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River Road: The Right Road for Selling a Secured Lender's Collateral Under a Chapter 11 Plan of Reorganization

ERIK W. CHALUT AND BLAIR R. ZANZIG

The authors analyze recent circuit court decisions that upset long settled expectations regarding a secured creditor's right to credit bid its claim in a sale of its collateral free and clear of liens under a plan of reorganization — and a circuit court decision that disagreed with those cases.

Two recent cases, *Philadelphia Newspapers*[1] and *Pacific Lumber*,[2] from the Third and Fifth Circuit Courts of Appeal respectively, sent shockwaves through the bankruptcy bar and lending community. Specifically, they upset long settled expectations regarding a secured creditor's right to credit bid its claim in a sale of its collateral free and clear of liens under a plan of reorganization. Since adoption of the Bankruptcy Code in 1978, most courts had held, and most bankruptcy practitioners had assumed, that the right to credit bid, which exists in bankruptcy asset sales outside of a plan, is also protected with respect to asset sales under a plan.[3]

Section 1129(b)(2)(a) provides three alternative treatments to cram down a dissenting class of secured creditors under a plan of reorganization. One of

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those alternatives, Section 1129(b)(2)(a)(ii), provides for a sale free and clear of liens but requires that such sales be subject to the credit bid requirement set forth in Section 363(k) of the Bankruptcy Code.[4] *Philadelphia Newspapers* and *Pacific Lumber* decided, however, that subsection (ii) was not the exclusive authority for selling collateral free and clear of liens. They decided that a plan proponent could also rely on Section 1129(b)(2)(a)(iii) to sell collateral without affording a secured creditor the right to credit bid.[5] Subsection (iii) requires only that the plan provide a class of secured creditors with the "indubitable equivalent" of its secured interest.[6]

River Road Hotel Partners, LLC v. Amalgamated Bank,[7] decided by the Seventh Circuit in June 2011, disagreed with the conclusions reached in these cases. Holding that subsection (ii) provides the sole authority for selling collateral free and clear under a plan, the court determined that a secured creditor's rights under Section 363(k) must be preserved.[8]

The implications of this dispute among the circuits are profound. The decisions of the Third and Fifth Circuits significantly impaired secured lenders' rights and their leverage in Chapter 11 cases. As described below, however, the Seventh Circuit's decision, vindicates secured creditors' rights consistent with the structure of the Bankruptcy Code and intent of Congress. The Seventh Circuit's decision also retains the historical balance of power between debtors and secured creditors in Chapter 11 cases. In December 2011, the Supreme Court agreed to review the Seventh Circuit's decision in *River Road* creating an opportunity for the Supreme Court to resolve the current division among the circuits.[9]

BACKGROUND OF CREDIT BIDDING IN THE BANKRUPTCY CODE

The right of a secured creditor to credit bid at a sale of collateral subject to its secured claim, is a powerful tool in the secured creditor's bankruptcy toolkit. The right to credit bid derives from Section 363(k) of the Bankruptcy Code.[10] Section 363(k) provides that at a sale of property subject to a lien, the lienholder may bid for the property up to the amount of its claim, and then offset such claim against the purchase price of the property.[11] Thus, where a debtor seeks to sell property free and clear of liens under Section 363, the debtor is required to provide the secured creditor with an opportunity to credit bid.[12]

If instead, a debtor seeks to sell property as part of a plan of reorganization, the debtor must comply with Section 1129 to confirm its proposed plan.[13] If a class of secured creditors consents to the plan, the plan may be confirmed even though it proposes a sale without credit bidding rights.[14] If, however, the class of secured creditors objects, the debtor may attempt to "cram down" the plan over the class's objection by complying with Section 1129(b).[15] Under Section 1129(b)(1), a plan of reorganization may be confirmed over the objection of an impaired class so long as the plan does not discriminate unfairly and is fair and equitable.[16] Section 1129(b)(2)(A) defines what constitutes "fair and equitable" as it relates to secured creditors and provides the debtor with three options.[17] First, under subsection (i), the debtor may sell (or retain) the property subject to the secured creditor's liens, while providing for deferred cash payments.[18]

Second, under subsection (ii), the debtor may sell the property free and clear of such liens subject to Section 363(k) (i.e. by permitting the secured party to credit bid), while attaching the creditor's liens to the proceeds of the sale.[19] Pursuant to subsection (ii), a debtor could, over the objection of a class of secured creditors, confirm a plan proposing to sell property subject to a lien free and clear of such lien so long as the lienholders' credit bid rights under Section 363(k) are preserved. Until recently, few courts held that a plan could propose the sale of an encumbered asset without providing this protection.

Third, under subsection (iii), the debtor may satisfy the "fair and equitable" requirement by providing a class of secured creditors with the "indubitable equivalent" of its claim.[20] The precise meaning of "indubitable equivalent" is the source of much controversy among the courts and bankruptcy practitioners, and lies at the heart of the dispute between the circuits over whether a sale free and clear of liens without offering the right to credit bid is the "indubitable equivalent" of the secured claim.

