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Bankruptcy Plan Sales

***Secured Lenders Do Not
Have an Absolute Right
To Credit Bid***

By Sam J. Alberts
and David Lee Tayman

In a decision that could have wide-ranging consequences for secured lenders and the distressed debt market, a divided U.S. Court of Appeals for the Third Circuit has held that secured creditors do not have an absolute right to credit bid the value of their loans in Chapter 11 plan-based sales of assets. The case, *In re Philadelphia Newspapers, LLC*, 599 F.3d 298 (3d Cir. Mar. 22, 2010), follows on the heels of a similarly decided ruling by the Fifth Circuit in *Bank of New York Trust Co., NA v. Official Unsecured Creditors' Committee (In re Pacific Lumber Co.)*, 584 F.3d 229 (5th Cir. 2009). Both courts held that notwithstanding Bankruptcy Code § 1129(b)(2)(A)(ii), which permits secured creditors the right to credit bid under a plan-based sale, a plan may alternatively permit the sale of the creditor's collateral under subsection 1129(b)(2)(A)(iii) without credit bidding protection if the secured creditor receives the "indubitable equivalent" of its claim under the plan. These are the only published circuit court decisions addressing this issue, and thus, absent a contrary ruling by the U.S. Supreme Court or revision of the Bankruptcy Code

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Pre-packaged Bankruptcies: A Faster Way to Emerge from a Bankruptcy Involving Leases?

By Michael P. Richman, Mark Salzberg and David G. Mayer

Many of the gigantic bankruptcies of 2009 did not follow the usual bankruptcy rules. In cases such as General Motors Corp. (Case No. 0950026), Chrysler LLC (Case No. 50002) and Calpine Corporation, exigent circumstances forced creditors to make a dramatic shift in the strategies previously used in Chapter 11 bankruptcy cases from preparing a plan of reorganization to making a fast sale of the bankruptcy estate assets under § 363 of the Bankruptcy Code.

Traditional Chapter 11 reorganizations have proven to be costly and disruptive for corporate debtors. Section 363 sales have largely supplanted traditional Chapter 11 reorganizations because they are faster and more cost efficient. Though not a new concept, parties have recently opted to pursue "pre-packaged" bankruptcy filings or "pre-packs."

PRE-PACKAGED BANKRUPTCY

The increased use of "pre-packaged" bankruptcy filings or "pre-packs" represents one of the most significant new trends in bankruptcy proceedings. In 2009, debtors filed more than 30 pre-pack cases, a 300% increase over 2008. See www.totalbankruptcy.com/blog/the-year-of-the-prepackaged-bankruptcy.

A traditional Chapter 11 bankruptcy filing and reorganization arises under Title 11, Chapter 11 of the U.S. Code, a federal law governing the substance and procedure of bankruptcies filed by or against the debtor. It is usually an extended restructuring of a company and its balance sheet. By contrast, a pre-pack is an expedited proceeding in which the parties negotiate as fully as possible the bankruptcy reorganization in advance of commencing the Chapter 11 case, which they effectuate through the Chapter 11 filing (subject to approval of the Bankruptcy Court).

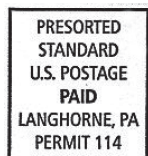
Debtors reorganize through such methods as:

- generating liquidity through the sale of assets;
 - reducing expenses by shedding executory contracts and unexpired leases;
- and

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- compromising claims through negotiations with claimants and other interested parties.

In most cases, the Bankruptcy Code requires as a condition precedent to effectuating a reorganization (including a pre-pack, where the essential terms may be agreed to by the parties prior to filing) that there be a court-approved disclosure statement and a plan of reorganization. Once a debtor completes a disclosure statement and plan, its creditors then vote for or against the plan. Voting is conducted by "class" of claims and interest, and approval requires an affirmative vote by claimants in each class holding at least 2/3 of the value and consisting of more than 1/2 of the number of creditors voting per class.

