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Third Circuit Holds Plan Providing for Asset Sale Free and Clear of Liens Need Not Allow Secured Creditors to Credit Bid at Such Sale: *In re Philadelphia Newspapers, LLC, et al.*

In a divided ruling issued on March 22, 2010, In re Philadelphia Newspapers, LLC, et al., No. 09-4349, 2010 WL 1006647 (3d Cir. Mar. 22, 2010) ("Philadelphia Newspapers"), the U.S. Court of Appeals for the Third Circuit held that the debtors were permitted under Section 1129(b)(2)(A) of the Bankruptcy Code to pursue a sale free and clear of their secured lenders' liens under a plan of reorganization without allowing the lenders to credit bid their debt at the auction. The Third Circuit thus joined the recent Fifth Circuit decision in In re Pacific Lumber Co.[1] in holding that a sale pursuant to a plan of reorganization does not need to afford dissenting secured creditors with a credit bid right so long as the plan provides the secured creditors with the "indubitable equivalent" of their secured claims. In so holding, these Courts rely almost entirely on what they perceive to be "plain language" of Section 1129(b)(2)(A) of the Bankruptcy Code, i.e., as providing three distinct alternative paths for confirming a chapter 11 plan over a dissenting class of secured creditors.

I. In re Philadelphia Newspapers, LLC, et al.

In Philadelphia Newspapers, the debtors, which own and operate newspapers including the *Philadelphia Inquirer* and *Philadelphia Daily News*, proposed a plan of reorganization providing for the sale of substantially all of their assets free and clear of all liens at a public auction with a staking horse bidder largely composed of and controlled by the debtors' current and former management and equity holders. The plan further provided that the debtors' secured lenders, which held loans of about $318 million secured by first priority liens in substantially all of the debtors' assets, would receive about $37 million in cash proceeds from the sale as well as the debtors' headquarters, valued at $29.5 million, subject to a two-year rent free lease to the purchaser. In connection with the plan, the debtors sought to require that any qualified bidder fund the purchase with cash only – thereby attempting to preclude secured lenders from credit bidding for their collateral.

The lenders objected to the debtors' proposed bidding procedures arguing that Section 1129(b)(2)(A)(ii) of the Bankruptcy Code requires that a chapter 11 plan providing

[1] 584 F.3d 229 (5th Cir. 2009).

for the sale of the debtors' assets free and clear must allow secured creditors to bid their debt in lieu of cash.[2] The Bankruptcy Court for the Eastern District of Pennsylvania agreed and refused to approve the debtors' proposed bidding procedures. On appeal, the District Court reversed relying on the plain language of the statute. The Third Circuit affirmed, similarly concluding that Section 1129(b)(2)(A) permits the debtors to sells their assets free and clear under a plan without allowing secured lenders to credit bid, so long as the secured creditor is provided with the "indubitable equivalent" of its secured claim pursuant to Section 1129(b)(2)(A)(iii) of the Bankruptcy Code.

A. The Plain Meaning of Section 1129(b)(2)(A) Permits Asset Sales Free and Clear of any Liens Without Allowing Credit Bidding

The Third Circuit's ruling principally relied on the plain meaning of the statute. The Third Circuit noted that Section 1129(b)(2)(A) provides three alternative paths to confirming a plan over the dissent of a class of secured creditors: (i) the secured creditors retain their liens and receive deferred cash payments equal to the present value of the lenders' secured interest in the collateral as of the effective date of the plan, and totaling the allowed amount of the creditors' secured claim; (ii) the collateral is sold free and clear of liens with the secured creditors having the opportunity to credit bid at the sale (absent specific cause to deny such right) and with the liens attaching to the proceeds of the sale; or (iii) the secured creditors realize the "indubitable equivalent" of their secured claims.[3] Critically, the Third Circuit emphasized that these three paths are phrased in the disjunctive, i.e., subsections (i), (ii) and (iii) are separated by the disjunctive "or." Accordingly, the Third Circuit concluded that a plan may provide for a free-and-clear asset sale under subsection (iii) without allowing secured lenders to credit bid (as subsection (ii) requires), provided that the secured creditors receive the "indubitable equivalent" of their secured claims.