CASES AUTHORIZING SALES OF COLLATERAL UNDER PLANS WITHOUT GIVING SECURED CREDITOR THE RIGHT TO CREDIT BID

In re Pacific Lumber Co.

Relying on Section 1129(b)(2)(A)(iii), two federal courts of appeals have

held that a plan may be approved authorizing a sale of collateral free and clear of liens without affording a secured creditor the right to credit bid. The first of these cases was the Fifth Circuit's decision in *Pacific Lumber*.[21] In *Pacific Lumber*, the debtors were involved in the growing, harvesting and processing of redwood timber. Although there were six debtors, the appeal concerned the reorganization of the two primary debtors, Palco and Scopac. Palco owned and operated a sawmill and power plant. Marathon Structured Finance held a secured claim against the assets of Palco which were estimated to be worth $110 million on the bankruptcy petition date. The second debtor was Scopac which was a Delaware special purpose entity wholly owned by Palco. Palco transferred ownership of 200,000 acres of redwood timberland to Scopac to facilitate the sale of $867.2 million in notes secured by the timberlands and Scopac's other assets. The bankruptcy court ultimately confirmed a plan proposed by Marathon and Mendocino Redwood Company, a competitor of Palco. The plan proposed to transfer the assets that were secured by the notes to a newly created entity, and Marathon and Mendocino would contribute $580 million to pay the claims against Scopac. At the confirmation hearing, the bankruptcy court concluded that the noteholders' secured claim was valued at $510 million. Because the plan proposed to give the noteholders $510 million on account of their secured claim, the court concluded that the noteholders received the "indubitable equivalent" of their secured claim. The bankruptcy court overruled the noteholders' objection that they should have been offered the right to credit bid when the property on which they held a lien was transferred.

On direct appeal, the Fifth Circuit held that the payment to the noteholders of the valued amount of their secured claim — $510 million — satisfied the fair and equitable requirement because it constituted the "indubitable equivalent" of their claim. The court found that the three subsections of Section 1129(b)(2)(A) are alternatives, as they are joined by the disjunctive word "or."[22] In fact, the court went further by noting that since the introduction to Section 1129(b)(2) states that the "condition that a plan be fair and equitable *includes* the following requirements ...," the three subsections constitute a non-exhaustive list of possible means for satisfying the "fair and equitable" requirement. Because it concluded the list is non-exhaustive, the court reasoned that it would be inconsistent to hold that each subsection was intended to set forth a

compartmentalized option; in particular it reasoned it would be inconsistent to hold that subsection (ii) was the exclusive means by which a debtor could propose selling collateral free and clear of any liens.[23] In response to the noteholders' argument that allowing a sale without credit bid protections would render Section 1129(b)(2)(A)(ii) superfluous, the court held that "[a]lthough a credit bid option might render Clause (ii) imperative in some cases, it is unnecessary here because the plan offered a cash payment to the Noteholders."[24]

In re Philadelphia Newspapers, LLC

Following the *Pacific Lumber* case, the Third Circuit rendered a similar verdict in *Philadelphia Newspapers*.[25] Philadelphia Newspapers owned and operated the print newspapers the *Philadelphia Inquirer* and *Philadelphia Daily News* and the online publication philly.com. The debtors acquired the assets in 2006 for $515 million; $295 million of the purchase price was financed by a consortium of lenders. The debtors filed a plan which included a sale of substantially all of their assets at public auction. A majority interest in the stalking horse bidder was owned by two parties who respectively held 20 percent and 30 percent of the equity in one of the debtors. The bid procedures associated with the sale process precluded the lenders from credit bidding at the auction.

The Third Circuit held that it was possible that a plan could propose a sale of assets without affording the secured creditor a right to credit bid. Like the Fifth Circuit, the court relied on the language of the statute. It noted that the language is stated in the disjunctive and therefore provided three independent options for treatment of a secured creditor.[26] It further concluded that the language was not ambiguous.[27] The court dismissed the lenders' argument that subsection (ii) should be the exclusive means through which the sale of an encumbered asset could be accomplished. Instead, the court concluded that the use of the "catch-all" phrase "indubitable equivalent" in subsection (iii) permitted "yet other methods of conducting asset sales, so long as those methods sufficiently protected the secured creditor's interests."[28]

Ultimately, because the narrow issue in front of the court was the propriety of the bidding procedures rather than whether to confirm the plan, there had been no valuation, no disclosure statement and no plan confirmation

hearing. As such, the court did not rule on whether the secured creditor in fact received the indubitable equivalent of its secured interest.[29] It merely determined it was *possible* for a plan involving the sale of assets to comply with Section 1129(b)(2)(A) without providing the secured creditor with the right to credit bid.

