Third Circuit Bids Credit Bidding Adieu

William P. Weintraub, Gregory W. Fox, and Kizzy L. Jarashow

On March 22, 2010, the Court of Appeals for the Third Circuit issued a landmark decision rejecting the right of a secured lender to credit bid its claim in a sale by the debtor of the lender's collateral as part of a plan of reorganization. The court's ruling was contrary both to Bankruptcy Code section 363(k)—which grants a secured creditor the absolute right in a bankruptcy case to credit bid its debt when a sale of its collateral is done outside of the context of a plan—and to the conventional wisdom that the secured creditor's right to credit bid is preserved under Bankruptcy Code section 1129(b)(2)(A)(ii) when a sale of its collateral will occur pursuant to a plan of reorganization. In *In re Philadelphia Newspapers, LLC*,[1] the Third Circuit held that secured creditors do not have a legal entitlement to credit bid in a sale of their collateral pursuant to a plan. This decision highlights fundamentally different interpretations of section 1129(b)(2)(A), governing "cramdown" of a plan on secured creditors, and will undoubtedly impact the decision making of lenders and debtors on a forward-going basis, especially as to how, and when, bankruptcy court sales will occur.

I. Factual Background

Philadelphia Newspapers, LLC and certain of its affiliates (the Debtors) owned and operated two of Philadelphia's major newspapers, the Philadelphia Inquirer and Philadelphia Daily News, as well as an online publication called philly.com. The Debtors purchased these publications in July 2006 for $515 million using the proceeds of a $295 million secured loan (the Loan) from a syndicate of lenders (collectively, the Secured Lenders) who held first priority liens on substantially all of the

The authors are attorneys who practice bankruptcy and creditors' rights law at Friedman Kaplan Seiler and Adelman LLP, New York, N.Y., representing debtors, creditors and other principal parties-in-interest in bankruptcy cases and restructuring matters. Mr. Weintraub is a partner in the firm, and Mr. Fox and Ms. Jarashow are associates with the firm.

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Debtors' real and personal property. As of the date of the Third Circuit's decision, approximately $318 million was outstanding under the Loan.

After filing voluntary Chapter 11 petitions in February 2009, on August 20, 2009, the Debtors filed a joint Chapter 11 plan of reorganization (the Plan) that provided for the sale of substantially all of the Debtors' assets free and clear of existing liens, including those of the Secured Lenders. Rather than pursuing a "section 363 sale" ahead of proposing a plan of reorganization, the Debtors instead used the Plan to structure a sale under section 1129(b)(2)(A)(iii) of the Bankruptcy Code, in an apparent effort to prohibit the Secured Lenders from credit bidding at the auction. Even though subsection (ii) of section 1129(b)(2)(A) expressly applies to "plan sales" and mandates the secured creditor's right to credit bid, the Debtors instead used subsection (iii), which does not on its face either apply to sales or require credit bidding. Contemporaneously with the filing of the Plan, the Debtors entered into an asset-purchase agreement with Philly Newspapers, LLC (the Stalking Horse), which is a joint venture comprised of Carpenters Pension and Annuity Fund of Philadelphia and Vicinity (Carpenters) and Bruce Toll. Both Carpenters and Toll are insiders of the Debtors.[2]

The Plan provided that the Secured Lenders would receive on account of their $318 million claim at least $37 million in cash, which represented the cash purchase price to be paid by the Stalking Horse under the asset-purchase agreement (the Stalking Horse Bid).[3] Pursuant to the Bid Procedures (defined below), the Stalking Horse Bid was subject to higher and better cash bids. The Plan also provided that the Secured Lenders would receive the Debtors' Philadelphia headquarters, valued at $29.5 million.[4] Accordingly, if the Stalking Horse Bid was the winning bid at auction, the Secured Lenders would only receive $66.5 million on account of their $318 million secured claim, leaving them with a $251.5 million unsecured deficiency claim.

The Debtors' proposed bid procedures in connection with the auction of their assets (the Bid Procedures) provided that bids must be in cash in order to be deemed "qualified." By requiring bids to be in cash, the Debtors sought to preclude the Secured Lenders from credit bidding[5] their $318 million secured claim at the auction. The Debtors reasoned that because the sale was being conducted pursuant to a plan under Code section 1123(a)(5)(D) (as opposed to Code section 363) and because section 1129(b)(2)(A) provides the Debtors with an option to cram down a plan on the Secured Lenders that does not permit credit bidding, the Secured Lenders were not legally entitled to credit bid their interest.

The Secured Lenders objected to the Bid Procedures, arguing that, as a matter of law, a debtor cannot strip a secured creditor's lien without permitting it to credit bid because to do so would conflict with certain Bankruptcy Code provisions which, when read together and in the context of their legislative history, indicate a Congressional intent to provide for credit bidding in any sale of a secured creditor's collateral. The Secured Lenders also asserted that the right to credit bid was crucial to their ability to realize upon the fair value of their collateral and that if they were not permitted to credit bid, the Stalking Horse could and would collude with the Debtors to effectuate a below-market sale of the collateral to insiders. Only by credit bidding their claims, the Secured Lenders argued, could they ascertain the "true" value of their collateral for the purposes of determining whether they were receiving fair and equitable treatment under the Plan.

II. Bankruptcy Code Sections at Issue

In order to fully understand the decisions of the Third Circuit and the courts below, the key sections of the Bankruptcy Code at issue in these decisions are briefly analyzed below.