While sounding rather straightforward, this process often produces unpredictable delays as creditors not only fight among themselves for control and authority, but also battle with the debtor. Numerous horror stories litter the bankruptcy landscape as major bankruptcies have continued for the better part of a decade. For example, the UAL Corporation (United Airlines) bankruptcy lasted for three years; the Interstate Bakeries Corp./Hostess bankruptcy lasted for four and one-half years; and the Dow Corning bankruptcy lasted for nine years.

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (2005 Amendments) limited the lifespan of many bankruptcy cases by requiring that a plan of reorganization had to be filed no later than 18

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months from the petition date. Under prior law, courts could grant an unlimited number of extensions in time to file a plan for cause shown.

One of the benefits of pre-planning is that the parties can plan the reorganization completely prior to filing under Chapter 11, including obtaining creditor approval to a plan and disclosure statement (by soliciting creditor votes in advance). When the pre-planning succeeds, the Chapter 11 case can be filed and completed in as little as 60 to 90 days (and sometimes even faster).

That is the essence of a pre-packaged bankruptcy or "pre-pack." In this way, a company can reduce the amount of attorneys' fees incurred battling adversaries in court, avoid some of the U.S. Trustee's quarterly fees (by reducing the length of the case), bypass the lengthy notice and hearing requirements of motions before the court, and reduce numerous other expenses that are incurred in the typical Chapter 11 case. Moreover, the less time the debtor spends in bankruptcy, the less likely it will lose the intrinsic value of its business. Strategically, if a company moves rapidly through bankruptcy, it has a better chance to keep control of the bankruptcy proceeding.

Some commentators question the time and cost savings of the pre-pack process. Generally speaking, however, it would appear that there are material savings when most of the process is consensual rather than adversarial, and the parties do not resort to court hearings. See findarticles.com/p/articles/mi_m4130/is_n1_v24/ai_17330848/.

Analysts argue that while the parties incur less time and attorneys' fees during the actual bankruptcy proceeding, the parties still use significant time and pay high professional fees prior to the filing in the negotiations with creditors as part of the restructuring plan and associated activities. See www.ohiopracticalbusinesslaw.com/2008/12/articles/bankruptcy/how-prepackaged-bankruptcy-really-works/. Thus, they argue, both approaches to a bankruptcy filing cost the same in total time and fees.

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District Court Recognizes Texas Legislation in Overturning *Clark Contracting* Decision

By Michael D. Jewesson

As reported in the September 2009 edition of *LJN's Equipment Leasing Newsletter* ("Texas Legislature Passes Certificate of Title Bill Negating Effect of *Clark Contracting* Decision," Michael D. Jewesson), Senate Bill 1592, S.B.1592, 81st Leg., Reg. Sess. (Tex. 2009) ("SB1592") was signed into law by Texas Gov. Rick Perry on June 19, 2009, thereby negating a decision handed down by a bankruptcy court in the Western District of Texas in late 2008 relating to the perfected status of an assignee lender on a loan purportedly secured by six equipment trucks. *Clark Contracting Serv., Inc. v. Wells Fargo Equip. Fin. (In re Clark Contracting Serv., Inc.)* 399 B.R. 789 (Bankr. W.D. Tex. 2008).

In *Clark Contracting*, the lender, Wells Fargo, in accordance with standard industry practice, did not apply for new certificates of title to reflect itself as the new lienholder after CIT (the original lender) assigned the loan and the related lien in the trucks to Wells Fargo. Instead, Wells Fargo relied on permissive language in the Texas Certificate of Title Act ("TCTA") (TEX. TRANSP. CODE ANN. §§ 501.001-501.159 (2007)) and commentary to Chapter 9 of the Texas Uniform Commercial Code that indicated that re-titling in such circumstances was not necessary to transfer the perfected status of the assignor lienholder to its assignee. The implications

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of the bankruptcy court's decision to render Wells Fargo unperfected extended far beyond the parties to the *Clark Contracting* case to cast doubt upon the perfected status of other secured parties in Texas motor vehicles and other titled assets that did not customarily re-title upon assignment.