Judge Ambro dissented from the *Philadelphia Newspapers* majority opinion. As a preliminary matter, he quarreled with the court's conclusion that the statute was non-ambiguous. He argued that although the statute uses the word "or," there are numerous instances in the Bankruptcy Code in which the word "or" is not exclusive.[30] More importantly, he argued that a plausible interpretation of Section 1129(b)(2)(A) is that each subsection sets forth the specific requirements for a distinct option a plan proponent may take.[31] In other words, subsection (i) applies to all situations where the secured creditor retains the lien, subsection (ii) applies to all situations where the plan provides for the sale of collateral, and subsection (iii) applies whenever the plan provides for the realization of the indubitable equivalent. He also took issue with *Pacific Lumber*'s conclusion that the use of the word "includes" in Section 1129(b)(2) suggests that the list in Section 1129(b)(2)(A) is non-exhaustive.[32] Judge Ambro concluded that the word "includes" modifies Section 1129(b)(2) — not section (A). He asserted that the operative word is "provides" — set forth in the introduction to Section 1129(b)(2)(A). In Judge Ambro's view, this suggests the opposite conclusion to that reached in *Pacific Lumber*: that the list of three subsections is exhaustive — supporting the possibility that the three subsections do in fact set forth three compartmentalized options.

Since Judge Ambro concluded that both his interpretation and the majority's interpretation are plausible, he disagreed with the majority's conclusion that the statute is non-ambiguous. Invoking familiar canons of construction, Judge Ambro argued that the majority's view of subsection (iii) would inappropriately render subsection (ii) superfluous, and the specific statute (subsection (ii)) should prevail over the general statute (subsection (iii)).[33] He also argued that the majority's opinion was inconsistent with Section 1111(b) and 363(k) of the Bankruptcy Code and the legislative history.[34] Based on this analysis, Judge Ambro concluded that subsection (ii) is the exclusive authority for the sale of collateral under Section 1129(b)(2)(A) and dissented from the ruling in *Philadelphia Newspapers*.

In re River Road Hotel Partners, LLC

River Road addressed the consolidated appeals of two companion cases involving two sets of debtors: River Road Hotel Partners, LLC and its affiliates (the "River Road Debtors") and RadLAX Gateway Hotel LLC and its affiliates (the "RadLAX Debtors").[35] The River Road Debtors had obtained construction loans totaling $155 million to finance the construction of the InterContinental Chicago O'Hare Hotel and related event space.[36] Various investment funds constituting the secured lenders provided the secured financing. The River Road Debtors requested additional financing from the secured lenders to complete construction of the hotel restaurant and to pay various suppliers, but the parties were unable to reach agreement on acceptable terms and the River Road Debtors filed Chapter 11. As of its filing, the River Road Debtors owed at least $140 million on their loans, with another $9.5 million in mechanic's liens having been asserted against the hotel.

Similarly, the RadLAX Debtors had obtained a construction loan totaling approximately $142,000,000 to finance the purchase and renovation of a hotel near the Los Angeles International Airport, including the construction of an adjacent parking structure.[37] After several million dollars of unanticipated costs, the RadLAX Debtors ran out of funds and halted construction.[38] Unable to agree to mutually satisfactory terms with is lender for additional funding, the RadLAX Debtors also filed bankruptcy under Chapter 11.[39] As of its filing, the RadLAX Debtors owed at least $120 million on the loans with another $15 million in mechanic's liens asserted against the RadLAX properties.[40]

In their plans of reorganization, the Debtors proposed to auction off their respective assets to the highest bidder subject to a stalking horse bid.[41] The Debtors filed motions seeking approval of their bid procedures pursuant to which the Debtors proposed to sell their assets free and clear of the lenders' liens despite failing to provide the secured lenders with the right to credit bid.[42] The lenders objected to the bid procedures motions asserting that because the Debtors proposed to sell encumbered assets free and clear of the lenders' liens, the Debtors could only confirm their plans over the lenders' dissent (i.e. "cram down" the plan) by satisfying the requirements of subsection (ii), including permitting the secured lenders the right to credit bid.[43] The Debtors maintained that their plans were nevertheless confirmable be-

cause they satisfied subsection (iii) by providing the secured lenders with the "indubitable equivalent" of their claim.[44] Relying on Judge Ambros' dissent in *Philadelphia Newspapers*, the bankruptcy court sustained the secured lenders' objection, found the Debtors' plans to be unconfirmable, and denied the Debtors' bid procedures motion.[45] The bankruptcy court certified its decision for direct appeal to the Seventh Circuit.[46]

Splitting from the Third Circuit's decision in *Philadelphia Newspapers*, the Seventh Circuit affirmed the bankruptcy court holding that cramdown plans that contemplate selling encumbered assets free and clear of liens at an auction must satisfy subsection (ii), including providing the secured lenders with the right to credit bid. In reaching its decision, the Seventh Circuit first considered the plain language of Section 1129(b)(2)(A), but found it to be ambiguous for two reasons. First, the court found that nothing in Section 1129(b)(2)(A) indicated whether subsection (iii) applied to all plans or just to those plans that fell outside the scope of the earlier subsections.[47]