A. Section 363(k)

Section 363 generally governs sales of assets by a debtor, including sales outside of the ordinary course of business under section 363(b). Pursuant to 363(k), secured lenders are permitted to credit bid their claims if a debtor seeks to sell their collateral. Section 363(k) provides, in pertinent part, as follows:

> At a sale under subsection (b) of this section [363] of property that is subject to a lien that secures an allowed claim, unless the court for cause orders otherwise the holder of such claim may bid at such sale, and, if the holder of such claim purchases such property, such holder may offset such claim against the purchase price of such property.[6]

B. Section 1123(a)(5)(D)

Section 1123(a)(5)(D) allows a debtor to sell assets pursuant to a plan. It provides, in pertinent part, that a plan shall "provide adequate means for the plan's implementation" including, inter alia, the "sale of all or any part of the property of the estate, either subject to or free of any lien."[7] Section 1123(a)(5)(D) should be read in conjunction with section 1129(b), governing treatment of classes of claims pursuant to a plan.

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C. Section 1129(b)

Section 1129(b), commonly known as the "cramdown" section of the Bankruptcy Code, governs treatment of claims under a plan and permits a debtor to confirm a plan of reorganization over the objection of an impaired class of creditors that has voted against the plan, provided that such dissenting class is treated fairly and equitably.[8] Pursuant to section 1129(b)(2)(A), a class consisting of secured claims will be deemed to be treated fairly and equitably if 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.[9]

D. Section 1111(b)

Section 1111 provides, in pertinent part, as follows:

(b) (1) (A) A claim secured by a lien on property of the estate shall be allowed or disallowed under section 502 of this title the same as if the holder of such claim had recourse against the debtor on account of such claim, whether or not such holder has such recourse, unless—

(i) the class of which such claim is a part elects… application of paragraph (2) of this subsection; or

(ii) such holder does not have such recourse and such property is sold under section 363 of this title or is to be sold under the plan.

(B) A class of claims may not elect application of paragraph (2) of this subsection if—

(i) the interest on account of such claims of the holders of such claims in such property is of inconsequential value; or

(ii) the holder of a claim of such class has recourse against the debtor on account of such claim and such property is sold under section 363 of this title or is to be sold under the plan.

(2) If such an election is made, then notwithstanding section 506(a) of this title, such claim is a secured claim to the extent that such claim is allowed.[10]

Section 1111(b) does two things. First, with certain exceptions, section 1111(b) provides that, if a secured creditor has a lien on property, such claim "is to be allowed against the debtor, as if the claimant had recourse against the debtor, whether or not by contract or under applicable state law the creditor had that recourse."[11] Put another way, nonrecourse claims become recourse in Chapter 11 (which means that, notwithstanding the loan agreement or applicable state law, the undersecured nonrecourse secured creditor will have an unsecured deficiency claim in the case). Second, section 1111(b)(2) provides a secured creditor with an election: the so-called "1111(b)(2) election." Under section 1111(b)(2), subject to certain exceptions, a secured creditor who is undersecured because the value of its collateral is less than the amount of its claim can, rather than permitting its claim to be bifurcated under section 506(a) into a secured claim limited to the value of the collateral and an unsecured claim for any deficiency, elect to have its claim treated as if it was fully secured. Thus the election enables the undersecured creditor to retain its lien on its collateral for the full amount of its claim (including the deficiency amount) and not just for the value of the collateral. An undersecured creditor that is permitted to and makes the 1111(b) election to be fully secured must be treated differently under section 1129(b)(2)(A)(i) than an undersecured creditor who cannot or does not make the election.

Section 1111(b) was enacted in response to the decision in *Great Nat'l Life Ins. Co. v. Pine Gate Assocs., Ltd. (In re Pine Gate Assocs., Ltd.)*[12] to prevent lien stripping.[13] *Pine Gate* was a single-asset real estate case. The bankruptcy court in that case confirmed a plan of reorganization over the objection of a secured creditor that had made a nonrecourse loan to the debtor secured by the debtor's only asset—improved real estate. Pursuant to the plan, the debtor stripped the lien of the secured creditor from

real property and, in exchange, paid the secured lender the appraised value of the asset. This all took place at a time when the real property market was depressed, so the secured lender received substantially less than was owed to him by the debtor. The debtor retained ownership of the property, free and clear of the lender's mortgage, and was able to benefit from the subsequent appreciation in value of the property. The Third Circuit has noted that, as a result of the *Pine Gate* decision, "a debtor could file bankruptcy proceedings during a period when real property values were depressed, propose to repay secured [nonrecourse] lenders only to the extent of the then-appraised value of the property, and 'cram down' the secured lender class, preserving any future appreciation of the property for the debtor."[14] Congress enacted section 1111(b) to remedy this inequitable result and provide secured lenders with an opportunity to receive the benefits for which they bargain.

Section 1111(b) benefits both debtors and creditors: debtors are able to retain valuable encumbered property and undersecured nonrecourse creditors are able to treat their deficiency claims as secured and retain liens on the full value of their claims. However, Congress carved out certain claimants from the election remedy. Specifically, a secured creditor may not make a section 1111(b)(2) election if: (i) the creditor's interest is of inconsequential value, or (ii) the secured creditor has recourse and the collateral is being sold pursuant to section 363 or under a plan.[15]

III. Lower Court Decisions in *Philadelphia Newspapers*

On October 8, 2009, the Bankruptcy Court for the Eastern District of Pennsylvania ruled in favor of the Secured Lenders on the credit bidding issue.[16] Specifically, the bankruptcy court determined that a secured creditor is legally entitled to credit bid its claims in any sale of its collateral. In so holding, the bankruptcy court found that the sale provisions in the Plan were structured as a plan sale free and clear of liens under section 1129(b)(2)(A)(ii), irrespective of the Debtors' attempts to utilize the language in section 1129(b)(2)(A)(iii) to get around the credit bidding requirements of subsection (ii), which references section 363(k) and explicitly provides secured lenders with the right to credit bid. Accordingly, the bankruptcy court ruled that any sale pursuant to a plan of reorganization that will be free and clear of liens would necessarily be governed by section 1129(b)(2)(A)(ii) rather than 1129(b)(2)(A)(iii).

