

Recent Developments

CREDITORS' RIGHTS DEVELOPMENTS

Court Rules That Secured Creditors Need Not Be Allowed to Credit Bid in Sale of Collateral

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A sharply divided panel of the United States Court of Appeals for the Third Circuit recently ruled that a chapter 11 plan may provide for a sale of assets subject to a secured creditor's lien without affording the secured creditor the opportunity to credit bid its debt. *In re Philadelphia Newspapers, LLC*, No. 09-4266, slip op. (3d Cir. March 22, 2010). This case has particular importance because Delaware, a key bankruptcy venue, is in the Third Circuit.

The debtors, owners of various newspapers, proposed a chapter 11 plan under which their assets would be sold free of liens at a public auction, and contemporaneously entered into an asset purchase agreement with a group of insiders who proposed to acquire the debtors' assets for cash in an amount substantially below the amount of the lenders' claim secured by those assets. As well, the debtors proposed bidding procedures designating the insider group as stalking horse and requiring any competing bid to be in cash. The secured lenders objected, arguing that the procedures unlawfully deprived them of the opportunity to credit bid.

The Third Circuit's majority decision rejected the lenders' challenge to the procedures. Analyzing Section 1129(b)(2)(A) of the Bankruptcy Code, which sets out alternative means by which a chapter 11 plan may be crammed down as "fair and equitable" on a rejecting class of secured creditors, the majority held that a sale without the opportunity to credit bid could be approved so long as the plan ultimately provided the secured creditor with the "indubitable equivalent" of its secured claim. The majority reasoned that although one provision of section 1129(b)(2)(A) expressly conditioned secured creditor cramdown on an opportunity to

credit bid, the "indubitable equivalent" test in the same section did not, with the result that a secured creditor can be crammed down by a chapter 11 plan providing for a sale free and clear of liens without credit bidding if the plan satisfies the indubitable equivalent standard.

In a strongly worded dissent, Judge Ambro (a former bankruptcy practitioner) rejected the majority's view that a sale free and clear of liens without an opportunity to credit bid can ever meet the statutory standards for secured creditor cramdown. He also took pains to outline the factors that should be considered by the bankruptcy court before finding the proposed asset sale satisfies the indubitable equivalent standard.

Assuming that the *Philadelphia Newspapers* decision is not modified on rehearing or otherwise, secured creditors have reason to be concerned that the Third Circuit's approach may allow debtors to preclude the use of credit bidding as a safeguard against low-value acquisitions of collateral under a plan. While secured creditors may compete with cash bids of their own, it is often difficult for large creditor groups to do so, particularly when they include CLO's or other entities that are unable to advance funds. The decision also undercuts other recent decisions affirming the ability of the required lenders to instruct the agent to credit bid, when the Credit Agreement so permits, and "drag along" the remainder of the lenders in the group. This decision may leave creditor groups with little choice but to design mechanisms for making cash bids, knowing that any cash advanced will essentially be round tripped at the end of the process. Secured creditors should also consider conditioning use of cash collateral or provision of DIP financing on the debtor's agreement that credit bidding will be permitted in any sale of their collateral pursuant to a plan or otherwise.

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