Second, the court also found that, even considered in isolation, subsection (iii) did not unambiguously indicate that it was applicable to plans like River Road's proposal.[48] In particular, the court found that what constitutes the "indubitable equivalent" of a secured lender's claim depends on whether the lender is over or undersecured. Where a lender is undersecured, the value of the collateral may be determined either by the court (*see* 11 U.S.C. § 506(a)(1)), or through a free market valuation established by an open auction (*see* 11 U.S.C. § 363(k) & 1129(b)(2)(A)). In the context of a bankruptcy auction, as the Debtors had proposed, the court noted that a number of factors may create a substantial risk that assets could be undervalued. Ordinarily, lenders could use the right to credit bid to trump any bid that they believed undervalued the asset. In the absence of the right to credit bid, the court held lenders would lose a crucial check against undervaluation of the asset thereby increasing the risk that the winning bid would fail to provide lenders with the current market value of the encumbered asset. Thus, the court seemed to conclude that absent credit bidding there was no assurance that the sale the Debtors proposed would provide the secured lenders the indubitable equivalent of their claim. Because nothing in subsection (iii) indicated that a plan that merely *might* provide secured lenders with the indubitable equivalent was confirmable, the Seventh Circuit found the plain meaning of subsection

(iii) did not unambiguously resolve the issue.

Having found the statute susceptible to two conflicting interpretations, the Seventh Circuit turned to principles of statutory interpretation to resolve the ambiguity. Specifically, the court looked to the canon of construction that urges courts to interpret statutes in ways that gives meaning to each part of a statute while taking care to not render any section superfluous.[49] The court noted that subsection (i) and (ii) set forth specific requirements to confirm plans seeking to sell encumbered assets.[50] The Seventh Circuit held that interpreting subsection (iii) to confirm plans proposing to sell encumbered assets that nevertheless failed to satisfy subsections (i) or (ii) would render those subsections superfluous.[51] Instead, the court found that the "infinitely more plausible interpretation" of Section 1129(b)(2)(A) was to read each of the subsections as conclusively governing the category of proceedings it addresses.[52] As such, the court held that plans could only qualify as "fair and equitable" under subsection (iii) if they proposed to dispose of assets in ways that are not described in subsections (i) and (ii).[53] Because River Road's plan proposed selling the assets free and clear of liens it fell within the gamut of subsection (ii) and thus had to provide the secured lenders the right to credit bid.

The RadLAX Debtors filed a petition for certiorari, which the Supreme Court granted in December 2011.[54]

ANALYSIS

In the authors' opinion, *River Road* reached the correct conclusion for several reasons. First, to allow a sale of collateral under Section 1129(b)(2)(A)(iii) without a credit bid renders subsection (ii) superfluous. Second, although not addressed in detail in *River Road*, the Seventh Circuit's reading is strongly supported by pre-Code precedent and legislative history. Third, by depriving the secured creditor of the right to credit bid, the Third and Fifth Circuits have denied the secured creditor a crucial check against the undervaluation of its collateral, in contravention of the structure of the Bankruptcy Code and intent of Congress. Finally, the conclusions reached in *Philadelphia Newspapers* and *Pacific Lumber* are inconsistent with Sections 1111(b) and 363(k) of the Bankruptcy Code. By contrast, *River Road*'s analysis har-

monizes these sections and is consistent with the structure and intent of the Bankruptcy Code.

Section 1129(b)(2)(A) Is Ambiguous

A preliminary question that bedeviled all three courts is whether Section 1129(b)(2)(A) is ambiguous. The critical question as described in *River Road* is whether "Subsection (iii) can be used to confirm any type of plan or if it can only be used to confirm plans to propose disposing of assets in ways that can be distinguished from those covered by Subsections (i) and (ii)."[55] And relevant to the issues presented by this article, can a sale of encumbered assets be accomplished under subsection (iii) that eschews the carefully crafted requirements set forth for such sales in subsection (ii).

The *Philadelphia Newspapers* majority concluded that it was not ambiguous by reading subsection (iii) in isolation. While the Third Circuit's reading may be a plausible interpretation of the statutory language, in the authors' opinion, it is not the only plausible interpretation. Read together with the other two subsections of Section 1129(b)(2)(A), a second interpretation is plausible. That interpretation, as articulated in Judge Ambro's dissent in both *Philadelphia Newspapers* and in *River Road*, is that each subsection sets forth the specific requirements for a particular treatment a plan can choose.[56] In other words, if a plan proposes to have the secured creditor retain the lien, then subsection (i) and only subsection (i) applies, and if a plan proposes to sell a secured lender's collateral free and clear of liens, then subsection (ii) and only subsection (ii) applies.

One of the *Pacific Lumber* court's attempts to undermine this alternate interpretation rings particularly hollow. Effectively, it held that since Section 1129(b)(2) is modified by the word "includes" that the list set forth in Section 1129(b)(2)(A) is non-exhaustive, and that the "non-exhaustive nature of the three subsections is inconsistent with treating them as compartmentalized alternatives."[57] Judge Ambro challenges this argument by pointing out that the word "includes" modifies only Section 1129(b)(2) — not section (A) thereof.[58] Section 1129(b)(2)(A) requires that "with respect to a class of secured claims, the plan provides" one of the three forms of treatment discussed herein, i.e., Section 1129(b)(2)(A)(i), (ii) or (iii). As Judge Ambro correctly

points out, this suggests that a plan *must* provide for one of those three forms of treatment.

