Seventh Circuit Affirms Secured Creditors' Right to Credit Bid in Sale of Collateral Under Cram-Down Plans in Split from Third Circuit Decision in *Philadelphia Newspapers*

In *In re River Road Hotel Partners, LLC*,[1] the United States Court of Appeals for the Seventh Circuit recently affirmed a lower court's decision not to confirm two "cram-down" plans of reorganization that provided for the sales of assets free and clear of secured creditors' liens with sale procedures that did not permit the secured creditors to "credit bid" their secured claims. At odds with the recent decision of the United States Court of Appeals for the Third Circuit in *Philadelphia Newspapers*,[2] the decision appears to be a victory for secured creditors. The debate regarding a secured creditor's right to credit bid in this context will continue, however, until the Supreme Court decides the issue.

I. Background on Bankruptcy Sales and Credit Bidding

Sales generally occur in one of two ways during a bankruptcy case: under Bankruptcy Code § 363 or pursuant to a plan of reorganization under Bankruptcy Code § 1123(b)(4).

Sales of a debtor's assets or property outside of the ordinary course of business, and not in the context of a plan, are governed by Bankruptcy Code § 363, which requires a justifiable business reason for the sale. Bankruptcy Code § 363(k) provides that, unless the court for cause orders otherwise, a secured creditor may "credit bid" at a non-plan "363 sale." Such a right enables a secured creditor to bid on the purchase of its collateral on a cashless basis up to the full amount of its secured claim. Specifically, if a secured creditor tenders the highest and best bid, it receives the collateral and reduces its claim against the debtor by the amount of its bid. The purpose of section 363(k) is to protect a secured creditor from any perceived undervaluation of its collateral.

A plan of reorganization, including one providing for the sale of assets, by contrast, must comply with Bankruptcy Code § 1123 and meet the requirements for confirmation set forth in Bankruptcy Code § 1129. In general, for a plan to be confirmable by a bankruptcy court, in addition to other technical legal requirements, it must receive votes to accept by a majority of creditors (holding at least two-thirds in amount of claims) actually voting in each impaired class, or it must satisfy the requirements for "cram down" under Bankruptcy Code § 1129(b) and be "fair and equitable" and not "unfairly discriminate" as to any class that does not accept the plan.

In the cram-down context, Bankruptcy Code § 1129(b)(2)(A) requires that, with respect to each class of secured claims, the plan provide:

> (i) (I) that the holders of such claims retain the liens securing such claims . . . to the extent of the allowed amount of such claims; and
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> (II) that each holder of a claim of such class receive on account of such claim deferred cash payments totaling at least the allowed amount of such claim, of a value . . . of at least the value of [its collateral];

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[1] *In re River Road Hotel Partners, LLC v. Amalgamated Bank*, Nos. 10-3597, 10-3598, 2011 WL 2547615 (7th Cir. June 28, 2011), available at http://www.ca7.uscourts.gov/tmp/9W0ZONUU.pdf.

[2] *In re Philadelphia Newspapers, LLP*, 599 F.3d 298 (3d Cir. 2010).

(ii) for the sale, subject to section 363(k) of this title, 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, and the treatment of such liens on proceeds under clause (i) or (iii) of this subparagraph; or

(iii) for the realization by such holders of the indubitable equivalent of such claims.

The question under these provisions is whether a plan providing for a sale of assets must comply with section 1129(b)(2)(A)(ii) and be subject to the right of secured creditors to credit bid on their collateral pursuant to section 363(k) or whether the plan could be confirmed, even in the absence of such right, if one of the other prongs of section 1129(b)(2)(A) is satisfied.

II. Third Circuit Decision in *Philadelphia Newspapers*

Last year, in *In re Philadelphia Newspapers*, the United States Court of Appeals for the Third Circuit permitted the debtors to proceed with bidding procedures for a sale of substantially all of their assets under their plan that denied secured creditors the right to credit bid. The majority opinion of the court emphasized that plan sales are governed by Bankruptcy Code § 1123, and not section 363, and noted that section 1123 does not incorporate section 363(k)'s requirements. As such, any right to credit bid required under Bankruptcy Code § 1129(b)(2)(A)(ii) is independent of (and could be alternatively satisfied by) the ability of a debtor to provide the indubitable equivalent to a dissenting class of secured creditors under Bankruptcy Code § 1129(b)(2)(A)(iii). Thus, the court concluded that a plan can include procedures for the sale of collateral without allowing the secured creditor to credit bid, so long as the secured creditor is provided other consideration determined to be essentially the same as the underlying secured claim, to be decided at plan confirmation (and not prior to the auction).

The proposed sale procedures in *Philadelphia Newspapers*, designed to favor an insider bidding group preferred by the debtors, set the value of the collateral at the cash amount paid by the winning bidder at the auction. Although the court approved these procedures, it did not decide whether receipt of that cash amount, if it was less than the secured claim, would actually be the indubitable equivalent when determining whether the plan could be confirmed. The objecting secured creditor ultimately prevailed at the auction with a cash bid (which presumably it would ultimately receive as the proceeds of its collateral), so the issue of whether the plan as proposed would have provided the indubitable equivalent of such secured claims was never litigated or decided.

In a dissenting opinion, Judge Ambro, a former bankruptcy practitioner, rejected the majority's reasoning and argued that any plan providing for the sale of collateral must specifically meet the requirements of section 1129(b)(2)(A)(ii) and afford secured creditors the right to credit bid on their collateral.

