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Circuits Split Over Credit Bidding in Sales Under Chapter 11 Plans

Introduction

Chapter 11 debtors often sell assets pursuant to section 363 of the Bankruptcy Code, outside of a chapter 11 plan of reorganization. Typically, “section 363 sales” involve an auction process to obtain the highest and best purchase price and determine the market value of the assets. Section 363 also protects secured creditors by explicitly permitting them to “credit bid” in a sale of their collateral.

Asset sales also may be consummated as part of a chapter 11 plan. In the chapter 11 plan context, the United States Court of Appeals for the Third Circuit, which issues decisions binding on the U.S. Bankruptcy Court for the District of Delaware, has held that secured creditors with a lien on assets to be sold may be denied the right to credit bid if they are otherwise provided with the “indubitable equivalent” of their claims under the plan. That case, *In re Philadelphia Newspapers, LLC*, 599 F.3d 298 (3d Cir. 2010), affirmed a lower court decision highlighted in a November 2009 Kirkland Alert.

In a recent decision, *River Road Hotel Partners, LLC v. Amalgamated Bank*, No. 10-3597 (7th Cir. Jun. 28, 2011), the United States Court of Appeals for the Seventh Circuit declined to follow *Philadelphia Newspapers*. Instead, the Seventh Circuit upheld a secured lender’s right to credit bid at an auction for a debtor’s assets conducted as part of a chapter 11 plan. This decision creates a clear circuit split regarding secured creditors’ rights to credit bid in sales under chapter 11 plans.

The River Road Hotel Decision

On August 17, 2009, the owners and operators (the “Debtors”) of the InterContinental Chicago O’Hare Hotel commenced chapter 11 cases in the United States Bankruptcy Court for the Northern District of Illinois. The Debtors elected to market and sell substantially all of their assets under a chapter 11 plan and entered into a \$42 million stalking-horse purchase agreement, subject to higher and better offers at an auction. However, the Debtors’ proposed bidding procedures prohibited secured creditors from credit bidding, in reliance on the *Philadelphia Newspapers* decision. The secured lenders, whose claims exceeded \$140 million, objected to the proposed bidding procedures, arguing that the Debtors’ chapter 11 plan and bidding procedures failed to provide them with the “fair and equitable” treatment due under the Bankruptcy Code to secured creditors who did not receive full payment or otherwise consent to a plan of reorganization. The bankruptcy court agreed. On appeal directly to the Seventh Circuit, the court affirmed the bankruptcy court’s decision. The court held that nonconsensual, “cram-down” chapter 11 plans that propose to sell encumbered assets free and clear of existing liens must permit secured creditors to credit bid.

River Road Hotel’s Analysis of Philadelphia Newspapers

Like the Debtors in *River Road Hotel*, the *Philadelphia Newspapers* debtors had proposed to sell substantially all of their assets pursuant to a chapter 11 plan and proposed bidding procedures that prohibited credit bidding. The *Philadelphia Newspapers* debtors asserted that Bankruptcy Code section 1129(b)(2) provides three alternative methods to “cram down” a plan over secured lenders’ objections, and only one alternative preserves a

lender's right to credit bid in an auction of assets under a chapter 11 plan. Specifically, under section 1129(b)(2), for a plan to be confirmed over the objections of secured creditors, the plan must provide that the creditors: (1) retain their liens and receive deferred cash payment of their secured claims; (2) retain the right to credit bid at any sale of collateral; *or* (3) receive the "indubitable equivalent" of their secured claims.

The *Philadelphia Newspapers* debtors claimed their plan would comply with the third alternative — i.e., providing the lenders with the "indubitable equivalent" of their claims — by paying the lenders the auction sale proceeds. Initially, the *Philadelphia Newspapers* bankruptcy court refused to approve the bid procedures, holding that section 1129(b)(2) did not permit a debtor to preclude credit bidding. On appeal, however, both the district court and the Third Circuit disagreed, finding that, because the three cram-down alternatives in section 1129(b)(2) were stated in the disjunctive, a debtor need only satisfy one alternative to the exclusion of the others. Because the *Philadelphia Newspapers* plan could provide the lender the "indubitable equivalent" of their claims, the Third Circuit found that the plan could meet the required "fair and equitable" standard even without allowing the lenders to credit bid. A dissenting opinion reasoned that section 1129(b)(2) required credit bidding in any chapter 11 plan sale context, based on canons of statutory construction, the legislative history of section 1129(b)(2), and the notion that the Bankruptcy Code generally protects secured creditors' rights.

In *River Road Hotel*, the Seventh Circuit expressly rejected the Third Circuit's conclusion that the statute's use of the word "or" permitted a debtor to rely on any one of section 1129(b)(2)'s three prongs to confirm its plan. The Seventh Circuit found that the Debtors' plan, which contemplated a sale of encumbered assets free and clear of liens, could not rely on the "indubitable equivalent" prong of the statute to be confirmed and, instead, must satisfy the credit-bidding requirement set forth in the second prong of section 1129(b)(2). In its opinion, the Seventh Circuit endorsed the dissenting opinion in *Philadelphia Newspapers*. Were the *River Road Hotel* lenders not permitted to credit bid their claims, the Seventh Circuit explained, they would be unable to protect themselves from an undervaluation of the Debtors' assets.

Considerations in Future Chapter 11 Cases

River Road Hotel makes clear that the *Philadelphia Newspapers* decision is far from settled law, at least in jurisdictions outside the Third Circuit. The circuit split created by the Seventh Circuit's decision may at some point be resolved by the U.S. Supreme Court, if the Court chooses to weigh in on the issue. In the meantime, however, debtors and secured creditors in other circuits likely will continue to fight over secured creditors' rights to credit bid in chapter 11 plan asset sales.

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