million, respectively. (The Skyline project is a 50% joint venture with an undisclosed partner.)

Both developments could see an average monthly rent topping \$2,400, with Skyline closer to \$3,000. Amenities at the Skyline development, which should see tenants soon,

include a sauna, yoga room, temperature-controlled wine locker and bocce ball court, according to the company. The lofts remain under construction and residents should move in this fall.

Green Street pointed out the locations are in "arguably below-average submarkets" surrounded mostly by office parks with little retail within walking distance.

"The bet being made by Essex is that prospective renters will choose high-quality, lavish new units over older product offering superior locations," Green Street analyst Andrew McCulloch wrote earlier this month.