The Third Circuit rejected the lenders' arguments that the specific statutory provision permitting credit bidding with free-and-clear asset sales should prevail over the more general right to provide a creditor the "indubitable equivalent" of its claim, given the disjunctive structure of the statute. Accordingly, the court concluded that when a debtor proposes to sell collateral free and clear under a plan and treat secured claims under subsection (iii), the secured creditors simply have no absolute right to credit bid at a sale of their collateral, although they are free to argue that the absence of a right to credit bid in a particular case does not provide them with the "indubitable equivalent" of their secured

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[2] Although Section 1129(b)(2)(A)(ii) does not refer to credit bidding by name, it makes sales free and clear pursuant to that subsection "subject to section 363(k) [of the Bankruptcy Code]." Section 363(k) of the Bankruptcy Code permits a secured creditor to credit bid on its collateral where a debtor or trustee proposes to sell the collateral outside of the ordinary course of business, absent the Court determining that "cause" exists to deny the secured creditor the right to credit bid.

[3] The court defines "indubitable equivalent" as a term of art that refers to a secured creditor receiving the unquestioned value of its security interest in collateral.

claims. The court did not decide on appeal whether the lenders in this case had in fact been offered the "indubitable equivalent."

Finally, the Third Circuit rejected the lenders' arguments that Section 1129(b)(2)(A), when read in conjunction with Sections 1111(b) and 363(k), requires a different result. The lenders argued that the legislative history regarding the enactment of the Bankruptcy Code makes clear that secured recourse creditors are not eligible for the protections afforded by the Section 1111(b) election[4] in two limited circumstances, namely a Section 363 sale and a plan sale under Section 1129(b)(2)(A)(ii), precisely because the secured creditors have the opportunity to credit bid under Section 363(k). According to the lenders, permitting an asset sale under a chapter 11 plan without according the lenders a right to credit bid would undermine the protections afforded to secured creditors under this integrated statutory framework. The Third Circuit rejected this argument because it held that the plain reading of Section 1129(b)(2) was not at odds with Section 1111(b) or 363(k). In support of its conclusion, the Third Circuit pointed to other provision in which assets are transferred without affording a secured creditor the right to credit bid: a transfer of collateral under subsection (i) of Section 1129(b)(2)(A) and a for-cause denial of credit bidding under Section 363(k).

B. Judge Ambro's Dissent

Judge Ambro, a former bankruptcy practitioner, submitted a vigorous dissent fundamentally disagreeing with the court's conclusion that Section 1129(b)(2)(A) was unambiguous. He reasons that the language at issue is susceptible to another plausible reading: that Section 1129(b)(2)(A) provides distinct routes that apply specific requirements depending on how a given plan proposes to treat the claims of secured creditors. Pursuant to this reading, subsection (i) applies to a situation where secured creditors retain the lien securing their claims, subsection (ii) applies to a situation where the plan provides for the sale of the secured creditors' collateral free and clear of secured claims, and subsection (iii) applies whenever the plan provides for the realization of the "indubitable equivalent" of a secured creditor's claim in other circumstances (e.g., by providing the secured creditor with substitute collateral). Thus, Section 1129(b)(2)(A) prescribes specific treatments afforded to secured creditors depending on whether the plan transfers the collateral subject to the liens, sells the collateral free and clear of any liens, or otherwise deals with the secured claims.

