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SECURED LENDERS DO NOT HAVE AN ABSOLUTE RIGHT TO CREDIT BID

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March 24, 2010

In a recent opinion issued in the case *In re Philadelphia Newspapers, LLC, et al.*, Case No. 09-4266 (3rd Cir. 2010), the United States Court of Appeals for the Third Circuit held that secured lenders do not have an absolute right to credit bid on all asset sales under section 1129(b)(2)(A) of the Bankruptcy Code. This opinion could have a profound effect on the manner in which debtors seek approval of a sale pursuant to a plan of reorganization and, potentially, a chilling effect on the willingness of lenders to extend credit in the future.

The debtors² own and operate several newspapers in Philadelphia, and are parties to a Credit and Guaranty Agreement entered into with a group of lenders owed approximately \$318,000,000. In exchange for the \$318,000,000 in loans made by the lenders, the debtors granted to the lenders a security interest in substantially all of their assets. The debtors defaulted under the lenders' loan documents.

After defaulting on their obligations to the lenders, the debtors filed for bankruptcy protection. The debtors later filed a joint Chapter 11 plan of reorganization pursuant to which they proposed to sell substantially all of their assets free of any liens at a public auction (the "Proposed Sale"). The debtors devised procedures to govern the Proposed Sale, and filed a motion with the bankruptcy court seeking approval of those procedures. Among the sale procedures proposed by the debtors was a ban on the ability of the lenders to "credit bid"³ for the assets being sold by the debtors. In support of the proposed ban on credit bidding, the debtors pointed to the fact that the Proposed Sale was to be conducted pursuant to sections 1123(a) and (b) of the Bankruptcy Code⁴, which sections do not specifically address the right of a secured lender to make a credit bid, and not pursuant to section 363 of the Bankruptcy Code, which does specifically address the right of a secured creditor to make a credit bid. Because the Proposed Sale was to be conducted pursuant to a section of the Bankruptcy Code that does not expressly provide a secured creditor with the right to make a credit bid, the

debtors argued that it was permissible to conduct the Proposed Sale without providing for such a right. Several parties, including the lenders, objected to the sale procedures.

The Bankruptcy Court disagreed with the debtors on the issue of credit bidding, and approved revised sale procedures that provided the lenders with the opportunity to make a credit bid at the auction. The Bankruptcy Court based its decision on its reading of section 1129(b)(2)(A) of the Bankruptcy Code,⁵ which lists the requirements for a plan of reorganization when fewer than all classes of creditors vote to accept the plan. The Bankruptcy Court noted that though the debtors considered the Proposed Sale as proceeding under subsection (iii) of that section, the Proposed Sale was more properly a sale pursuant to subsection (ii), which expressly addresses credit bidding by secured lenders through its reference to section 363. The Debtors appealed the Bankruptcy Court's decision to the District Court.

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The District Court reversed the Bankruptcy Court's decision, and held that the lenders did not have a right to credit bid at the Proposed Sale. The District Court also based its opinion on the language of section 1129(b)(2)(A) of the Bankruptcy Code, but interpreted that language differently. The District Court found that each subsection provides separate and independent paths to confirmation of a plan of reorganization, and held that a plan of reorganization need only comply with the specific provisions of any one of the subsections. The District Court reasoned that because the Proposed Sale was to proceed under subsection (iii), which does not expressly provide for a right of secured creditors to credit bid, the lenders did not have the right to credit bid in connection with the Proposed Sale. The District Court's order was appealed to the Third Circuit Court of Appeals by the lenders.