III. Facts of River Road Hotel Partners and RadLAX

River Road Hotel Partners, LLC, and related entities (collectively, the "River Road Debtors"), constructed the InterContinental Chicago O'Hare Hotel after obtaining a $155.5 million construction loan from Longview Ultra Construction Loan Investment Fund and the Longview Ultra I Construction Loan Investment Fund (together, the "River Road Lenders"). The River Road Debtors became unable to obtain necessary funding to pay general contractors and suppliers, and on August 17, 2009, they filed for Chapter 11 bankruptcy protection in the United States Bankruptcy Court for the Northern District of Illinois (the "Bankruptcy Court").

In 2007, RadLAX Gateway Hotel, LLC and its affiliates (collectively, the "RadLAX Debtors"), obtained a $142 million construction loan from the Longview Ultra Construction Loan Investment Fund (the "RadLAX

Lender") to purchase and renovate a hotel property near LAX airport. The RadLAX Debtors halted construction because of cost overruns that they were unable to negotiate additional funding to cover, and on the same day that the River Road Debtors filed for Chapter 11 protection, the RadLAX Debtors also commenced separate cases in the Bankruptcy Court.

Both the River Road Debtors and the RadLAX Debtors filed proposed plans of reorganization in the Bankruptcy Court on June 4, 2010, providing for the auction sales of substantially all of their assets free and clear of liens and the distribution of the proceeds thereof to their creditors. The River Road Debtors' and the RadLAX Debtors' proposed bidding procedures for conducting these auction sales did not allow The River Road Lenders and the RadLAX Lender to credit bid their secured claims at the auctions. The Debtors asserted that the bidding procedures were approvable, and the plans were confirmable, because they offered the potential for objecting secured creditors to obtain the indubitable equivalent of their secured claims by virtue of the cash received for the collateral after the auction process had been conducted, even though the underlying procedures did not permit credit bidding.

IV. Bankruptcy Court Decision in *River Road Hotel Partners* and *RadLAX*

The Bankruptcy Court found for the River Road Lenders and the RadLAX Lender, denying the Debtors' bidding procedures motions on October 5, 2010, and adopting the reasoning of the dissent in *Philadelphia Newspapers*. Specifically, the Bankruptcy Court held that Bankruptcy Code § 1129(b)(2)(A)(ii) provides the exclusive means to permit a cram-down sale free and clear of creditors' liens under a plan, and the general standard of Bankruptcy Code § 1129(b)(2)(A)(iii) cannot be used to circumvent the specific requirements of section 1129(b)(2)(A)(ii) as they pertain to plan sales.

V. Seventh Circuit Decision in *River Road Hotel Partners* and *RadLAX*

The United States Court of Appeals for the Seventh Circuit Court heard the subsequent, consolidated appeal of *River Road Hotel Partners* and *RadLAX* directly from the Bankruptcy Court. The Court of Appeals ultimately affirmed the Bankruptcy Court's holding that the proposed bid procedures violated the Bankruptcy Code (and thus the proposed plan was not confirmable) because they did not permit credit bidding.

First, the court examined the plain language of Bankruptcy Code § 1129(b)(2)(A) to determine whether it clearly authorized the confirmation of the River Road Debtors' and the RadLAX Debtors' plans, and it held that it did not. Specifically, in finding that the language of section 1129(b)(2)(a) was ambiguous, the court noted that, if the plain language of a statutory provision is unambiguous, then courts "enforce the statute in accordance with its plain meaning;" however, if there is more than one compelling interpretation of the language of a statute, then courts must look beyond the text of the statute to determine which interpretation to apply.[3] Because "there are two plausible interpretations of [section 1129(b)(2)(A)]: one that reads Subsection (iii) as having global applicability and one that reads it as having a much more limited scope"[4] the court held that the statute does not have a single plain meaning.

Then, in determining which interpretation of Bankruptcy Code § 1129(b)(2)(A) it should adopt, it concluded, "We cannot conceive of a reason why Congress would state that a plan must meet certain requirements if it provides for the sale of assets in particular ways and then immediately abandon these requirements in a

3 *In re River Road Hotel Partners,* 2011 WL 2547615, at *6.

4 *Id.* (citing *Philadelphia Newspapers*, 599 F.3d at 324-27 (Ambro, J., dissenting)).

subsequent subsection."[5] The court emphasized the legislative history in favor of limiting the applicability of Subsection (iii) to plans that propose treatment distinct from that already covered by Subsections (i) and (ii), and, looking to Bankruptcy Code §§ 363(k), 1111(b), and 1129(b)(2)(A)(ii), it noted that the Bankruptcy Code demonstrates "an expressed interest in insuring that secured creditors are properly compensated."[6]

Ultimately, the court applied what it considered the more plausible interpretation of the requirements of Bankruptcy Code § 1129(b) to find that a debtor proposing a cram-down plan to sell collateral of a secured creditor must provide that the secured creditor can credit bid its secured claim. Noting that the Bankruptcy Code tries to protect the rights of secured creditors in their collateral, the court concluded that cram-down plans for the sale of secured collateral must permit secured creditors to credit bid on their collateral.

VI. Practical Significance of the Decision

This decision favors the protection of secured creditors, especially with respect to their collateral. By limiting cram-down plans providing for a sale to the explicit requirements of Bankruptcy Code § 1129(b)(2)(A)(ii), the Court of Appeals for the Seventh Circuit, contrary to a prior holdings by the Court of Appeals for the Third Circuit, protected the rights of secured creditors to credit bid. Despite this holding, the status of this right to credit bid nonetheless remains uncertain. Indeed, this decision creates a split among the Circuits, ripening the issue for Supreme Court review.

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email Joel Levitin at 212.701.3770 or jlevitin@cahill.com; or Richard Stieglitz at 212.701.3393 or rstieglitz@cahill.com.

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5 *Id.* at *8.

6 *Id.* (citing *Philadelphia Newspapers*, 599 F.3d at 331 (Ambro, J., dissenting)).

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