On appeal, the district court reversed the bankruptcy court and held that the Bankruptcy Code does not provide secured lenders with a legal entitlement to credit bid in the context of a sale pursuant to a plan of reorganization.[17] In so holding, the district court focused almost exclusively on the plain language of section 1129(b)(2), noted the disjunctive nature of the

three "fair and equitable" prongs set forth in section 1129(b)(2)(A), and determined that a plan can be confirmed over the objection of a secured lender provided that the conditions in any one of the three prongs are satisfied. The district court reasoned that if Congress had intended to include a legal right to credit bid in the third prong of section 1129(b)(2)(A) (the Indubitable Equivalent Prong), the plain language of the text would have reflected such intent. Since the Indubitable Equivalent Prong contains no express or implied right to credit bid, a debtor may confirm a plan over the objection of a secured creditor provided that the secured creditor received the "indubitable equivalent" of such creditor's claim. The district court noted that a "plan sale is potentially another means to satisfy th[e] indubitable equivalent standard" set forth in section 1129(b)(2)(A)(iii).[18]

IV. Third Circuit's Majority Ruling

In a 2-to-1 decision written by Judge Fisher, the Third Circuit affirmed the district court and held that secured creditors do not have a presumptive right to credit bid in the context of a sale pursuant to a plan.[19] The question that the Third Circuit resolved was whether, when dealing with a sale of property subject to liens pursuant to a plan, the three subsections set forth in 1129(b)(2)(A)(i) to (iii) "were meant to be alternative paths to meeting the fair and equitable test."[20] In other words, in a plan of reorganization that effects a sale of the Secured Lender's collateral, could the Debtors utilize 1129(b)(2)(A)(iii) to strip the Secured Lenders' lien from the assets to be sold without providing the Secured Lenders with the opportunity to credit bid their debt?

The majority found in favor of the Debtors, approved the Bid Procedures, and held that the Debtors could permissibly propose and seek confirmation of a plan to sell their assets free and clear of the Secured Lenders' liens under section 1129(b)(2)(A)(iii) without providing the Secured Lenders an opportunity to credit bid. In order for the Plan to be confirmed, however, the Secured Lenders must receive the indubitable equivalent of their claims, a question that the Third Circuit explicitly did not address.[21]

A. Plain Language of Section 1129(b)(2)(A) Allows a Debtor to Sell Assets Free and Clear of Secured Lenders Liens Under Subsection (iii) Without Allowing Secured Lenders to Credit Bid

The guiding rationale behind the majority's ruling was that the plain language and meaning of section 1129(b)(2)(A) was unambiguous and that consequently the court did not need to look outside the four corners of the statute for guidance. Specifically, the court held that since subsections (i), (ii), and (iii) are phrased in the disjunctive, a plan can be

crammed down over a secured creditor's objection so long as any one of the three subsections is satisfied. The court, citing to Bankruptcy Code section 102(5), noted that when a statute is written in the disjunctive (using 'or' rather than 'and'), the intent of the drafters is to offer nonexclusive choices to the debtor, e.g., "the party may do either or both."[22] According to the court, by using the disjunctive in section 1129(b)(2)(A), the drafters of the Bankruptcy Code provided a debtor with the opportunity to "craft an appropriate treatment of a secured creditor's claim, separate and apart from the provisions in subsection (ii)."[23] While the Secured Lenders argued that "the proposed treatment of collateral determines which of the § 1129(b)(2)(A) alternatives is applicable" and that, as such, subsection (ii) would necessarily apply in the case of any sale of assets, the majority disagreed. The majority opinion holds that the use of the disjunctive in section 1129(b)(2)(A) provides the Debtors with the option of choosing any one of the three alternatives, since all three subsections "provide[] a… route to a 'fair and equitable' plan of reorganization."[24] In other words, section 1129(b)(2) only requires that the treatment of the secured creditor's claim be fair and equitable, but how such treatment is accomplished is not limited by how the secured creditor's collateral is handled or disposed; rather, it is a function of how the claim is paid.

As further support for its ruling, the majority cited to the Fifth Circuit case, *Bank of N.Y. Trust Co., NA v. Official Unsecured Creditors' Comm. (In re Pacific Lumber Co.)*.[25] The Fifth Circuit in *Pacific Lumber* is the only other appellate court to "address[] whether a lender had a right to credit bid under subsection (iii)."[26] The Fifth Circuit reached the same conclusion as the majority—namely, that subsection (iii) of section 1129(b)(2)(A) may be used to effectuate a plan sale of assets free and clear of liens, regardless of whether the secured creditor has been afforded an opportunity to credit bid.

In *Pacific Lumber*, the debtors attempted to sell assets free and clear of liens through a plan that did not provide the secured lenders with the option to credit bid their debt but purported to provide the secured lenders with the indubitable equivalent of their claims under 1129(b)(2)(A)(iii). The secured lenders objected to plan confirmation based on the prohibition on credit bidding. In holding that the prohibition on credit bidding was permissible, the court in *Pacific Lumber* noted that "the three subsections of § 1129(b)(2)(A) were 'alternatives' and 'not even exhaustive' of the ways in which a debtor might satisfy the 'fair and equitable' requirement."[27] As such, the debtors were not required to use subsection (ii)—notwithstanding the fact that they were attempting a sale pursuant to a plan.

Much like the decision in *Pacific Lumber*, the majority's approach in *Philadelphia Newspapers* "focuses on fairness to creditors over the structure of the cramdown."[28] Provided that creditors receive the indubitable equivalent of their claims under subsection (iii), the Third Circuit reasoned, such creditors are afforded fair and equitable treatment.