Based on such ambiguity, Judge Ambro relies on principles of statutory interpretation to determine the proper reading of the statute. Judge Ambro concluded that the specific asset sale provision in subsection (ii) must prevail over the general "indubitable equivalent" provision in subsection (iii) in order to avoid rendering subsection (ii) entirely superfluous and a nullity. Judge Ambro also emphasizes the overall statutory context, as

[4] Section 1111(b)(2) provides a class of secured claims with the ability to elect to treat their claim as fully secured, thereby waiving any unsecured deficiency claim.

opposed to solely focusing on the language of Section 1129(b)(2)(A). In his view, Section 1111(b) in particular provides strong support for the reading that subsection (ii) of Section 1129(b)(2)(A) provides the exclusive treatment for free and clear asset sales under a plan. Specifically, Section 1111(b) is designed to protect secured creditors from the risk of undervaluation of their collateral, including by allowing a secured creditor to forgo its unsecured deficiency claim and instead elect to have its claim treated as if it were fully secured. However, the protections of Section 1111(b) are not available to a secured creditor when its collateral is to be sold under Section 363 or under a plan, i.e., exactly the circumstances in which a secured creditor is permitted to credit bid under Section 363(k). To deny credit bid protection in the plan context would thus undermine the complementary nature of this statutory framework.

II. Implications of In re Philadephia Newspapers, LLC, et al.

The decision in Philadelphia Newspapers enables plan proponents (at least in the Third Circuit) to structure sales pursuant to a chapter 11 plan without affording secured creditors the opportunity to credit bid under Section 363(k) of the Bankruptcy Code, so long as such secured creditors receive the "indubitable equivalent" of their secured claims. Accordingly, debtors may structure asset sales as sales under chapter 11 plans, as opposed to stand-alone sales pursuant to Section 363, in order to attempt to deprive secured creditors of their right to credit bid without having to make a special showing of "cause". In response to these attempts, secured creditors are likely to argue that they must be afforded the right to credit bid in a given case in order for them to receive the "indubitable equivalent" of their secured claim under a plan. To this end, the Third Circuit was careful to note that it did not find the "indubitable equivalent" had been provided to the Philadelphia Newspapers lenders, but merely that the debtors had the ability to seek confirmation of the proposed plan if they were later able to make such a showing. Lenders also may well attempt to submit cash bids on their collateral in order to prevent the risk of undervaluation, reasoning that the proceeds of any successful bid will merely flow back to them on account of their secured claims. It is unclear how courts will respond to these attempts by secured creditors to protect against undervaluation. It is likewise unclear whether a court would ever find that a secured creditor did not receive the "indubitable equivalent", so long as the secured creditors' liens attach to the proceeds of the sale, whatever they may be.

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CLEARY GOTTLIEB STEEN & HAMILTON LLP

CLEARY GOTTLIEB

Office Locations

NEW YORK
One Liberty Plaza
New York, NY 10006-1470
1 212 225 2000
1 212 225 3999 Fax

WASHINGTON
2000 Pennsylvania Avenue, NW
Washington, DC 20006-1801
1 202 974 1500
1 202 974 1999 Fax

PARIS
12, rue de Tilsitt
75008 Paris, France
33 1 40 74 68 00
33 1 40 74 68 88 Fax

BRUSSELS
Rue de la Loi 57
1040 Brussels, Belgium
32 2 287 2000
32 2 231 1661 Fax

LONDON
City Place House
55 Basinghall Street
London EC2V 5EH, England
44 20 7614 2200
44 20 7600 1698 Fax

MOSCOW
Cleary Gottlieb Steen & Hamilton LLP
CGS&H Limited Liability Company
Paveletskaya Square 2/3
Moscow, Russia 115054
7 495 660 8500
7 495 660 8505 Fax

FRANKFURT
Main Tower
Neue Mainzer Strasse 52
60311 Frankfurt am Main, Germany
49 69 97103 0
49 69 97103 199 Fax

COLOGNE
Theodor-Heuss-Ring 9
50668 Cologne, Germany
49 221 80040 0
49 221 80040 199 Fax

ROME
Piazza di Spagna 15
00187 Rome, Italy
39 06 69 52 21
39 06 69 20 06 65 Fax

MILAN
Via San Paolo 7
20121 Milan, Italy
39 02 72 60 81
39 02 86 98 44 40 Fax

HONG KONG
Bank of China Tower
One Garden Road
Hong Kong
852 2521 4122
852 2845 9026 Fax

BEIJING
Twin Towers – West
12 B Jianguomen Wai Da Jie
Chaoyang District
Beijing 100022, China
86 10 5920 1000
86 10 5879 3902 Fax