In any case, it is inconsistent for the *Philadelphia Newspapers* majority on one hand to refer to subsection (iii) as a "catch-all" provision, while *Pacific Lumber* claims that the three subsections are a non-exhaustive list. Congress would not have presumably included a catch-all provision in a non-exhaustive list. Even in this difference of interpretation between the Third and Fifth Circuit, an ambiguity exists. Ambiguity in the language of the statute requires a review of other principles of statutory interpretation.

Allowing a Sale of Collateral Under Section 1129(b)(2)(A)(iii) Without a Credit Bid Renders Subsection (ii) Superfluous

Following a long line of cases, *River Road* held that no clause or phrase should be read in such a way as to render another clause or phrase superfluous. The problem with the *Pacific Lumber* and *Philadelphia Newspapers* analysis, as noted in *River Road*, is that it renders subsection (ii) unneccessary. If any sale of encumbered assets were possible without meeting the carefully crafted standards set forth in subsection (ii), it would have made little sense for Congress to have included subsection (ii) in the first place. This is particularly true as the purpose of subsection (ii) is to achieve the same result as that set forth in subsection (iii) — to provide the secured lender with the value of its secured interest. If Congress believed that affording the credit bid was required to provide a secured lender with the value of its claim in the sale context under subsection (ii), then it makes little sense that a plan can circumvent that requirement by arguing that a sale without credit bidding qualifies as the indubitable equivalent under subsection (iii). In effect, this reading of subsection (iii) would read subsection (ii) out of the Bankruptcy Code entirely.

At the same time, *River Road*'s proposed reading of Section 1129(b)(2)(A) does not render subsection (iii) superfluous.[59] Congress provided examples of non-sale alternatives that could meet the indubitable equivalent standard including "abandonment of the collateral to the creditor…as would a lien on similar collateral."[60] Since the adoption of the Bankruptcy Code, courts have found that a plan satisfied the indubitable equivalent standard

under circumstances where the debtor surrendered a creditor's collateral[61] or provided replacement collateral to the creditor that was valued at least the amount of the original collateral.[62]

Pre-Code Case Law and the Legislative History Support the Conclusion Reached in *River Road*

Pre-Code case law and the legislative history of Section 1129(b)(2)(A) further support the conclusion in *River Road*. Any discussion of the "fair and equitable" requirement now codified in Section 1129(b)(2)(A) should start with Judge Learned Hand's decision in *In re Murel Holding Corp*.[63] Applying the pre-Code Bankruptcy Act, Judge Hand held that normally a secured lender can be crammed down in one of four ways. The first three ways were that (a) the liens may be kept in status quo, (b) the property may be sold free and clear and the liens attach to the proceeds, or (c) the value of the liens may be appraised and paid to the lender, or, if the objectors prefer, the same course might be taken with any new securities which shall be offered to them in reorganization.[64] The fourth option was, as Judge Hand put it, a vague grant, under which the judge acting "fairly and equitably" could approve a plan that provided "adequate protection" to the secured creditor so long as it afforded it the "most indubitable equivalence" of its interest.[65] It is worth noting that the sale option was considered as an alternative to the "indubitable equivalence" option in Judge Hand's decision, though credit bidding was not mentioned. The legislative history of the Bankruptcy Code clarifies that the indubitable equivalent option set forth in subsection (iii) is derived from Judge Hand's decision in *Murel Holding*. In the Senate Judiciary Committee's report, the Committee mentions the three options that ultimately appear in Section 1129(b)(2)(A). The Committee Report stated as follows:

> Paragraph 9(A) provides a special alternative with respect to secured claims. A plan may be confirmed against a dissenting class of secured claims if the plan or order of confirmation provides for the realization of their security (1) by the retention of the property subject to such security; (2) by a sale of the property and transfer of the claim to the proceeds of sale if the secured creditors were permitted to bid at the sale and set off against the purchase price up to allowed amount of their claims; or (3)

> by such other method that will assure them the realization of the indubitable equivalent of the allowed amount of their secured claims. The indubitable equivalent language is intended to follow the strict approach taken by Judge Learned Hand in *In Re Murel Holding Corp*. 75 F.2d 941 (2d Cir. 1935).[66]

The legislative history helps to clarify the ambiguity in Section 1129(b)(2)(A). Prior to the Bankruptcy Code, as Judge Hand elucidated, a sale of assets was one of four alternatives to provide fair and equitable treatment to a secured creditor — but there was no reference to credit bidding. The Bankruptcy Act did not place significance on the right of the secured creditor to do so. It stands to reason that a sale of assets could not have been within the scope of Judge Hand's "indubitable equivalent" standard because it was already taken into account as an alternate option. Section 1129(b)(2)(A)(ii) uses nearly the identical formulation employed by Judge Hand to describe the conditions for cramming down a secured creditor, except that Congress expressly added the requirement that a credit bid be used in the context of a sale of the secured lender's collateral.[67]