Fortunately, the Texas legislature was in session when the *Clark Contracting* decision became known to leasing and securitization participants and SB1592 was quickly drafted, debated, and passed. In the year since SB1592 was under consideration by the Texas legislature,

The district court's reasoning was similar to that of the Indiana and Arkansas courts ...

copycat cases challenging statutes governing perfection in motor vehicles were heard in both Arkansas and Indiana. See *In re Johnson*, 2009 WL 1863219 (Bankr. E.D. Ark. 2009) and *In re Scott*, 2010 WL 933896 (Bankr. S.D. Ind. 2010). In each case, the conclusions reached by the Texas bankruptcy court were unequivocally rejected, resulting in judicial recognition of standard industry practice in those states and assuring assignee lienholders that their perfected status was not affected by opting not to re-title.

A CLARIFICATION OF EXISTING LAW

While SB1592 clearly had the prospective effect of giving comfort to assignees of liens that took their assignments after the effective date of that legislation, it was not until the original *Clark Contracting* decision was reviewed by a federal district court on appeal that assignee lienholders taking assignment of liens prior to the effective date of SB1592 could be assured that the perfected status of their liens would be recognized by Texas courts. On April 14, 2010, the federal district court reviewing the *Clark Contracting* decision overturned the bankruptcy court and gave effect to the lan-

guage in SB1592 that indicated that the legislation was a clarification of existing law rather than a change to the law. *Clark Contracting Serv., Inc. v. Wells Fargo Equip. Fin. (In re Clark Contracting Serv., Inc.)*, Ch. 7 Case No. 08-50046-LMC, Adv. No. 09-726-FB (W.D. Tex. Apr. 14, 2010). The intended effect of the clarification language in SB1592 was to avoid the possibility that a Texas court (such as the district court reviewing the *Clark Contracting* decision) would view any application of SB1592 to pre-effective-date assignments as a retroactive application of the law, which is generally not permitted under Texas and most other states' laws.

The district court found grounds for overturning the *Clark Contracting* decision, thereby reinstating Wells Fargo's perfected status, solely as a result of the enactment of SB1592 into law, but went on to assail the bankruptcy court's reasoning in the original opinion. The district court's reasoning was similar to that of the Indiana and Arkansas courts and what industry practitioners have opined upon for years; if the certificate of title law does not address the perfected status of assignee lienholders, the principles of § 9-310(c) of the Uniform Commercial Code, that an assignee of a perfected security interest need not file an assignment of the assignor's financing statement to enjoy the perfected status of the assignor as against creditors of and transferees from the original debtor, should apply. It remains to be seen whether three defeats in three attempts by debtors to upset this long-settled practice will be enough to dissuade additional challenges in other states that don't have certificate of title statutes that clearly protect the perfected status of assignees.



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WHEN A COMPANY SHOULD RESORT TO A PRE-PACK OR PRE-NEGOTIATED PLAN

The pre-pack process begs the question why a distressed company needs Chapter 11. Why not effectuate a complete out-of-court restructuring and avoid Chapter 11 altogether? The answer is that with a pre-pack a company can avail itself of the many bankruptcy protections and rights not present in an out-of-court-restructuring. A court-approved pre-pack plan has the same legally binding effect as any traditional plan confirmation in a traditional reorganization process. In addition, debtors can benefit from the automatic stay to halt ongoing litigation or other detrimental proceedings.

“Prearranged” or “pre-negotiated” plans appear to be similar to pre-packs, but differ in significant ways. Under prearranged plans, the company and its major constituencies negotiate the terms of the final plan before the debtor files its petition in bankruptcy (pre-petition). Once submitted, the parties then typically execute a plan support agreement.

The plan of reorganization and disclosure statement are filed at the outset of the case, oftentimes before a committee of unsecured creditors is formed, but without the pre-petition solicitation of votes that is the hallmark of the pre-pack. Instead, that process takes place after the Chapter 11 is commenced. It may add somewhat to the duration of what would otherwise have been a pre-pack, yet still travels through the bankruptcy court very quickly. However, companies using pre-negotiated plans should be aware of some pitfalls not usually present with pre-packs. For example, on June 15, 2009, Six Flags, Inc. entered Chapter 11 with a pre-negotiated bankruptcy, expecting to quickly emerge. But it did not have the support of its bondholders who forced Six Flags to scrap its originally proposed reorganization in favor of a new modified plan.