B. The "Indubitable Equivalent" Language in 1129(b)(2)(A)(iii) Unambiguously Excludes the Right to Credit Bid

The Secured Lenders argued that the term "indubitable equivalent" is ambiguously broad and urged the court to consider "other canons of statutory construction to determine whether a sale of collateral in the absence of credit bidding can ever provide the 'indubitable equivalent' of the secured interest."[29] The Third Circuit, in response, analyzed the origination, definition, and historical application of the term "indubitable equivalent" and found that the term was not ambiguous. In so holding, the court cited to a number of sources that illustrate the meaning of "indubitable equivalent" including, inter alia, the Judge Learned Hand opinion in *In re Murel Holding Corp.*, Webster's Third New International Dictionary, *Pacific Lumber*, and *In re Sun Country*.[30]

Finding that the plain language of the statute is unambiguous, the majority determined that the Secured Lenders would only be afforded a statutory right to credit bid their debt if such a right were built in to subsection (iii) of section 1129(b)(2)(A). The court found that it was not. "A plain reading of § 1129 (b)(2)(A)(iii)… compels the conclusion that, when a debtor proceeds under subsection (iii), Congress has provided secured lenders with no right to credit bid at a sale of the collateral."[31]

C. Denying Secured Creditors the Right to Credit Bid Is Not Inconsistent With Congressional Intent

Finally, the Secured Lenders argued that reading section 1129(b)(2)(A) as a stand-alone statute without recognizing the protections afforded to secured lenders as set forth in sections 363(k) and 1111(b) would be contrary to Congressional intent. The Secured Lenders "argue that the Code guarantees a secured lender one of two rights—either the right to elect to treat their deficiency claims as secured under § 1111(b) or the right to bid their credit under § 363(k)."[32]

As detailed above, pursuant to section 1111(b)(1)(B)(ii), a secured recourse creditor is not permitted to make a section 1111(b)(2) election if its collateral is being sold pursuant to section 363 or under a plan. In theory, and as argued by the Secured Lenders, this is because such creditor (even a recourse lender like the Secured Lenders) can make a credit bid to purchase its collateral and therefore avoid its lien being stripped.

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Likewise, a secured nonrecourse creditor can make the 1111(b)(2) election unless the collateral is to be sold under section 363 or the plan. This is because, as a result of the legislative reaction to *Pine Gate*, the nonrecourse secured creditor's lien cannot be stripped. To protect itself, the nonrecourse secured creditor can either credit bid its claim (if its collateral is to be sold by the debtor) and acquire its collateral or make the 1111(b)(2) election (if its collateral is to be retained by the debtor) and preserve its full claim against its collateral. Because the Debtors in *Philadelphia Newspapers* proposed to sell the Secured Lenders' collateral pursuant to a plan, the Secured Lenders would not be permitted to make an 1111(b)(2) election.[33] The Debtors argued that because the sale was not under section 363 or section 1129(b)(2)(A)(ii), the language of the statute did not mandate that the Secured Lenders be given the right to credit bid. The Secured Lenders argued that, in the absence of the right to make the 1111(b)(2) election, they must be allowed to credit bid at the auction to ensure that the Debtors did not collude with the insider-controlled Stalking Horse to sell the assets for less than market value.

The court dismissed this argument, holding that the Bankruptcy Code does not provide secured lenders with an absolute right to preferred treatment in the form of guaranteed upside. To the contrary, "[a]sserting an absolute right to such preferential treatment is plainly contrary to other provisions of the Code, which limit a secured lender's recovery to the value of its secured interest."[34] As such, the court determined that the prohibition on credit bidding was not inconsistent with the protections afforded secured creditors in sections 363(k) and 1111(b).

V. Third Circuit's Dissent

Judge Ambro, a former bankruptcy lawyer, wrote a spirited dissent in *Philadelphia Newspapers* in which he argued that the Bankruptcy Code does provide secured creditors with a presumptive right to credit bid when their collateral is being sold through a plan of reorganization. Permeating Judge Ambro's dissent is his perception (which Bankruptcy Judge Raslavich also expressed in his decision) that the Debtors' ulterior motive for denying the Secured Lenders the right to credit bid was to gain leverage to steer the sale to the insider Stalking Horse group so that they could buy those assets "on the cheap" and free and clear of the Secured Lenders' liens.[35] In other words, the concern is that the Debtors are seeking to prevent the Secured Lenders from credit bidding to insure that their owners of choice have the ability to win the Debtors' assets at auction when they would otherwise likely lose at an auction in which the Secured Lenders could make a credit bid.

The linchpin of Judge Ambro's dissent is that section 1129(b)(2)(A) has more than one plausible interpretation and therefore is ambiguous. Given that ambiguity, under the principles of statutory interpretation, Judge Ambro argued that section 1129(b)(2)(A) cannot be read in isolation—as was done by the majority and the Fifth Circuit in *Pacific Lumber*—but instead must be read in the "context of the entire Bankruptcy Code" and the statute's legislative history. According to Judge Ambro, reading the statute in proper context leads to "the conclusion that the Code requires cramdown plan sales free of liens to fall under the specific requirements of § 1129(b)(2)(A)(ii) [which requires the opportunity for secured lenders to credit bid] and not to the general requirements of subsection (iii)."[36]

This interpretation of section 1129(b)(2)(A) to which Judge Ambro subscribes—and which he posits is the "longer-lived" interpretation—is that the three alternatives set forth in that section are not "routes to cramdown confirmation that are universally applicable to any plan" but instead are "distinct routes that apply specific requirements depending on how a given plan proposed to treat the claims of secured creditors."[37] According to Judge Ambro, (a) clause (i) applies when the plan provides that "the secured lender retains the lien securing its claim in a given class"; (b) clause (ii) applies when the plan provides for the sale of "any property that is subject to the liens securing such claims, free and clear of such liens" and requires that the sale be subject to secured creditors' right to credit bid under section 363(k) and that the stripped lien attach to the proceeds of such sale; and (c) clause (iii) only applies whenever the plan provides for the secured creditor to realize the "indubitable equivalent" of its secured claim through the plan, for example, by offering secured lenders replacement liens on other collateral or abandonment of property to secured lenders.[38] Under this reading, debtors can only proceed under clause (iii) in situations where the treatment of secured creditors under the plan is not addressed by clauses (i) or (ii).[39]

