

Bankruptcy Alert

Seventh Circuit Holds That Secured Lenders Must Have the Opportunity to Credit Bid

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On June 28, 2011, the Seventh Circuit issued a decision holding that a proposed plan of reorganization that contemplates the sale of a debtor's assets free and clear of a dissenting secured lender's liens cannot be confirmed under Bankruptcy Code section 1129(b)(2)(A) unless the proposed plan offers the secured lender the opportunity to credit bid in connection with the sale of the assets.¹ The *River Road* decision conflicts with last year's Third Circuit ruling in *In re Philadelphia Newspapers*,² in which the Third Circuit held that a debtor could sell assets free and clear of liens under a proposed plan of reorganization without affording dissenting secured lenders the opportunity to credit bid.³ This alert examines the Seventh Circuit's opinion in *River Road* and its implications for secured lenders.

Background

In August 2009, two sets of debtors (River Road and RadLAX) filed for bankruptcy relief in the U.S. Bankruptcy Court for the Northern District of Illinois. At that time, River Road and its related debtor affiliates owed approximately \$140 million to a group of lenders, which amount was secured by liens on, among other assets, the InterContinental Hotel at Chicago O'Hare Airport. RadLAX similarly owed approximately \$120 million at the time of its filing, which amount was secured by liens on, among other assets, the Radisson Hotel at Los Angeles International Airport. Both sets of debtors submitted proposed plans of reorganization on June 4, 2010, which contemplated the sale of substantially all assets held by the debtor groups. At the same time the debtors filed proposed bid procedures which, if approved, would govern the debtors' asset auctions but would preclude the secured lenders from credit bidding. In support of the proposed plans and bid procedures, the debtors asserted that although the plans did not meet Bankruptcy Code section 1129(b)(2)(A)(ii)'s requirement that the secured lenders have the right to credit bid, the plans did satisfy the "indubitable equivalent" requirement of Bankruptcy Code section 1129(b)(2)(A)(iii) and thus could be crammed down on the dissenting lenders. The lenders, on the other hand, objected to approval of the bid procedures and argued that the plans could not be confirmed unless they preserved the lenders' ability to credit bid. On July 22, 2010, the bankruptcy court delivered an oral ruling in favor of the lenders with respect to both plans and entered orders denying the proposed bid procedures. The debtors appealed directly to the Seventh Circuit.

The Seventh Circuit's Decision

The Seventh Circuit addressed two issues on appeal: (i) whether the appeal was mooted by the fact that the relevant asset purchase agreements had arguably expired during the pendency of the appeal; and (ii) whether the bankruptcy

¹ *River Road Hotel Partners, LLC v. Amalgamated Bank*, Nos. 09-30029, 09-30047 (7th Cir. June 28, 2011).

² 599 F.3d 298 (3d Cir. 2010).

³ The majority opinion issued by the Third Circuit is consistent with an earlier decision issued by the Fifth Circuit in *In re Pacific Lumber, Co.*, 584 F.3d 229 (5th Cir. 2009).



court correctly interpreted and applied section 1129(b)(2)(A). The Seventh Circuit quickly dispensed with the first issue, holding that even if the debtors were right that the asset purchase agreements had expired, the issue warranted adjudication because plans that provide for the sale of a debtor's assets typically incorporate short timelines. Accordingly, appellate courts would rarely, if ever, have an opportunity to review an order denying confirmation of any such plan. Moreover, the Seventh Circuit found it likely that the debtors before it would simply refile their proposed plans together with new asset purchase agreements, making the court's resolution of the issue relevant to all parties.

The Seventh Circuit then addressed the substance of the appeal—whether section 1129(b)(2)(A) enables a debtor to sell assets under a plan without granting secured lenders the right to credit bid. The court began its discussion by analyzing the statute itself. Section 1129(b)(2)(A) governs whether a plan is fair and equitable as to a debtor's secured lenders. A plan is fair and equitable if it satisfies either subsection (i), (ii) or (iii) of section 1129(b)(2)(A), although as discussed below the Seventh Circuit imposed limitations on which subsections may be applicable to a given plan. The two subsections relevant to the *River Road* court's analysis are (ii) and (iii). Subsection (ii) states that a plan is fair and equitable if it provides for the sale, subject to Bankruptcy Code section 363(k), of any property subject to a lien, with the lien to attach to the proceeds of the sale. Subsection (iii) provides more generally that a plan is fair and equitable if it provides secured lenders with the “indubitable equivalent” of their claims.

The *River Road* court found that although debtors typically sought to cram down secured lenders under subsection (ii), debtors were increasingly utilizing subsection (iii) to sell assets under a plan without abiding by Bankruptcy Code section 363(k), which permits parties to offset their secured claim against the purchase price of the encumbered assets. The court also found, however, that subsection (iii) was ambiguous as to whether it could be applied to any plan, regardless of whether the plan contemplated an asset sale. The court similarly concluded that the statute was not clear as to how the phrase “indubitable equivalent” was to be construed with respect to a secured lender's claim, referencing the difficulty inherent in determining the indubitable equivalent of an undersecured creditor's claim through an auction process in bankruptcy. Recognizing that its view diverged from that articulated by the majority in *Philadelphia News*, the *River Road* court instead cited Judge Ambro's dissenting opinion in *Philadelphia News* in support of its determination that the statute did not have a single plain meaning.

The *River Road* court next examined established principles of statutory interpretation as applied to section 1129(b)(2)(A). The court first considered whether the debtors' interpretation of section 1129(b)(2)(A) would render any other provisions of the Bankruptcy Code superfluous, and found that it would. The *River Road* court reasoned that if a debtor could circumvent the more stringent and specific requirements of subsections (i) and (ii) in favor of the less specific, more ambiguous language of subsection (iii), the first two subsections would be rendered meaningless. The proper interpretation of section 1129(b)(2)(A), as determined by the *River Road* court, was to read each subsection as containing the requirements for the plan it specifically addresses—i.e., subsection (ii) should be applied to plans that provide for the sale of assets. The *River Road* court then concluded that the debtors' interpretation was fundamentally at odds with the way secured lenders are otherwise treated under the Bankruptcy Code. In connection with this analysis, the court cited sections 363(k) and 1129(b)(2)(A)(ii), which provide a secured lender with the right to credit bid, and section 1111(b), which provides secured lenders with the ability to protect their claims if a debtor does not seek to sell the underlying asset. Based on its interpretation of the Bankruptcy Code and the interplay of the sections cited above, the *River Road* court affirmed the bankruptcy court's decision denying the debtors' proposed bid procedures.

Conclusion

The Seventh Circuit's decision, squarely at odds with opinions delivered by the Third Circuit and Fifth Circuit, creates substantial uncertainty as to whether other jurisdictions will allow a debtor to sell assets under a plan so long as the plan merely provides secured lenders with the “indubitable equivalent” of their claim. Although the Seventh Circuit's decision may dissuade debtors from proceeding under section 1129(b)(2)(A)(iii), the risk remains that debtors (particularly those in the Third and Fifth Circuits) will continue to propose plans that circumvent a secured lender's right to credit bid at any sale of its collateral. The Seventh Circuit's parting of ways with the earlier Circuit decisions renders the issue ripe for adjudication by the Supreme Court.

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