Court approval of a pre-pack plan depends on meeting Bankruptcy Code standards designed to guard against a circumvention of the bankruptcy process. *See* 11 U.S.C. § 1126(b); Fed. R. Bankr. P. 3018(b). Under § 1126(b), votes made on a pre-pack plan prior to bankruptcy will be invalid unless one of two requirements is met. First, the plan disclosure and solicitation must be in compliance with any applicable non-bankruptcy disclosure laws, like securities regulations for example. This requirement can often impose a greater burden than what is typically required in bankruptcy, as 11 U.S.C. § 1125(d) specifically exempts traditional bankruptcy plan disclosure statements from complying with securities law disclosure requirements. Second, if there are no applicable non-bankruptcy disclosure laws, then the pre-pack disclosure and solicitation must comply with the traditional bankruptcy disclosure requirements under 11 U.S.C. § 1125(a).

In addition to the determination of the adequacy of the disclosure and solicitation, Rule 3018(b) of the Federal Rules of Bankruptcy Procedure imposes a notice and timing requirement for the pre-bankruptcy solicitation of votes. Pre-pack votes will be disqualified if a court finds that the plan was not “transmitted to all creditors and equity holders of the same class” or if “an unreasonably short time” was given for the voting. Bankruptcy courts will carefully scrutinize the pre-petition solicitation of a pre-packaged Chapter 11 plan of reorganization to ensure that substantially all creditors affected by the plan receive notice.

While pre-packs are often more predictable and efficient than traditional Chapter 11 bankruptcy, the requirements imposed on pre-packs still add uncertainty to the process. There have been cases where the disclosure and timing objections of dissenting creditors have derailed the pre-pack process. *See In re Southland Corp.*, 124 B.R. 211 (Bankr. N.D. Tex. 1991). Consequently, debtors should prepare a detailed disclosure and plan ma-

terials, and provide creditors with enough time for the proper review and acceptance of such a plan.

A company would be remiss in its bankruptcy planning if the pre-pack’s legal requirements were the only hurdle considered. A company must also consider the pragmatic requisites like generating the consensus necessary for the approval of a pre-pack plan. This is a non-trivial task, and coordinating various creditors becomes significantly more challenging as parties with divergent interests are added to the mix.

In addition, companies run the risk of alerting creditors to an impending bankruptcy. Aggressive creditors may push a distressed company into an involuntary bankruptcy, may initiate actions against the board of directors for breach of fiduciary duty, or may take other adverse actions in the absence of an automatic stay. This action leads many bankruptcy attorneys to conclude that pre-packs are most appropriate for companies with a predictable voting body: one that is made up of a smaller, finite, and sophisticated set of creditors and equity holders.

TRAPS FOR THE UNWARY WHEN CONSIDERING THE USE OF PRE-PACKS

Pre-packaged bankruptcies work best where the debtor has a limited number of secured creditors and unsecured creditors with varying claims. As part of the process, proponents of a pre-packaged plan should use extreme care to ensure that it satisfies the disclosure and solicitation requirements under applicable non-bankruptcy disclosure laws. If applicable non-bankruptcy disclosure laws place too heavy a burden on the debtor, a debtor may consider proceeding with the traditional Chapter 11 filing. Specifically, the plan must be transmitted to all creditors and equity holders of the same class, and a reasonable time must be given to creditors and equity holders to vote on the proposed plan.

Proponents of a pre-packaged plan should also be aware of defensive

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actions that dissatisfied creditors and equity holders can take during the solicitation process, especially the institution of an involuntary petition. To manage this risk factor, proponents of a prearranged plan should ensure that the plan has support from those parties whose consent is necessary for confirmation. The support should be confirmed, if at all possible, through a plan support agreement. In other words, a debtor should avoid finding out post-petition, for the first time, that its major constituencies do not support the plan.

TREATMENT OF UNEXPIRED LEASES IN SALES UNDER 11 U.S.C. § 363

In some instances, a pre-packaged plan may include a sale of assets under 11 U.S.C. § 363(b). As part of such a sale, the debtor may seek to assume unexpired leases (meaning to legally take over the obligations subject to the lease terms), and to assign those leases to the purchaser under the provisions of 11 U.S.C. § 365. The sale of a debtor's assets under 11 U.S.C. § 363(b) can, therefore, have a substantial impact upon the debtor's unexpired leases and the non-debtor parties to those leases.

