



### Third Circuit Delivers Key Decision on Credit Bidding

*In re Philadelphia Newspapers, LLC*, 599 F.3d 298 (3d Cir. 2010)

On March 22, 2010, the U.S. Court of Appeals for the Third Circuit addressed whether pursuant to a plan of reorganization a debtor may sell assets free and clear of all liens at an auction at which the secured creditor is not permitted to credit bid (i.e., to bid its secured debt at auction in lieu of cash consideration). A divided three judge panel held that a debtor may proceed with a plan that provides for a sale of assets free and clear of all liens at an auction that does not allow the secured creditor to credit bid.

The appeal arose from the bankruptcy cases of Philadelphia Newspapers, LLC (Debtors). The Debtors owned and operated print newspapers. Prior to their petition date, the Debtors financed the acquisition of their assets through a \$295 million loan provided by a consortium of lenders (Lenders). The Debtors later defaulted and filed a voluntary petition for relief under Chapter 11 of the U.S. Bankruptcy Code (Code) in the U.S. Bankruptcy Court for the Eastern District of Pennsylvania.

The Debtors' plan of reorganization provided for the sale of substantially all of the Debtors' assets at a public auction. The Debtors proposed to sell such assets free and clear of all liens, including the Lenders' liens. The Debtors did not, however, want to permit the Lenders to credit bid at the auction. Instead, the Debtors moved the Bankruptcy Court for an order precluding the Lenders from credit bidding at the auction and requiring all bids to be in the form of cash consideration. The Debtors forecast that the auction likely would generate approximately \$37 million in cash for the Debtors' estates and under the Debtors' proposed plan the Lenders would receive the cash generated at auction as well as certain of the Debtors' real property valued at \$29.5 million.

The Lenders opposed the Debtors' request for authority to prevent the Lenders from credit bidding at auction and the Bankruptcy Court ruled with the Lenders. According to the Bankruptcy Court, the Debtors' attempt to prevent the Lenders from credit bidding at auction ran afoul of provisions of the Code (such as 11 U.S.C. § 1129(b)(2)(A)(ii)) that expressly subject the debtor's right to sell assets free and clear of liens at auction to the secured creditor's right to credit bid. Therefore, while the Bankruptcy Court approved auction procedures, it did not approve the Debtors' request to ban credit bidding.

The Debtors appealed to the district court and the district court reversed the Bankruptcy Court. According to the district court, a secured creditor does not enjoy the immutable right under Section 1129(b)(2)(A) of the Code to credit bid at an auction conducted pursuant to a plan of reorganization. Instead, while Section 1129(b)(2)(A)(ii) permits a debtor to conduct an auction of its assets subject to the secured creditor's right to credit bid, Section 1129(b)(2)(A)(iii) also permits a debtor to afford the secured creditor the "indubitable equivalent" of its claim. Accordingly, if a debtor provides the "indubitable



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equivalent” of the secured creditor’s claim, the debtor may, pursuant to a plan, conduct an auction at which the secured creditor is not permitted to credit bid.

The Third Circuit affirmed the district court on the grounds that a debtor may propose a plan under Section 1129(b)(2)(A)(iii) that includes a sale of assets at auction with no right for the secured creditor to credit bid. The court noted that Section 1129(b) permits a court to confirm a plan over the objection of a secured creditor where, among other things, the proposed plan provides for the “fair and equitable” treatment of the secured creditor’s claim. Two subsections of 1129(b)(2)(A) were extensively discussed by the court. Section 1129(b)(2)(A)(ii) refers to asset sales under Section 363 of the Code and incorporates the credit bidding protections afforded to secured creditors under Section 363(k). Section 1129(b)(2)(A)(iii) requires that secured creditors receive the “indubitable equivalent” of their secured claims. Thus, Section 1129(b)(2)(A)(ii) specifically addresses the secured creditor’s right to credit bid in the context of a debtor’s proposed sale of assets while Section 1129(b)(2)(A)(iii) more generally requires the secured creditor to receive the indubitable equivalent of its claim.

The Third Circuit did not find, however, that the specific provisions of Section 1129(b)(2)(A)(ii) control over the general provisions of Section 1129(b)(2)(A)(iii). Instead, the Third Circuit focused on the drafting in the disjunctive of Sections 1129(b)(2)(A)(i)–(iii) and the separation of subsections (i) through (iii) by the word “or.” According to the Third Circuit, “or” connotes alternatives. Moreover, the Code expressly states that the term “or” as used in the Code is not exclusive. Accordingly, the Third Circuit determined that the plain language of the Code was not ambiguous and that the use of the term “or” means that the debtor may demonstrate that a secured creditor has received fair and equitable treatment of its claim through recourse to any one of the three subsections of Section 1129(b)(2)(A).

In reaching its decision, the Third Circuit rejected the Lenders’ argument that the Code guaranteed to the secured creditor either the right to treat its deficiency claim as secured pursuant to Section 1111(b) or credit bid. According to the Third Circuit, the Lenders’ argument assumed that Congress intended to afford to secured lenders through the Code the right to “recognize some value greater than their allowed secured claim—either by treating their unsecured claim as a secured deficiency claim under § 1111(b), or bidding their credit under § 363(k) in hopes of realizing a potential upside in the collateral.” Not so, according to the majority decision. Instead, “the Code provides for a variety of treatments of secured claims, all of which are calculated to balance the interests of the secured lender and the protection of the reorganized entity, and none of which ensure an advantageous return on a secured investment.”

While the Third Circuit held that the plain language of Section 1129(b)(2)(A) allowed a debtor to propose a plan under any one of its three subsections, the Third Circuit also emphasized that its holding only prevented the secured creditor from asserting that it benefits from an absolute right to credit bid when its collateral is being sold pursuant to a Section 1129(b)(2)(A)(iii) plan of reorganization. The Third Circuit did not conclude that

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the debtor's auction of assets pursuant to such a plan necessarily results in the provision to the secured creditor of the indubitable equivalent of its claim; nor did it conclude that the secured creditor is prevented from arguing to the Bankruptcy Court under the specific circumstances of its case that the failure to allow the secured creditor to credit bid precluded the secured creditor from receiving the indubitable equivalent of its collateral.

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