

## SECURED CREDITORS' RIGHTS TO CREDIT BID: BACK ON THE AUCTION BLOCK

August 16, 2011

To Our Clients and Friends:

On June 28, 2011, a panel of the United States Court of Appeals for the Seventh Circuit ruled that a plan of reorganization providing for a sale of encumbered assets but denying secured creditors the right to credit bid on such assets may not be confirmed over the objection of secured creditors. The decision in *In re River Road Hotel Partners, LLC* holds that a plan of reorganization that seeks to sell encumbered assets free and clear of secured creditors' liens must satisfy the requirements of Section 1129(b)(2)(A)(ii) of the Bankruptcy Code and allow secured creditors to credit bid at the auction of their collateral.

The Seventh Circuit's holding directly contrasts recent opinions of the Third and Fifth Circuits in *In re Philadelphia Newspapers, LLC* and *In re Pacific Lumber Co.*, respectively. Those decisions held that a plan of reorganization that prohibits credit bidding may be confirmed under Section 1129(b)(2)(A)(iii) of the Bankruptcy Code so long as it provides secured creditors with the "indubitable equivalent" of their secured claims. The *River Road* ruling thus represents a notable change in precedent and significant victory for secured creditors.

### BACKGROUND

River Road Hotel Partners, LLC, River Road Expansion Partners, LLC, RadLAX Gateway Hotel, LLC and related entities filed voluntary bankruptcy petitions on August 17, 2009. At the time the petitions were filed, the debtors owed at least \$260 million in construction loans to multiple secured creditors, incurred while developing the InterContinental Chicago O'Hare Hotel and the Radisson Hotel at Los Angeles International Airport, among other facilities.

In June 2010, the debtors filed plans of reorganization that sought to sell substantially all of their assets in an open auction. Under the proposed plans, secured creditors would receive the proceeds from the asset sales but would be precluded from credit bidding their loans at the auction. The secured creditors objected, arguing that the plans violated Section

1129(b)(2)(A)(ii)'s requirement that secured creditors be granted credit bidding rights in a sale of assets free and clear of liens. The debtors contended that the plans satisfied Section 1129(b)(2)(A)(iii) by providing secured creditors with the "indubitable equivalent" of their claims.

#### BANKRUPTCY CODE

Under Section 1129(b) of the Bankruptcy Code, a plan of reorganization may be "crammed down," or confirmed without the consent of an impaired class of creditors or interest holders, if the plan does not "discriminate unfairly" and is "fair and equitable" with respect to such class. A plan is fair and equitable with respect to a class of secured claims if the plan provides one of three things: (i) that the secured creditors retain their liens and receive deferred cash payments of a specified amount and value, (ii) that the sale of the assets securing the claims is free and clear of the secured creditors' liens, but the liens attach to the proceeds of the sale and the secured creditors retain the right to credit bid in connection with the sale pursuant to Section 363(k) of the Bankruptcy Code or (iii) that the secured creditors receive the "indubitable equivalent" of their secured claims.

#### DECISION

The Seventh Circuit affirmed the bankruptcy court's ruling that the debtors' plans could not be confirmed under Section 1129(b)(2)(A)(iii) over objections of the secured creditors because the Bankruptcy Code requires cramdown plans that contemplate selling encumbered assets free and clear of liens to satisfy Section 1129(b)(2)(A)(ii) of the Code. In arriving at this determination, the court agreed with Judge Ambro's dissenting opinion in *In re Philadelphia Newspapers, LLC*, which argued that the Bankruptcy Code mandates that secured creditors have the right to credit bid in a sale of collateral free of liens. Judge Ambro, a prominent member of the Delaware bankruptcy bar prior to his appointment to the Third Circuit, contended that this reading of Section 1129(b)(2)(A) was supported by the text of the statute itself, canons of statutory interpretation, relevant legislative history and the broader statutory scheme reflected in the Bankruptcy Code.

The Seventh Circuit rejected the debtors' contention that the plain language of Section 1129(b)(2)(A) allows courts to approve any cramdown plan that complies with Section 1129(b)(2)(A)(iii) by granting secured creditors the indubitable equivalent of their claims. Concluding that the statute does not have a "single plain meaning," the court reasoned that nothing in the text of the statute indicates whether Section 1129(b)(2)(A)(iii) can be invoked

to confirm any type of reorganization plan or only those that are distinguished from Subsections (i) and (ii). The court also questioned the debtors' argument that the secured creditors would receive the indubitable equivalent of their claims. As determining the current market value of assets sold in corporate bankruptcies is a problematic task, the court made clear that providing secured creditors with proceeds from an asset sale does not necessarily equate to granting them the indubitable equivalent of their claims. According to the court, the debtors' plans "lack[ed] a crucial check against undervaluation" and were incongruous with other provisions of the Bankruptcy Code, such as Sections 363(k) and 1129(b)(2)(A)(ii), which permit secured creditors to credit bid to protect them from the risk that the winning auction bid diverges from the asset's actual value.

The court also held that the debtors' interpretation of Section 1129(b)(2)(A) violated a "cardinal rule of statutory construction" that disfavors construing a statute in a manner that renders another part of the statute superfluous. The court explained that reading the statute to allow a reorganization plan to dispose of encumbered assets in ways discussed by Subsections (i) and (ii), despite failing to meet the requirements of those subsections, would render such subsections superfluous. The court reasoned that the "infinitely more plausible" interpretation of Section 1129(b)(2)(A) is regarding each subsection as prescribing requirements for a particular type of sale. Therefore, the court concluded that plans can only qualify as "fair and equitable" under Subsection (iii) if they propose disposing of assets in ways not described in Subsections (i) and (ii).

As a final criticism of the debtors' argument, the court stated that the debtors' interpretation of Section 1129(b)(2)(A)(iii) was inconsistent with other parts of the Bankruptcy Code, which demonstrate "an expressed interest in insuring that secured creditors are properly compensated." The court held that a construction of Section 1129(b)(2)(A) should grant similar protection to the interests of secured creditors.

## IMPLICATIONS

The Seventh Circuit's holding represents a significant shift in precedent, after prior Third and Fifth Circuit decisions established a trend limiting a secured creditor's right to credit bid in a cramdown plan. Relying substantially on Judge Ambro's dissent in *In re Philadelphia Newspapers, LLC*, the Seventh Circuit opened the door to other courts adopting a similar view. Therefore, debtors in jurisdictions outside of the Third and Fifth Circuits should be

wary of crafting reorganization plans that deny secured creditors an opportunity to credit bid. The circuit split generated by the *River Road* decision now increases the likelihood that the Supreme Court will adjudicate the issue of Section 1129(b)(2)(A)'s interpretation.

\* \* \*

Please feel free to contact us with any questions.

Steven R. Gross  
+1 212 909 6586  
srgross@debevoise.com

Richard F. Hahn  
+1 212 909 6235  
rfhahn@debevoise.com

Michael E. Wiles  
+1 212 909 6653  
mewiles@debevoise.com

Jasmine Ball  
+1 212 909 6845  
jball@debevoise.com

George E.B. Maguire  
+1 212 909 6072  
gebmaguire@debevoise.com

My Chi To  
+1 212 909 7425  
mcto@debevoise.com

Joan M. Stout  
+1 212 909 6357  
jmstout@debevoise.com