Judge Ambro explained that because his reading of section 1129(b)(2)(A) was plausible and fundamentally different than the admittedly plausible interpretation endorsed by the majority, the necessary ambiguity existed to permit the court to look outside of the four corners of the statute to canons of statutory interpretation, related statutory provisions, legislative history, and commentary from the drafters of the Bankruptcy Code.[40]

In making the case that his interpretation of the statute was more plausible than that of the majority, Judge Ambro relied on the canons of statutory construction. First, under the canon of statutory construction that "a specific provision will prevail over a general one," Judge Ambro

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asserted that it did not make sense that Congress would "expend the ink and energy detailing procedures in clause (ii) that specifically deal with plan sales of property free of liens, only to leave general language in clause (iii) that could sidestep entirely those very procedures."[41] Accordingly, Judge Ambro asserted that "[a]lthough it may be facile to conclude that the general language of clause (iii) is applicable to plan sales free of liens, such a result ignores the specific language Congress enacted in clause (ii)."[42] Second, the dissent argued that the majority's reading of the statute violated the statutory canon that no provision should be rendered "superfluous, void, or insignificant" because "[a] presumptive right to credit bid would not need to be specifically mentioned if, as the majority believes, it was not a requirement of a plan sale free of liens."[43]

Judge Ambro also looked to other sections of the Bankruptcy Code related to sales of encumbered property and other secured creditor protections to demonstrate that, when read in context of "congressional policy pertaining to secured creditors' rights when their collateral is sold," a secured lender has a presumptive right to credit bid when there is a sale of its collateral under a plan or otherwise.[44] First Judge Ambro looked to section 1123(a)(5)(D), which allows a plan to provide adequate means for its implementation—including the sale of estate property subject to or free of liens—and determined that this section places all plan sales of encumbered property "within the purview of section 1129(b)(2)(A)." Accordingly, Judge Ambro argued, somewhat circularly, that "adequate means for the plan's implementation" cannot be read expansively to allow a debtor to "craft a means (a cramdown plan sale free of liens without credit bidding) that is contrary to the express text of the Bankruptcy Code."[45]

Judge Ambro next analyzed section 363(k), which, as described above, gives secured creditors the right to credit bid when its collateral is sold outside of a plan, which right is incorporated by reference into the cramdown provisions of section 1129(b)(2)(A)(ii) for a sale of collateral free and clear of liens under a plan. The dissent argued that Congress, in providing for credit bidding under sections 363(k) and 1129(b)(2)(A)(ii), demonstrated its intent to provide a method for a secured creditor to protect itself from an undervaluation of its collateral regardless of the method of sale.[46]

Judge Ambro also supported his reading of 1129(b)(2)(A) by looking at that section in the context of a statutory scheme that provides undersecured creditors with the right to make an election under section 1111(b) to be fully secured, which, like credit bidding, "helps to minimize the deficiency claims that can be asserted against the rest of the bankruptcy estate and other encumbered assets, maximizing recovery

for all creditors."[47] According to the dissent, sections 1129(b)(2)(A)(ii) and 1111(b) are "best understood as alternative protections for the secured creditor: one to apply when its collateral is sold free and clear of liens, and the other to apply when its collateral is treated other than as a sale."[48] The dissent also addressed the legislative history of these sections and pointed out that sections 1129(b) and 1111(b) were enacted in conjunction with each other as stronger creditor safeguards than what had existed under the prior Bankruptcy Act. Accordingly, "[i]n this context, it would be anomalous for Congress to draft a specific provision, clause (ii), providing protections above and beyond those given to secured creditors under the prior Bankruptcy Act, only to allow clause (iii) to be used to circumvent those protections and return to the precise mechanism used prior to the Code."[49]

Based on the foregoing, the dissent concluded that section 1129(b)(2)(A), when considered in conjunction with sections 363(k), 1111(b), and 1123(a)(5)(D), and its legislative history, demonstrated a "comprehensive arrangement enacted by Congress to avoid the pitfalls of undervaluation, regardless of the mechanism chosen" and supported the reading that "funnels all plan sales free of liens into clause (ii)."[50] In effect, Judge Ambro argues, "a single 'or' becomes the bell, book, and candle that excommunicates congressional intent from the Bankruptcy Code."[51]

Judge Ambro also made several fairness and policy arguments against the majority's ruling. First, he rejected as "underwhelming" the argument that credit bidding somehow chills cash bidding. Specifically, relying on the hypothetical example of Warren Buffet participating in an auction of a debtor's assets, he wrote "credit bidding chills cash bidding no more than a deep-pocketed cash bidder would chill less capitalized cash bidders. Having the ability to pay a certain price does not necessarily mean there is a willingness to pay that price."[52] The dissent's analogy, however, may not work because a secured lender may make a seemingly irrational large credit bid at an auction of its collateral because it is essentially bidding with its unsecured deficiency claim (which is often worth much less than 100 cents on the dollar), whereas Mr. Buffet would have to bid actual cash. Presumably, Mr. Buffet, as a rational actor, would not overpay, while the undersecured creditor whose deficiency claim is otherwise worthless could have incentives to overpay with its worthless deficiency claim.

Judge Ambro also argued that the majority's decision to deny secured creditors a presumptive right to credit bid in plan sales free of liens denies them the "benefit of their bargain" with the debtor and "uproots settled expectations of secured lending."[53] Therefore, he argued, because the majority's decision means that secured lenders now face the

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prospect of their collateral being sold through a Chapter 11 plan without the right to credit bid, the cost of secured credit will rise in the future.[54]

VI. Events Since the Third Circuit Decision

Following the adverse ruling on appeal, the secured lenders requested a stay of the sale and en banc review of the panel's decision. Both requests were denied, and in the early hours of April 28, 2010, the auction went forward. Following heated cash bidding by the secured lenders and two other bidding groups, the secured lenders were declared the winning bidders with a $138.9 million bid comprised of $105 million in cash and the company's real estate, valued at approximately $33.9 million. Because the senior lenders were owed approximately $318 million by the debtors, the cash portion of the bid will remain in the secured lenders' hands. Plan confirmation is scheduled for May 25, 2010, and there appear to be no impediments to confirmation.