Before the debtor can assume and assign an expired lease, the debtor must satisfy three requirements. First, the debtor must cure, or provide adequate assurance that it will promptly cure, all monetary defaults under the lease. Thus, a lessor whose lease is assumed in a sale may have a significant benefit over other unsecured creditors; Second, the debtor must compensate, or provide adequate assurance that it will promptly compensate, the non-debtor party for any actual pecuniary loss resulting from any default under the lease; Third, the debtor must provide adequate assurance of future performance under the lease. See 11 U.S.C. § 365(b)(1)(A). Debtors will typically serve notices identifying the leases to be assumed and assigned and the amount necessary

to cure any monetary defaults. The notice will provide a deadline by which objections to the proposed assumption and assignment of the leases must be filed. The failure to timely object will preclude the non-debtor parties from raising any objection to the assumption and assignment of the leases, including the cure amount.

A sale under 11 U.S.C. § 363(b) will fix the rights of non-debtor parties to unexpired leases. Furthermore, non-debtor parties to such leases will typically have only a brief time in which they can review the proposed assumption and assignment and assert their rights. Therefore, it is crucial that these non-debtor parties take the appropriate action once they learn of a bankruptcy filing involving a sale under 11 U.S.C. § 363(b), or preferably, before a filing is actually made. These actions include the following:

- A lease that expired or was properly terminated prior to a bankruptcy filing is not resurrected by the filing and cannot be assumed and assigned. Non-debtor parties should therefore regularly review their contracts and leases to determine if any should be terminated or allowed to expire by their terms.
- Non-debtor parties to leases must closely monitor the bankruptcy case from the outset, particularly with respect to the debtor's proposed assumption and assignment of leases and the associated objection deadlines.
- The cure amount proposed by the debtor must be reviewed to ensure that it is correct as of the date of the proposed assumption of the lease, not the date that notice was served.
- It is the debtor's burden to provide adequate assurance of future performance under the lease. Therefore, non-debtor parties to leases should review the financial ability of the proposed pur-

chaser to perform under the lease and should timely assert any objections. Note that the sale procedures typically provide that objections concerning the ability of a successful bidder, other than the stalking-horse bidder, to provide adequate future performance, can be raised at the hearing to approve the sale since the successful bidder's identity will not be known prior to the objection deadline.

CONCLUSION

The rocky economic environment since 2008 has lent itself to a rise in pre-pack bankruptcies, adding new flavors of risk, uncertainty, and unpredictability for debtors facing a process under Chapter 11. Debtor-in-possession or DIP financing, the monetary lifeblood necessary to sustain a debtor through the bankruptcy process, has all but dried up since the latter part of 2008 and is still showing little signs of life today. The only entities typically able or willing to supply DIP financing are the captive lenders already invested in the debtor. On the other hand, the dramatic rise in distressed companies has pushed trade creditors to the bargaining table as they grow ever-reluctant to see the demise of their largest customers.

Many creditors today would rather come to a consensual agreement than take their chances battling it out in the bankruptcy courtroom. These concerns have led to a common desire for all parties to exert as much control and ensure the highest degree of certainty over the bankruptcy process. Traditional Chapter 11 proceedings lack those features, forcing realistic parties to join forces and pursue pre-packaged and prearranged bankruptcies for the benefit of all concerned.



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by Congress, these cases may have an impact not only within the Third and Fifth Circuits but also throughout the United States. In fact, anecdotal evidence suggests that secured creditors are already seeking entry of cash collateral orders that require any plan-based sale to be conducted under subsection 1129(b)(2)(A) (ii) rather than subsection (iii). The extent to which such orders are enforceable and curative of the secured creditors' concerns remains to be seen.