Moreover, the legislative history bolsters the view that the alternatives under Section 1129(b)(2)(A) is an exhaustive list of the means for cramming down secured creditors. The legislative history quoted above says only that the plan can be confirmed if one of the three options is satisfied. In introducing the third option for meeting the "fair and equitable" requirement, the legislative history uses the phrase "by such other method" suggesting that the "indubitable equivalent" option was intended to describe a *method* other than those set out in subsections (i) and (ii), i.e., other than a replacement lien or sale.[68]

Because the legislative history followed Judge Hand and pre-Code developments, it also stands to reason that since "indubitable equivalent" was meant as an alternative to a sale before the Code, it was meant to remain an alternative to a sale afterwards as well. In expressly modifying the pre-Code procedure for conducting a sale by mandating credit bidding, subsection (ii) reflects Congress's preference to afford a right to secured lenders they did not have in the pre-Code era. It would circumvent that intent if subsection (iii) were construed to permit sales absent credit bidding that Congress expressly abolished in modifying subsection (ii).

Depriving Secured Creditors of Credit Bid Tool Appears to Contradict Structure and Intent of Congress

River Road noted that if it were to follow *Pacific Lumber* and *Philadelphia Newspapers* that lenders would lose a crucial check against undervaluation of their collateral. The Seventh Circuit reasoned that this would increase the risk that the winning bid would fail to provide the secured creditor with the current market value of an encumbered asset. Holding that because nothing in subsection (iii) indicated a plan that merely *might* provide secured lenders with the indubitable equivalent should be confirmed, the court found the plain meaning of subsection (iii) did not unambiguously resolve the issue.[69]

Although the Seventh Circuit raised this concern to point out an ambiguity in Section 1129(b)(2)(A)(iii), it is apparent that subsection (ii) reflected Congress's policy view that it was a necessary condition to any sale that the lenders be afforded the check of credit bidding. Congress believed that any one of the three options set forth in Section 1129(b)(2)(A) would allow the secured creditor to receive the value of its secured claim. In subsection (ii), to achieve the value of the secured creditor's claim, Congress required that a plan proposing a sale process must afford the credit bid protections set forth in Section 363(k). If this could be achieved with less, i.e., without the credit bid, then Congress would have had no reason for including it.

Affording secured creditors credit bidding rights is also consistent with practice. Credit bidding helps secured creditors ensure that the best and highest bid is received on an asset. Without credit bidding, there is no assurance that the winning bid at an auction will achieve the market value of the assets being sold. Under Section 1129(b)(2)(A), Congress gave a tool to secured creditors to ensure that the market price was achieved by keeping potential cash bidders honest. Under the Third and Fifth Circuit's formulation, however, the burden has been shifted to the secured creditor to prove that a cash bid is sufficient to satisfy its secured interest — i.e. to achieve market value — because it has *not* been afforded the right set forth in subsection (ii).

For courts following *Philadelphia Newspapers* and *Pacific Lumber*, there appears to be virtually no limit on using subsection (iii) to circumvent a specific and detailed provision set forth by Congress in subsection (ii). Moreover, it will likely lead to many more instances such as existed in *Philadelphia*

Newspapers, where an insider stalking horse uses its insider position to demand (a) the filing of cases in favorable forums (like the Third and Fifth Circuit), and (b) bid procedures denying the right of secured creditors to credit bid against the stalking horse. The authors do not believe this is consistent with either the structure of Section 1129(b)(2)(A) of the Bankruptcy Code or intent of Congress.

The *River Road* Decision Creates Greater Harmony Between Sections 1129(b)(2)(A), 1111(b) and 363(k) of the Bankruptcy Code

By design, the Bankruptcy Code creates comprehensive protections for secured creditors' rights to prevent undervaluation of their claims in a Chapter 11 case. If a debtor or trustee proposes to sell the secured creditor's collateral at auction free and clear of the secured creditor's lien under Section 363 of the Bankruptcy Code, it must provide the secured creditor the right to bid its claim at the auction.[70]

If the debtor or trustee proposes to retain the encumbered asset, Section 1111(b) of the Bankruptcy Code provides the secured creditor with means to protect its claim from undervaluation.[71] Under Section 506(a) of the Bankruptcy Code, the secured creditor's claim is bifurcated into two claims: a secured claim equal to the value of the collateral and an unsecured deficiency claim.[72] Under Section 1111(b)(1)(A), a nonrecourse secured lender is deemed to have recourse against the debtor for any debt deficiency.[73] Pursuant to Section 1111(b)(2), however, the secured lender can forego the deficiency claim and elect to be treated as if it were fully secured.[74] The bundle of rights set forth in Section 1111(b) were provided to protect the secured creditor from the scenario where a debtor filed for bankruptcy at a low point in the market for the secured creditor's collateral, thus ensuring a low valuation on a nonrecourse secured creditor's collateral. The right to make the Section 1111(b) election, however, was not offered where a property was sold under Section 363 or under the plan.