VII. Looking Forward

It is hard to say that either the majority or the dissent has a clear-cut winning argument. Indeed, the majority is correct in that the plain language of section 1129(b)(2)(A) provides for multiple avenues for a debtor to prove it is treating its secured creditors "fairly and equitably" in a cramdown. The majority decision fails to adequately address, however, the schism between a literal interpretation of section 1129(b)(2)(A) and legislative intent. The practical result of majority's decision—that secured creditors can credit bid in 363 sales but cannot credit bid when their collateral is sold pursuant to a plan—is hard to reconcile with what seems to be a clear indication that the drafters of the Bankruptcy Code intended to prevent debtors from stripping secured creditor's liens without providing them with a right to credit bid. It is simply unlikely that Congress intended this distinction.

The decision will also likely have a serious impact on the relationship between secured creditors and borrowers. As Judge Ambro noted in his dissent, this decision effectively denies secured creditors the "benefit of their bargain" and "uproots settled expectations of secured lending."[55] Going forward, lenders may insist on including provisions in loan documents that guarantee them the ability to credit bid in the plan sale context. In addition, distressed companies contemplating a Chapter 11 filing may also feel pressure by their lenders to file outside of the Third Circuit—where the law on this issue has not yet been settled and could possibly fall in the secured creditor's favor. Future debtors in possession in the Third Circuit and elsewhere may jump at the opportunity to use *Philadelphia Newspapers* as precedent and strip the liens of

their undersecured creditors while an insider buys the business on the cheap. Especially troubling is the prospect that *Philadelphia Newspapers* could be used as a roadmap for mischief by a Chapter 11 debtor seeking to circumvent subsection (ii) and its credit bidding requirement by structuring a hybrid sale that also provides for abandonment (or quasi-abandonment—as the Debtors have attempted through a proposed abandonment of their headquarters subject to a two-year, rent-free lease by the Debtors) of some portion of the collateral.

However, as was clear at the end of the auction on April 28, 2010, secured parties may circumvent the holding in *Philadelphia Newspapers* by cash bidding at the auction up to the value of their secured claims. By cash bidding, they can bid-up the assets as a way of testing the market and ensuring that insiders are not buying the company or its assets on the cheap. We could see, as a result of this decision, a rise in indubitable equivalent valuation fights at plan confirmation. If secured lenders choose not to make cash bids for their collateral and their collateral is sold for what is perceived to be a below-market price, such creditors may argue that they are not receiving the indubitable equivalent of their secured claims. In such situations, bankruptcy courts will have to determine whether the sale proceeds are sufficiently equivalent to the secured lenders' interest in the collateral and will be forced to deny confirmation if they find that the sale process in some way failed to properly value the secured lenders' collateral. Although the full import of the *Philadelphia Newspapers* decision cannot yet be determined, recent news reports indicate that secured lenders are already trying to extract concessions in DIP financing agreements to neutralize the plan strategy used by the Debtors in *Philadelphia Newspapers*. The concessions presumably take the form of an agreement that the secured lenders can credit bid in all circumstances where their collateral is to be sold. The enforceability of these concessions and the willingness of bankruptcy courts to approve lender incentives that possibly turn DIP orders into sub rosa plans remains to be seen. Those interested will have to stay tuned to see how *Philadelphia Newspapers* impacts plan sales in other Chapter 11 cases.

NOTES

1. In re Philadelphia Newspapers, LLC, 599 F.3d 298, Bankr. L. Rep. (CCH) P 81719 (3d Cir. 2010).

2. Carpenters owns approximately 30% of the equity in PMH Holdings, LLC, a debtor entity, and Toll owned approximately 20% of the equity in PMH Holdings, LLC until the day before the asset-purchase agreement was signed.

3. The Stalking Horse Bid merely served as a baseline bid at the auction. Since the Secured Lenders have a perfected first priority security interest in substantially all of the Debtors' assets, they are entitled to the full cash amount paid by the winning bidder at the auction, which ultimately was more than the Stalking Horse Bid.

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4. The Plan provided that the headquarters would be conveyed to the Senior Lenders subject to a two-year rent-free lease in favor of the Debtors, allowing them to continue operations following the sale.

5. "A credit bid allows a secured lender to bid the debt owed it in lieu of other currency at a sale of its collateral." In re Philadelphia Newspapers, LLC, 599 F.3d 298, 320, Bankr. L. Rep. (CCH) P 81719 (3d Cir. 2010) (Ambro, J., dissenting).

6. 11 U.S.C.A. § 363(k).

7. 11 U.S.C.A. § 1123(a)(5)(D).

8. 11 U.S.C.A. § 1129(b)(1).

9. 11 U.S.C.A. § 1129(b)(2)(A).

10. 11 U.S.C.A. § 1111(b).

11. Matter of Tampa Bay Associates, Ltd., 864 F.2d 47, 49, 19 Bankr. Ct. Dec. (CRR) 97 (5th Cir. 1989).

12. Great Nat'l Life Ins. Co. v. Pine Gate Assocs., Ltd. (In re Pine Gate Assocs., Ltd.), 2 Bankr. Ct. Dec. 1478 (Bankr. N.D.Ga. 1976).

