

ADVISORY | Bankruptcy

March 23, 2010

IN RE PHILADELPHIA NEWSPAPERS: ELIMINATING THE SECURED CREDITOR'S RIGHT TO CREDIT BID IN A SALE OF ASSETS UNDER A PLAN OF REORGANIZATION

On March 22, 2010, a three-judge panel of the U.S. Court of Appeals for the Third Circuit ruled that a debtor may prohibit a secured lender from credit bidding the amount of its secured claim in connection with a sale of assets pursuant to a plan of reorganization under the “cramdown” provisions of the Bankruptcy Code. The Third Circuit’s decision binds the U.S. Bankruptcy Court for the District of Delaware, a popular forum for large and complex Chapter 11 cases, and is therefore likely to have a substantial practical effect on the ability of secured creditors to enforce this right in bankruptcy. The Third Circuit is the second federal court of appeals to find against secured creditors on this issue, following a similar recent ruling by the Fifth Circuit in the *Pacific Lumber* bankruptcy case. The decision, *Citizens Bank of Pennsylvania v. Philadelphia Newspapers, LLC et al. (In re Philadelphia Newspapers)*, No. 09-4266, was issued on March 22, 2010 and is available [here](#).

Factual Background & Proceedings Below

The appeal before the Third Circuit arose out of the bankruptcy case of Philadelphia Newspapers, Inc., the publisher of the *Philadelphia Inquirer* and the *Philadelphia Daily News*. On August 20, 2009, the debtor filed a proposed Chapter 11 plan that provided for the sale of substantially all of its assets at a public auction. The proposed sale was to be free and clear of all liens, including the liens securing the \$318 million claim of the debtors’ senior lenders. Contemporaneous with the filing of the plan, the debtor entered into an asset purchase agreement with a “Stalking Horse Bidder” composed of certain insiders of the debtor. Under the plan, secured lenders would receive the cash proceeds of the sale—approximately \$37 million—and real property valued at approximately \$29 million, consisting of the debtors’ headquarters (subject, however, to a rent-free two-year lease to the Stalking Horse Bidder).

Soon after filing the plan, the debtor filed a motion to approve bid procedures in connection with the proposed sale. The bid procedures sought to preclude the secured lenders from credit bidding (i.e., deducting the amount of their claim from the purchase price) at the auction, and provided that any qualified bidder must fund its purchase with cash. The debtor’s motion in support of the bid procedures argued that the proposed elimination of the right to credit bid was proper because the sale of assets was to be effectuated under a plan of reorganization pursuant to Section 1123 of the Bankruptcy Code, rather than as a non-ordinary course sale under Section 363.

In response to a challenge by the secured lenders, the Bankruptcy Court for the Eastern District of Pennsylvania found that the debtor’s elimination of the secured lenders’ right to credit bid was invalid under the “cramdown” provisions of Section 1129(b) of the Bankruptcy Code. The District Court reversed, holding that Section 1129(b) unambiguously permitted a sale of assets free of the secured lenders’ right to credit bid, so long as the plan provided the lenders with the “indubitable equivalent” of their secured claim.

The Statutory Context & The Third Circuit’s Decision

At issue in the case was the interplay between two Bankruptcy Code provisions governing the sale of assets: Section 363(b), which permits asset sales outside of the ordinary course of business, and Section 1123(a), which provides for the sale of all or substantially all of the debtor’s assets under a plan of reorganization. Sales of all of a debtor’s assets may be accomplished under either provision; in fact, the most notorious of such sales to occur recently—the sales of Chrysler and GM—were structured as Section 363 sales. But the applicable legal standards differ depending on which statutory section is used to authorize the sale.

Section 363(k) explicitly preserves the secured creditor’s right to credit bid at an auction conducted under Section 363(b). By contrast, Section 1123 does not specifically address the right of secured creditor to bid at an auction conducted under a plan. The *Philadelphia Newspaper* courts all agreed that Section 1129(b)(2)(A)—the so-called “cramdown” provisions applicable to a nonconsensual confirmation of a plan of reorganization—provided the proper legal framework for analysis, because the terms of any “plan sale” would eventually have to satisfy the plan confirmation standards under Section 1129. Specifically, any such plan would have to satisfy the “fair and equitable” standard under Section 1129(b)(2)(A) by providing: (i) that the secured creditor retain the lien securing its claim and receive deferred cash payments; (ii) that the assets be sold free and clear of the secured creditor’s lien, but with the lien attaching to the proceeds, and the secured creditor retaining its right to credit bid in any such sale (the “sale prong”); or (iii) that the secured creditor receive the “indubitable equivalent” of its secured claim.

The main thrust of the secured lenders’ argument on appeal was that the sale prong provided the exclusive means for a debtor to sell assets free and clear of a secured party’s liens, and that any such sale must therefore preserve the right to credit bid. The lenders’ argument relied in large part on the canon of statutory construction providing that specific statutory provisions prevail over more general provisions: since the sale prong specifically addressed sales free and clear of liens, it should prevail over the more general (and in the lenders’ view, amorphous) “indubitable equivalent” prong. The Third Circuit disagreed. Section 1129(b)(2)(A), it held, plainly and unambiguously sets forth three alternative means for satisfying the “fair and equitable” standard. The debtor may choose to proceed under any one of the prongs, and if the debtor chooses to proceed with a sale under the “indubitable equivalent” prong, the statute plainly does not guarantee a secured creditor the right to credit bid. Further, the canon of statutory construction was inapplicable because the plain language of the alternative provisions created no conflict.

The Dissent’s View on The Likely Effects of the Decision

In a dissenting opinion, Judge Ambro outlined some of the likely negative consequences of the ruling. Most important, the ruling would upset the settled expectations of the secured lending market: a secured lender, who cannot definitively rely on the right to credit bid against the sale of its collateral, will be forced to adjust its pricing accordingly, potentially raising interest rates. Judge Ambro also noted that the debtor’s tactic seized upon coordination difficulties inherent in large syndicated loans. As a practical matter, many holders of syndicated bank debt (some of whom may be, for example, CLOs subject to various contractual restrictions on the use of assets) are unable to front the cash necessary to bid at an asset sale by, in effect, writing a check to themselves. By eliminating the right to credit bid in a plan sale, the debtor in this case used the Bankruptcy Code to maximize returns to insider equity holders (who had the cash in hand) over the returns to secured creditors—a perverse outcome in light of the Bankruptcy Code’s pervasive policy of protecting secured creditor rights. Although not specifically addressed in the dissenting opinion, the decision can be expected to alter

the negotiating posture of secured creditors, as the limitation on the right to credit bid takes away a significant “hammer” that secured creditors can employ in negotiations with the debtor.

Many of Judge Ambro’s concerns were echoed in *amicus* briefs filed by the Loan Syndications and Trading Association and the Commercial Finance Associations.

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