

FEDERAL APPELLATE COURT AFFIRMS DEBTORS' ABILITY TO BAR THEIR SENIOR LENDERS FROM USING DEBT OWED TO THEM TO TRY TO PURCHASE THE BANKRUPT COMPANIES' ASSETS AT AUCTION

The United States Court of Appeals for the Third Circuit very recently upheld the ability of Chapter 11 debtors Philadelphia Newspapers, LLC and its bankrupt affiliates to preclude senior lenders from "credit bidding" their debt at the public auction of the debtors' assets.

The right to credit bid is codified in section 363(k) of the Bankruptcy Code. Credit bidding allows the holder of a claim that is secured by a lien to use its claim as currency if the assets of the bankrupt company are sold pursuant to section 363 of the Bankruptcy Code except if the Court orders otherwise for cause.

The debtors had filed a motion with the Bankruptcy Court seeking to preclude their lenders from credit bidding. The motion was unsuccessful and the Bankruptcy Court approved bid procedures that allowed the lenders to bid their secured debt up to \$318,763,725. The District Court subsequently reversed, holding that the Bankruptcy Code provides no legal entitlement for secured creditors to credit bid at an auction pursuant to a reorganization plan.

On November 17, 2009, the United States Court of Appeals for the Third Circuit stayed the District Court's ruling pending resolution of the appeal on the merits.

Employing canons of statutory construction endorsed by the United States Supreme Court, the Third Circuit ruled that Bankruptcy Code section 1129(b)(2)(A) permits a debtor to conduct an asset sale without allowing secured creditors to credit bid. The Third Circuit also explained that its construction of the statute was not inconsistent with Congressional intent. Circuit Judge Ambro dissented, explaining: "Though the majority attempts to use literal text in isolation to support its conclusion, that reading cannot be the only plausible reading of § 1129(b)(2)(A). Indeed, both the District Court and the



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Bankruptcy Court read the statute in a plausible fashion, yet came to opposite conclusions. Reasonable minds can differ on the interpretation of § 1129(b)(2)(A) as it applies to plan sales free of liens.” Ultimately, a split panel of the Third Circuit (2-1) upheld the District Court’s ruling.

The Third Circuit’s ruling precluding credit bidding is significant because it limits the rights of secured creditors in a cramdown scenario. Bankruptcy Code section 1129(b) empowers the court to confirm a plan of reorganization nonconsensually, in a process sometimes referred to as “cramdown.” To be confirmable through cramdown under section 1129(b)(1) of the Code, the proposed plan must not discriminate unfairly and must be fair and equitable with respect to each class of claims or interests that is impaired under, and has not accepted, the plan. Section 1129(b)(2)(A) sets forth different ways in which a plan can provide fair and equitable treatment with respect to a class of secured claims. One way to provide fair and equitable treatment to secured creditors is by providing “for the sale, subject to section 363(k) of [the Bankruptcy Code], 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. . . .”

The Third Circuit ruled that “[a]lthough subsection (ii) specifically refers to a ‘sale’ and incorporates a credit bid right under § 363(k), we have no statutory basis to conclude that it is the only provision under which a debtor may propose to sell its assets free and clear of liens.”

While this analysis may comport with various canons of construction endorsed by the United States Supreme Court, it may come as a surprise to secured lenders who anticipate being able to use their claims as currency in an asset sale.

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