The Third Circuit affirmed the ruling of the District Court, holding that secured lenders do not have an absolute right to credit bid on all asset sales under section 1129(b)(2)(A) of the Bankruptcy Code. The Court began by observing that section 1123(a)(5)(D) of the Bankruptcy Code, which governed the Proposed Sale, does not address the procedural aspects of the sale. Like the Bankruptcy Court and the District Court, the

Court of Appeals turned to section 1129(b) to determine the procedural requirements, and made three crucial findings. First, the Court noted that the language of section 1129(b)(2)(A) is unambiguous and provides for three different methods, prescribed in subsections (i), (ii) and (iii), to effectuate a sale, and a debtor need comply with only one of these subsections. Second, the Court found that the language of subsection (iii), unlike the language of subsection (ii), does not expressly address the right of a secured creditor to credit bid. Because subsection (iii) does not expressly address the right to credit bid, the Court ruled that it could not read such a requirement into that subsection. Finally, the Court noted that even if the language of a statute is unambiguous, there are limited circumstances where a literal application would produce a result demonstrably at odds with the intentions of its drafters. After discussing the interplay of section 1129(b)(2)(A) with other sections of the Bankruptcy Code, the Court concluded that *In re Philadelphia Newspapers, LLC, et al.* did not present one of those limited exceptions, and it therefore was bound to enforce the language of the statute as written. In closing, the Court held that secured lenders do not have an absolute right to credit bid, but noted that certain circumstances may require such a right to achieve the "fair and equitable" requirement also

demanding by section 1129(b)(2)(A).

A dissent authored by Judge Ambro argues that subsection (iii), the provision relied upon by the debtors, may only be relied upon if a sale of assets is not encompassed by either subsection (i), addressing sales in which assets are transferred subject to pre-existing liens, or subsection (ii), addressing situations where assets are to be transferred clear of liens. Because the debtors proposed to transfer assets clear of liens, subsection (ii), which specifically addresses credit bidding by secured creditors, is the section that should govern.

The decision in *In re Philadelphia Newspapers, LLC, et al.* will almost certainly impact the manner in which sales in bankruptcy are effectuated going forward, may affect the willingness of lenders to provide post-petition financing in future cases and may also impact the terms upon which lenders are willing to provide such financing. The decision in *Philadelphia Newspapers* is yet another in a long line of decisions in which the Third Circuit applied a fairly strict "plain meaning" analysis to a question of statutory interpretation. A final point of note is that despite the persuasiveness of the majority's decision, the well written, well reasoned dissent in this case may provide other courts with a basis to disagree with the plain language interpretation employed by the Third Circuit in *In re Philadelphia Newspapers, LLC, et al.*

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² The debtors include PMH Acquisition, LLC; Broad Street Video, LLC; Philadelphia Newspapers, LLC; Philadelphia Direct, LLC; Philly Online, LLC; PMH Holdings, LLC; Broad Street Publishing, LLC; and Philadelphia Media, LLC.

³ As noted by the Third Circuit Court of Appeals, a credit bid allows a secured creditor to bid the debt owed to it in lieu of payment of some other consideration.

⁴ Over the objections of impaired classes of creditors and subject to the "cram down" provisions of Section 1129(b)(2)(A) of the Bankruptcy Code.

⁵ Section 1129(b)(2)(A) of the Bankruptcy Code provides, in relevant part:

(2) For the purpose of this subsection, the condition that a plan be fair and equitable with respect to a class includes the following requirements:

(A) With respect to a class of secured claims, the plan provides—

(i)

(I) that the holders of such claims retain the liens securing such claims, whether the property subject to such liens is retained by the debtor or transferred to another entity, to the extent of the allowed amount of such claims; and

(II) that each holder of a claim of such class receive on account of such claim deferred cash payments totaling at least the allowed amount of such claim, of a value, as of the effective date of the plan, of at least the value of such holder's interest in the estate's interest in such property;

(ii) for the sale, subject to section 363 (k) of this title, of any property that is subject to the liens securing such claims, free and clear of such liens, with such liens to attach to the proceeds of such sale, and the treatment of such liens on proceeds under clause (i) or (iii) of this subparagraph; or

(iii) for the realization by such holders of the indubitable equivalent of such claims.

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