THE SIGNIFICANCE OF CREDIT BIDDING

The ability of a secured creditor to credit bid its total loan amount at auction and to "buy" its collateral is an important and well-recognized tool in a secured creditor's toolbox. This remedy is typically viewed as a trump card available to a secured creditor to protect itself from an insufficient bid. Credit bidding is also an oft-cited rationale and exit strategy for distressed investing — an investor may acquire a distressed loan with the primary goal of foreclosing outside of bankruptcy or by acquiring the assets through credit bidding in bankruptcy. While credit bidding outside of a plan under Bankruptcy Code § 363(k) has always been subject to possible limitations or restrictions based upon "cause," the *Philadelphia Newspapers* and *Pacific Lumber* decisions

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weigh into an issue that has divided bankruptcy courts: whether a plan-based sale (as opposed to a § 363 sale) may be structured to prevent a secured creditor from credit bidding on its collateral. The answer, at least within the Fifth and Third Circuits, is yes.

CASE BACKGROUND AND THE LOWER COURT RULINGS

Philadelphia Newspapers, LLC and its related entities ("Philadelphia Newspapers") own and operate publications including *The Philadelphia Inquirer* and the *Philadelphia Daily News*. These assets were acquired in July 2006 for \$515 million, \$295 million of which came from a consortium of lenders (the "Lenders") who were given a first priority lien in substantially all of Philadelphia Newspapers' real and personal property. After work-out negotiations with the Lenders fell apart, Philadelphia Newspapers filed their Chapter 11 bankruptcy cases in February 2009. In August 2009, the debtors filed a joint Chapter 11 plan that proposed a sale of substantially all assets free and clear of liens at a public auction. Simultaneously, the debtors signed an asset purchase agreement with a stalking-horse bidder. Equity owners and former equity owners of Philadelphia Newspapers held a majority ownership interest in the stalking-horse. Under the proposed plan, the asset sale would generate \$37 million in cash for the Lenders, and the Lenders would receive Philadelphia Newspapers' headquarters subject to a two-year, rent-free lease to the entity that operates the newspapers. The plan also proposed that the Lenders receive any cash generated by a higher bid at the public auction.

The debtors sought to preclude the Lenders from credit bidding at the auction sale in the bidding procedures motion. This provision was objected to by the Lenders, the Unsecured Creditors' Committee, the Office of the U.S. Trustee, and the Pension Benefit Guaranty Corporation, among others. The bankruptcy court upheld the Lenders' objection,

entered an order permitting the Lenders to credit bid, and subsequently entered an order approving revised bid procedures that specifically allowed the Lenders to bid the full value of their secured debt as of the petition date. This ruling was appealed to the district court.

The district court reversed the bankruptcy court. In doing so, the district court relied on what it viewed as the plain language of Bankruptcy Code § 1129(b)(2)(A), and held that the Lenders were not entitled to credit bid if the proposed sale was being conducted under subsection (iii) rather than (ii). The district court further ruled that because the plan proposed to give the Lenders the "indubitable equivalent" of their secured interest, the treatment of the Lenders' claims was "fair and equitable" for purposes of confirmation. The Lenders appealed the district court's ruling to the Third Circuit.

THE THIRD CIRCUIT AFFIRMS

The Third Circuit affirmed the district court. The court began its analysis by looking at the language of the Bankruptcy Code, specifically § 1123(b)(2). After noting that the "plan sale" authorized by § 1123(a)(5)(D) does not contain explicit procedures for the sale of assets that secure debts of the bankruptcy estate, the court looked to the language of the Bankruptcy Code § 1129(b) to determine what requirements would have to be satisfied in order to confirm a plan, including a plan providing for an asset sale. In particular, the court looked to the standard that must be met for a plan to be found fair and equitable to secured creditors under § 1129(b)(2)(A).

Section 1129(b)(2)(A) provides that with respect to a class of secured claims, a plan must provide:

- (i) (I) that the holders of such claims retain the liens securing such claims, whether the property subject to such liens is retained by the debtor or transferred to another entity, to the extent of the allowed amount of

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such claims; and (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, as of the effective date of the plan, of at least the value of such holder's interest in the estate's interest in such property;

(ii) for the sale, subject to section 363(k) of [the Bankruptcy Code], 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.