13. Both the House of Representatives and the Senate considered legislative responses to *Pine Gate*. Ultimately, the House version was written into law as section 1111(b) of the Bankruptcy Code. The Senate's response, in the form of proposed section 1131 of the Bankruptcy Code, was not adopted. The Senate version was only applicable to real property and real property interests. Section 1111(b) has no such limitations. As such, there is little or no basis to argue that section 1111(b) is only applicable to real estate loans.

14. In re SubMicron Systems Corp., 432 F.3d 448, 460 n.15, 45 Bankr. Ct. Dec. (CRR) 232, 55 Collier Bankr. Cas. 2d (MB) 1077, Bankr. L. Rep. (CCH) P 80436 (3d Cir. 2006) (quoting Tampa Bay, 864 F.2d at 50).

15. 11 U.S.C.A. § 1111(b)(ii). Many commentators have insisted that the exception set forth in section 1111(b)(ii) for recourse secured creditors must be read in conjunction with the protections afforded secured creditors in sections 363(k) and 1129(b)(2)(A)(ii). Such commentators have noted that secured creditors whose assets are being sold under section 363(k) or a plan did not need the election remedies in section 1111(b) because they were entitled, pursuant to sections 363(k) or 1129(b)(2)(A)(ii), to credit bid their claims in a sale of collateral. The dissent in *Philadelphia Newspapers* discusses this issue in detail.

16. In re Philadelphia Newspapers, LLC, 52 Bankr. Ct. Dec. (CRR) 60, 2009 WL 3242292 (Bankr. E.D. Pa. 2009), rev'd in part, 418 B.R. 548, 52 Bankr. Ct. Dec. (CRR) 102 (E.D. Pa. 2009), aff'd, 599 F.3d 298, Bankr. L. Rep. (CCH) P 81719 (3d Cir. 2010).

17. In re Philadelphia Newspapers, LLC, 418 B.R. 548, 52 Bankr. Ct. Dec. (CRR) 102 (E.D. Pa. 2009), aff'd, 599 F.3d 298, Bankr. L. Rep. (CCH) P 81719 (3d Cir. 2010).

18. Philadelphia Newspapers, 418 B.R. at 568.

19. In re Philadelphia Newspapers, LLC, 599 F.3d 298, Bankr. L. Rep. (CCH) P 81719 (3d Cir. 2010). Judge Smith wrote a brief opinion concurring with Judge Fisher that the language of section 1129(b)(2)(A) is unambiguous and "any of the three subsections is sufficient to meet the fair and equitable test of § 1129(b)(2)(A)." Philadelphia Newspapers, 599 F.3d at 319. Judge Smith cautions, however, against the slippery slope of looking beyond the plain language of the statute. While Judge Smith acknowledges that "[t]here may be sound policy reasons for the dissent's approach" in looking past the statutory text, "such reasons cannot overcome the plain meaning of § 1129(b)(2)(A)." Philadelphia Newspapers, 599 F.3d at 319, n.1 (Smith, J., concurring).

20. Philadelphia Newspapers, 599 F.3d at 305.

21. The court made a critical distinction here: it did not hold that the Plan was confirmable but rather that nothing in section 1129(b)(2)(A)(iii) required the Debtors to permit the Secured Lenders to credit bid. In order to confirm the Plan, the bankruptcy court still had to determine whether the consideration being offered to the Secured Lenders under the Plan was sufficient to provide the Secured Lenders with the "indubitable equivalent" of their secured claims. The Secured Lenders could have argued that since they were not afforded the opportunity to credit

bid their claims, the value of their collateral was not properly ascertained, and thus the Plan does not offer them the indubitable equivalent of their claims. As discussed below, because the Secured Lenders cash bid at the auction and won, it is unlikely that there will be an indubitable equivalent valuation fight at confirmation.

22. Philadelphia Newspapers, 599 F.3d at 305 (citing 11 U.S.C.A. § 102 (Revision Notes and Legislative Reports)).

23. Philadelphia Newspapers, 599 F.3d at 310 (citing 418 B.R. at 568).

24. Philadelphia Newspapers, 599 F.3d at 305, 311, n.9.

25. In re Pacific Lumber Co., 584 F.3d 229, 52 Bankr. Ct. Dec. (CRR) 46, Bankr. L. Rep. (CCH) P 81642 (5th Cir. 2009).

26. Philadelphia Newspapers, 584 F.3d at 312.

27. Philadelphia Newspapers, 584 F.3d at 309.

28. Philadelphia Newspapers, 599 F.3d at 309.

29. Philadelphia Newspapers, 599 F.3d at 310. In essence, the Secured Lenders argued that only maintenance of the right to credit bid would provide them with the indubitable equivalent.

30. In re Murel Holding Corp., 75 F.2d 941, 942 (2d Cir. 1935); Webster's Third New Int'l Dictionary 769 and1154 (1971); Pacific Lumber, 584 F.3d at 246; and In re Sun Country, 764 F.2d 406, 409 (5th Cir. 1985).

31. Philadelphia Newspapers, 599 F.3d at 311.

32. Philadelphia Newspapers, 599 F.3d at 314.

33. It is worth noting that the majority decision perhaps too easily dismisses the applicability of section 1111(b) to section 1129(b)(2)(A). The majority asserts that it is "uncontroverted" that a secured creditor is not eligible to make a § 1111(b)(2) election in a situation where encumbered assets are being transferred under § 1129(b)(2)(A)(i)(I). Philadelphia Newspapers, 584 F.3d at 315 (holding that there are "two uncontroverted circumstances … where a secured creditor has neither a right to make a [section] 1111(b)(2) election, nor a right to credit bid under [section] 363(k): a transfer of encumbered assets under [section] 1129(b)(2)(A)(i)(I) and a for-cause exception to credit bidding under [section] 363(k)"). However, contrary to the majority's assertion, there is no prohibition against a secured creditor making an 1111(b)(2) election where such creditor's collateral is being transferred pursuant to the first subsection of section 1129(b)(2)(A). The distinction between a sale and a transfer here is crucial: while every sale does constitute a transfer, not every transfer constitutes a sale.