Pursuant to this scheme, in any Chapter 11 case, a secured creditor has protection against undervaluation if the plan proposes to keep its collateral pursuant to Section 1111(b). It is also protected against undervaluation if the debtor decides to sell its collateral under Section 363 by virtue of its right to

credit bid its claim. If *River Road* is followed, as set forth above, it would also be protected against undervaluation if the debtor decides to sell its collateral under the plan by virtue of the right to credit bid. If *Philadelphia Newspapers* and *Pacific Lumber* are followed, however, the secured creditor would not be protected against undervaluation if the debtor decides to sell its collateral under the plan because it would not necessarily be entitled to credit bid.

For two reasons, the interplay of Section 1111(b), 363(k) and 1129(b)(2)(A) support the decision in *River Road*. First, as noted above, Section 1111(b) allows the election except in two scenarios: (a) where the assets are sold under Section 363 or (b) where the assets are sold under the plan. This exception must derive from the fact that, in such cases, the secured creditor has a right to credit bid. Both Sections 363(k) and 1129(b)(2)(A) as written provide an alternative protection to secured creditors — the credit bid — that would obviate the need for the 1111(b) election. Where there is a right to credit bid, there would be no need for 1111(b) protection because credit bidding and Section 1111(b) serve the same purpose: to prevent undervaluation of the secured creditor's claim. As noted by Judge Ambro in his dissent, the scheme proposed by *Philadelphia Newspapers* and *Pacific Lumber* leaves a glaring hole. Specifically, it would allow a secured creditor to protect itself against undervaluation (a) if the collateral was to be retained (pursuant to Section 1111(b)), (b) if the secured creditor's collateral was to be sold outside of a plan process (pursuant to Section 363(k)), and (c) if the plan proponent decided to sell the secured lender's collateral pursuant to Section 1129(b)(2)(A)(ii), while denying the secured creditor the right to protect itself from undervaluation in one scenario: if its collateral is to be sold under the plan pursuant to Section 1129(b)(2)(A)(iii). The structure of the Bankruptcy Code, and the interplay of Sections 1111(b), 363(k) and 1129(b)(2)(A), do not support denying secured creditors the right to protect themselves against undervaluation in a sale of its collateral under the plan when it would have the right to protect itself in any other scenario.

Second, legislative history indicates Congress's intent to except plan sales from the 1111(b) election *because* it assumed all plan sales would be subject to Section 363(k) of the Bankruptcy Code. As pointed out in Judge Ambro's dissent, Senator Dennis DeConcini, the floor manager of the Bankruptcy Code, stated as follows:

> Sale of property under section 363 or under the plan is excluded from treatment under section 1111(b) because of the secured creditor's right to bid in the full amount of his allowed claim at any sale of collateral under section 363(k) of the House amendment.[75]

These statements support the Senate's floor manager understanding that "any sale" under the plan would be subject to the secured creditor's right to credit bid. If one ignores the clear intent set forth in this legislative history and allows a sale under Section 1129(b)(2)(A)(iii), it creates an irreconcilable conflict with Section 1111(b). The only reason that the 1111(b) election is exempted from plan sales is precisely because the secured lender can credit bid. Under the rationale of *Philadelphia Newspapers* and *Pacific Lumber*, a plan can deny (a) the secured lender its right to credit bid at a sale of its collateral and (b) the secured lender its right to make a 1111(b) election, notwithstanding that the sole reason it is denied the right to make the 1111(b) election is because of a right it should have — but is being denied (i.e., the credit bid). There is no reason to believe that Congress intended to do so.

CONCLUSION

Prior to *River Road*, case law was trending in favor of providing greater flexibility to plan proponents under 1129(b)(2)(A) to meet the "fair and equitable" standard in cramming down secured creditors. This of course creates greater risks for secured creditors. It also violated long-settled expectations as well as the structure and intent of the Bankruptcy Code. Furthermore, it will likely have the impact in some cases of incenting debtors to sell assets under a plan rather than under Section 363 to take advantage of the exception recognized by *Philadelphia Newspapers* and *Pacific Lumber*. We could also see more cases like *Philadelphia Newspapers* where insiders of a debtor acting as a stalking horse will use their insider position to leverage bid procedures without credit bid protections. *River Road* helped to turn the tide against this trend and in vindicating the rights of secured creditors. Having granted certiorari in *River Road*, the Supreme Court has the opportunity to resolve the conflict among circuits. In the meantime, secured creditors must be aware of the risks to their interests in a Chapter 11 case.