11 U.S.C. § 1129(b)(2)(A).

The court recognized that a sale conducted under subsection 1129(b)(2)(A)(ii) provides secured creditors with the right to credit bid by reference to § 363(k). The court focused on the disjunctive “or” in the statute, and held that this use of the disjunctive operates to provide alternatives. Thus, a debtor may conduct a sale under subsection (ii), which provides for a credit bid, but also subsection (iii), which does not provide for credit bidding but rather requires that the secured creditor receives the indubitable equivalent of its claims.

The Lenders, relying on a traditional canon of statutory interpretation — that the specific term prevails over the general — argued that a plan calling for a sale of assets free and clear of liens must comply with the requirements of subsection (ii) and include a secured creditor's right to credit bid; that is, a plan sale cannot also be conducted under subsection (iii). The court rejected this argument as applicable only if the specificity of subsection (ii) operates as a limitation on the

broader language in subsection (iii), which the court found not to be the case. According to the Third Circuit, Congress' inclusion of the indubitable equivalence option intentionally left open the potential for other methods of conducting asset sales, so long as those methods sufficiently protected the secured creditor's interests.

After holding that § 1129(b)(2)(A)(iii) excludes a secured creditor's right to credit bid, the court discussed the meaning of “indubitable equivalence.” The court found that indubitable equivalence in this instance means “the unquestionable value of a lender's secured interest in the collateral.” That is, the scope of indubitable equivalence under § 1129(b)(2)(A)(iii) is circumscribed by the same principle that underlies subsections (i) and (ii) — the protection of a fair return to secured lenders. The Third Circuit also recognized that a debtor may give a secured lender the indubitable equivalent of its claim in different ways, including through a cash payout, the exchange of collateral, abandonment of the collateral to the secured creditor, and a replacement lien on similar collateral. The court noted that even though § 1129(b)(2)(A)(iii) excludes a secured creditor's right to credit bid, the secured creditor may argue that the restriction on credit bidding failed to generate fair market value at the auction sale and thereby prevented the secured creditor from receiving the indubitable equivalent of its claim.

THE DISSENT

Third Circuit Judge Thomas L. Ambro, a former bankruptcy practitioner, wrote a lengthy dissenting opinion in which he disagreed with the majority's fundamental conclusion that § 1129(b)(2)(A) is unambiguous. Judge Ambro opined that § 1129(b)(2)(A) is ambiguous and is susceptible to more than one reasonable reading. As such, it must be interpreted in the context of the entire Bankruptcy Code, the legislative history, “and the comments of Code drafters.” Judge Ambro concluded that consideration of all of these

sources leads to the conclusion that the Bankruptcy Code requires cram-down plan sales free of liens to fall under subsection 1129(b)(2)(A)(ii) rather than under the “general” requirement of subsection (iii). Judge Ambro's dissent also addressed the right to credit bid in the context of the broader market. According to Judge Ambro, secured creditors have lawfully bargained pre-bankruptcy for unequal treatment, and the right to credit bid is an important “consequence” of this lawful bargaining. In his view, the majority opinion increases the potential for a secured creditor to lose its right to credit bid and thus potentially “uproots settled expectations.” Judge Ambro finally predicts that this will result in secured creditors adjusting their pricing to account for the new risks — potentially raising interest rates or reducing credit availability.

THE IMPORT OF THESE DECISIONS

The *Philadelphia Newspapers* decision follows closely on the heels of the Fifth Circuit's decision in *Pacific Lumber*. Based on very similar analysis, the Fifth Circuit held that a plan involving a sale of noteholders' collateral free and clear of their liens, but which denied the noteholders the right to credit bid, could be confirmed under the indubitable equivalent prong of § 1129(b)(2)(A)(iii). Additionally, while not having the same wide-ranging effects as the *Philadelphia Newspapers* and *Pacific Lumber* cases, the U.S. Bankruptcy Court for the District of Maryland had previously issued an opinion holding that a plan providing for an asset sale could be confirmable under § 1129(b)(2)(A)(iii) even if it does not afford a secured creditor the right to credit bid the value of its loan on the auction sale of its collateral. *In re Crimi Mae, Inc.*, 251 B.R. 796 (Bankr. D. Md. 2000).