Pursuant to section 1111(b)(1)(B), creditors are not permitted to make an 1111(b)(2) election if (i) such creditor has recourse against the debtor and (ii) property is being sold under section 363 or under a plan. 11 U.S.C. § 1111(b)(1)(B)(ii). Both the majority and the minority opinions fail to properly distinguish between instances where assets are "sold" pursuant to a plan and instances where assets are "transferred." There is no bar to making the election when assets are transferred rather than sold. Accordingly, a secured creditor with a deficiency claim would be entitled to make an 1111(b)(2) election in cases where such creditor's collateral is being transferred under section 1129(b)(2)(A)(i). For example, a secured creditor should be entitled to the protections of section 1111(b) if a debtor proposes to transfer (rather than sell) assets to an affiliate under a plan. Once an 1111(b)(2) election has been made, the secured creditor's deficiency claim would be treated as secured, and such creditor's recovery would include, under section 1129(b)(2)(A)(i), such deficiency claim. The failure of the court to make clear the distinction between a sale and a transfer in connection with the ability of a secured creditor to make the 1111(b)(2) election is troublesome and could result in dangerous precedent that a debtor could use to attempt to strip liens through plans that transfer, but do not sell, collateral. Another potential danger to secured creditors is the possibility of a debtor using section 1129(b)(2)(A)(i) to strip the recourse secured creditor's lien by selling the collateral under that subsection, denying the creditor the opportunity to credit bid, and limiting the creditor's secured claim to the value of its collateral. In that instance, consistent with its approach the section 1129(b)(2)(A)(iii), the majority seems to say the creditor would not be entitled to credit bid or make the 1111(b)(2) election. The creditor could be left with a worthless deficiency claim.

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Oddly, a nonrecourse secured creditor would be able to make the 1111(b)(2) election under that same scenario. We do not think Congress intended lien stripping to survive the *Pine Gate* protections in this manner.

34. Philadelphia Newspapers, 599 F.3d at 314.

35. See Philadelphia Newspapers, 599 F.3d at 320 (Ambro, J. dissenting).

36. Philadelphia Newspapers, 599 F.3d at 319 (Ambro, J. dissenting).

37. Philadelphia Newspapers, 599 F.3d 298, 325.

38. Philadelphia Newspapers, 599 F.3d at 325-326 (Ambro, J. dissenting).

39. Philadelphia Newspapers, 599 F.3d at 326 (Ambro, J. dissenting).

40. Philadelphia Newspapers, 599 F.3d at 319 (Ambro, J. dissenting). Judge Ambro also pointed to the fact that the bankruptcy judge and the district judge in Philadelphia Newspapers came to opposite conclusions with respect to section 1129(b)(2)(A) as further evidence of ambiguity. Philadelphia Newspapers, 599 F.3d at 322 (Ambro, J. dissenting).

41. Philadelphia Newspapers, 599 F.3d at 329 (Ambro, J. dissenting).

42. Philadelphia Newspapers, 599 F.3d at 330 (Ambro, J. dissenting). Of course, it is equally "plausible" that clause (ii) identifies treatment that is per se fair and equitable, while clause (iii) provides the debtor with the ability to try to do something else.

43. Philadelphia Newspapers, 599 F.3d at 330 (Ambro, J. dissenting). The observation made above in fn 39 applies equally here.

44. Philadelphia Newspapers, 599 F.3d at 331 (Ambro, J. dissenting).

45. Philadelphia Newspapers, 599 F.3d at 332 (Ambro, J. dissenting). It is odd that Judge Ambro initiated his contextual analysis of the Bankruptcy Code with his views on the interplay between sections 1123(a)(5)(D) and 1129(b)(2)(A). This section of the dissent appears to be exclusively focused on refuting dicta in the majority opinion and does little to bolster the argument that other sections of the Bankruptcy Code demonstrate congressional intent to provide presumptive rights to credit bid.

46. See Philadelphia Newspapers, 599 F.3d at 332 (Ambro, J. dissenting).

47. Philadelphia Newspapers, 599 F.3d at 333 (Ambro, J. dissenting).

48. Considering that the dissent went to great lengths to refute most of the majority opinion's assertions about these Bankruptcy Code provisions, it is curious that Judge Ambro did not address the majority's misstatements described in fn 30 above regarding a secured creditor's right to make an 1111(b)(2) election when property is transferred but not sold under a plan.

49. Philadelphia Newspapers, 599 F.3d at 335 (Ambro, J. dissenting). This is perhaps Judge Ambro's most compelling argument. If one accepts the proposition that the right to credit bid and the right to make the section 1111(b)(2) election are two sides of the same coin—designed to prevent lien stripping—the secured creditor should be protected in all permutations against a low-ball valuation by the debtor either by enabling the creditor to purchase its collateral through a credit bid or maintain its lien on its collateral for the full amount of its claim. In both cases the secured creditor is able to negate any efforts by the debtor to limit the creditor's claim to the low-ball value and pay nothing (or next to nothing) to the creditor on its resulting deficiency claim. The majority's response to this argument was that the Secured Lenders had no embedded right to the "upside" value of its collateral. Philadelphia Newspapers, 599 F.3d at 316 (Ambro, J. dissenting).

50. Philadelphia Newspapers, 599 F.3d at 334 (Ambro, J. dissenting).

51. Philadelphia Newspapers, 599 F.3d at 338 (Ambro, J. dissenting).

52. Philadelphia Newspapers, 599 F.3d at 321 (Ambro, J. dissenting).

53. Philadelphia Newspapers, 599 F.3d at 337 (Ambro, J. dissenting).

54. Philadelphia Newspapers, 599 F.3d at 337 (Ambro, J. dissenting).

55. Philadelphia Newspapers, 599 F.3d at 337 (Ambro, J. dissenting).