NOTES

[1] *In re Philadelphia Newspapers, LLC*, 599 F.3d 298 (3rd Cir. 2010).
[2] *Bank of New York Trust Co. v. Official Unsecured Creditors' Comm. (In re Pacific Lumber Co.)*, 584 F.3d 229 (2009).
[3] *Philadelphia Newspapers*, 599 F.3d at 336 (J. Ambro, dissenting) (the consequences of allowing sales of collateral free and clear of liens without credit bidding are contrary to the settled expectations of debtors and lenders bargaining in the shadow of the Bankruptcy Code).
[4] 11 U.S.C. § 1129(b)(2)(A)(ii); 11 U.S.C. § 363(k).
[5] *Philadelphia Newspapers,* 599 F.3d at 318; *Pacific Lumber*, 584 F.3d at 249.
[6] 11 U.S.C. § 1129(b)(2)(A)(iii).
[7] *River Road Hotel Partners, LLC v. Amalgamated Bank*, 651 F.3d 642 (7th Cir. 2011), *petition for cert. filed*, 80 U.S.L.W. 3090 (Aug. 5, 2011) (No. 11-166).
[8] *Id.* at 651.
[9] See Radlax Gateway Hotel, v. Amalgamated Bank, No. 11-166, 2011 WL 3499633, at *1 (Dec. 12, 2011) (granting petition for writ of certiorari).
[10] 11 U.S.C. § 363(k).
[11] *Id.*
[12] *Id.*
[13] 11 U.S.C. § 1129.
[14] 11 U.S.C. § 1129(a)(8).
[15] 11 U.S.C. § 1129(b).
[16] 11 U.S.C. § 1129(b)(1).
[17] 11 U.S.C. § 1129(b)(2)(A).
[18] 11 U.S.C. § 1129(b)(2)(A)(i).
[19] 11 U.S.C. § 1129(b)(2)(A)(ii); 11 U.S.C. § 363(k).
[20] 11 U.S.C. § 1129(b)(2)(A)(iii).
[21] *Pacific Lumber*, 584 F.3d 229
[22] *Id.* at 245.
[23] *Id.* at 245-46.
[24] *Id.* at 246.
[25] *Philadelphia Newspapers,* 599 F.3d 298.
[26] *Id.* at 305-06.
[27] *Id.* at 304-10.
[28] *Id.* at 308.
[29] *Id.* at 312-13.
[30] *Id.* at 324 (Ambro, J. dissenting).
[31] *Id.* at 325.

[32] *Id.* at 324-25.
[33] *Id.* at 328-31.
[34] *Id.* at 331-36.
[35] *River Road*, 651 F.3d at 644-645.
[36] *River Road*, 651 F.3d 642.
[37] *Id.* at 644.
[38] *Id.*
[39] *Id.*
[40] *Id.*
[41] *Id.* at 645.
[42] *Id.*
[43] *Id.*
[44] *Id.*
[45] *Id.*
[46] *Id.*
[47] *Id.* at 649-650.
[48] *Id.* at 650.
[49] *Id.* at 651-52.
[50] *Id.* at 652.
[51] *Id.*
[52] *Id.*
[53] *Id.*
[54] Shortly after the Seventh Circuit issued its decision, the bankruptcy court confirmed an alternative plan of reorganization in the River Road Debtors' cases. Accordingly, the River Road Debtors were not parties to the petition for certiorari.
[55] *Id.* at 649.
[56] *Philadelphia Newspapers*, 599 F.2d at 325 (Ambro, J. dissenting); *River Road*, 651 F.2d at 652.
[57] *Pacific Lumber*, 584 F.3d at 245-46.
[58] *Philadelphia Newspapers*, 599 F.3d at 324-25.
[59] For a fuller discussion of the application of the "indubitable equivalent" standard under subsection (iii), see Michael L. Molinaro, *Defeating a Cramdown: Getting a Grip on the Indubitable Equivalent Standard*, THE SECURED LENDER, November/ December 1994, at 6-7.
[60] 124 CONG. REC. H 11103 (daily ed. Sept 28, 1978) (statement of Rep. Edwards), 124 CONG. REC. S 17420 (daily ed. Oct 6, 1978) (statement of Sen. DeConcini).
[61] *Sandy Ridge Development Corp. v. Louisiana Nat'l Bank (In re Sandy Ridge Dev. Corp.)*, 881 F.2d 1346, 1350 (5th Cir. 1989).
[62] *In re TM Monroe Manor Assocs. Ltd.*, 140 B.R. 298, 300 (Bankr. N.D. Ga. 1991)

(holding that replacement collateral may be sufficient though not finding it to be sufficient on the fact of the case).

[63] *In re Murel Holding Corp.*, 75 F.2d 941 (2nd Cir. 1935).

[64] *Id. at 942.*

[65] *Id.*

[66] S. Rep. No. 95-989, at 127 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5913.

[67] 11 U.S.C. § 1129(b)(2)(A)(ii).

[68] S. Rep. No. 95-989, at 127 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5913.

[69] *River Road*,651 F.2d at 650-51.

[70] 11 U.S.C. § 363(k).

[71] 11 U.S.C. § 1111(b).

[72] 11 U.S.C. § 506(a).

[73] 11 U.S.C. § 1111(b)(1)(a).

[74] 11 U.S.C. § 1111(b)(2).

[75] *Philadelphia Newspapers,* 599 F.3d at 335 (quoting 124 Cong. Rec. 31,795, 32,407 (1978)).