These decisions make it the law of the land — at least within the Third and Fifth Circuits — that an asset sale under a bankruptcy plan need not provide a secured creditor

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IN THE MARKETPLACE

The **U.S. Supreme Court** has denied Textron's petition for writ of certiorari in *Textron Inc. v. United States*, U.S., No. 09-750, (cert. denied 5/24/10). The controversial en banc decision by the U.S. Court of Appeals for the First Circuit, as analyzed in the November 2009 issue of this newsletter, held that a corporate taxpayer could not shield from disclosure so-called "tax accrual workpapers." These documents, typically prepared by in-house tax attorneys, set out in detail sensitive areas of tax liability. In this case, the IRS had sought the tax accrual workpapers as part of an investigation into Textron's alleged use of an illegal "sale-in, lease-out" transaction. The sharply divided First Circuit (3-2) concluded that provisions of the federal securities law, in conjunction with prevailing accounting and auditing standards, made the creation of the tax accrual workpapers inevitable. Because the spreadsheets sought by the IRS were not the kind of

documents attorneys typically prepared when faced with the prospect or the reality of litigation, they were not entitled to work product protection.

The Alta Group has launched a practice focused on helping the \$600 billion equipment finance industry cope with the upcoming changes to the lease accounting rules. Headed by **Shawn Halladay**, an Alta principal, the division will focus on accounting compliance and implementation. To date, there has not been much information released on the new rules, which are being proposed by both the Financial Accounting Standards Board ("FASB") and the International Accounting Standards Board, but it is clear that equipment leasing companies will need to adjust their current business and accounting practices. Alta's new division will help clients understand the new lease accounting rules, design customer strategies, develop appropriate business

processes, maximize revenue recognition, and assess and implement needed system changes.

Foley & Lardner LLP has named **Ralph P. Dudziak** as a partner in the Finance & Financial Institutions Practice Group and the Energy Industry Team in the firm's Chicago office. Dudziak brings extensive experience in a wide array of transactional work, with a focus on lease financing. He advises clients on domestic and cross-border lease and leasehold financings, single investor lease financings, leveraged leases, synthetic leases, and operating leases. In addition, Dudziak has worked extensively in complex equipment-based finance, including aircraft and rolling stock financings, power generation and transmission equipment financings, and manufacturing equipment financings. Prior to joining Foley, Dudziak was a partner at DLA Piper.



Credit Bid

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with the right to credit bid its claim. Importantly, these courts are well-respected, and their decisions will be influential to other courts deciding whether to confirm Chapter 11 plans proposing asset sales and simultaneously restricting the secured creditors' rights to credit bid.

These decisions are important; in fact, they may be game changers in many bankruptcy cases and could affect investment decisions and interests in the distressed debt market. In bankruptcy cases, these decisions will shift some power (at least in the Fifth and Third Circuits) from secured creditors to debtors and other parties by denying secured creditors the presumptive right

to credit bid in certain plan-based sales. These cases may encourage other bidders who might otherwise have opted not to bid against a secured creditor and will undoubtedly lead to disputes and a new body of decisions on what does and does not constitute indubitable equivalence. All of this appears to give debtors leverage to restructure and/or cramdown secured debt.

Secured creditors also may seek to fight back, for example, by restricting or conditioning the use of cash collateral or other assets to better protect their position. Anecdotal evidence from recent Chapter 11 cases suggests that sophisticated secured lenders are already seeking to do so in bankruptcy courts within the Third Circuit. Secured creditors may seek to force debtors to sell as-

sets early in cases under a § 363 sale rather than waiting for the plan confirmation process because although § 363 recognizes limitations on credit bidding "for cause," the "for cause" limitation may be more difficult for a debtor to establish than establishing indubitable equivalence during plan confirmation. Also, these rulings may affect the distressed debt market well beyond the Fifth and Third Circuits in the ways Judge Ambro contemplated — by causing buyers of distressed secured debt to rethink pricing and exit options. Those who buy secured debt with a goal of acquiring the underlying assets or company should be particularly mindful of these added risks.



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