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### Extra! Extra!: Philadelphia Newspapers Jeopardizes Credit Bidding

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## **EXTRA! EXTRA!: PHILADELPHIA NEWSPAPERS JEOPARDIZES CREDIT BIDDING**

### INTRODUCTION

Secured creditors have generally enjoyed the opportunity to credit bid at the public auction of their collateral during bankruptcy proceedings. Recently, however, the Third and Fifth Circuits have authorized unprecedented cramdown plans that allow sales of collateral free and clear of liens to be authorized under § 1129(b)(2)(A)(iii) of the Bankruptcy Code.<sup>1</sup> Consequently, they have permitted secured creditors' once powerful credit bidding rights, granted in § 1129(b)(2)(A)(ii), to be circumvented.

#### *A. Facts of In re Philadelphia Newspapers*

Philadelphia Newspapers, LLC, the former owner and operator of several Philadelphia print and online publications, including the *Philadelphia Inquirer*, *Philadelphia Daily News*, and *Philly.com*, filed a voluntary chapter 11 petition in February 2009.<sup>2</sup> At the time of filing, the debtor owed its senior lenders \$295 million, a value that increased to \$318 million during the course of the bankruptcy proceedings.<sup>3</sup> The senior lenders held first priority liens on substantially all of the debtor's real and personal property.<sup>4</sup> In June 2009, PMH Holdings, LLC, Philadelphia Newspapers, LLC's parent company, also filed a voluntary chapter 11 petition.<sup>5</sup>

Philadelphia Newspapers, LLC and PMH Holdings, LLC proposed a plan of reorganization in August 2009 that contemplated selling substantially all of their assets free and clear of all liens and surrendering their headquarters building.<sup>6</sup> The debtors also entered into an asset purchase agreement with a stalking horse bidder, composed of some of the debtors' prepetition equity

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<sup>1</sup> 11 U.S.C. § 1129(B)(2)(A)(iii) (2006).

<sup>2</sup> Voluntary Petition at 1, *In re Phila. Newspapers, LLC*, No. 09-11204SR, 2009 WL 3242292 (Bankr. E.D. Pa. Feb. 22, 2009); *see also In re Phila. Newspapers, LLC*, 599 F.3d 298, 301 n.1 (3d Cir. 2010), *aff'g* 418 B.R. 548 (E.D. Pa. 2009).

<sup>3</sup> *In re Phila. Newspapers*, 599 F.3d at 301.

<sup>4</sup> *Id.*

<sup>5</sup> *Id.*

<sup>6</sup> *Id.* at 301-02.

holders.<sup>7</sup> Under the debtors' proposed plan, following a successful stalking horse bid, the senior lenders would only receive approximately \$36 million of their \$295 million claim.<sup>8</sup> Surprisingly, as the Bankruptcy Court for the Eastern District of Pennsylvania noted, these facts and circumstances are mundane:

To this extent the circumstances presented are unremarkable. Indeed, it has become increasingly common for [c]hapter 11 debtors to proceed in precisely the fashion the instant Debtors do. Often such proceedings are consensual. The present cases are distinguishable, however, in the degree of animosity that exists between the Debtors and their creditors. It is, regrettably, quite high.<sup>9</sup>

Pursuant to their plan, the debtors filed a motion for approval of their proposed bid procedures<sup>10</sup> that would preclude secured lenders from "credit bidding,"<sup>11</sup> at the public auction. It did this by requiring all bidders to fund their purchases with cash.<sup>12</sup> To justify this result, the debtors suggested a reading of the Bankruptcy Code that circumvented the secured creditors' express right to credit bid articulated in § 1129(b)(2)(A)(ii). The debtors proposed that the three provisions in § 1129(b)(2)(A) should be interpreted as disjunctive alternatives. Accordingly, the sale of the secured creditors' collateral could be

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<sup>7</sup> *Id.* at 301. A "stalking horse bidder" is "a prospective buyer who commits to an initial [minimum] bid" at a chapter 11 asset sale. 3 COLLIER ON BANKRUPTCY ¶ 363.02[7] (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2011). The stalking horse bidder for this public auction included insiders who owned a substantial share in PMH Holdings, LLC. See *In re Phila. Newspapers*, 599 F.3d at 301.

<sup>8</sup> *In re Phila. Newspapers, LLC*, 418 B.R. 548, 554 (E.D. Pa. 2009), *rev'g* No. 09-11204SR, 2009 WL 3242292 (Bankr. E.D. Pa. Oct. 8, 2009), *aff'd*, 599 F.3d 298.

<sup>9</sup> *In re Phila. Newspapers*, 2009 WL 3242292, at \*1, *rev'd*, 418 B.R. 548, *aff'd*, 599 F.3d 298.

<sup>10</sup> See Debtors' Motion for an Order: (A) Approving Procedures for the Sale of Certain of the Debtors' Assets; (B) Scheduling an Auction; (C) Approving Assumption and Assignment Procedures; (D) Approving Form of Notice; and (E) Granting Related Relief at 9, 15–18, *In re Phila. Newspapers, LLC*, No. 09-11204SR, 2009 WL 3242292 (Bankr. E.D. Pa. Aug. 28, 2009) [hereinafter Debtors' Motion for an Order Approving Sale Procedures].

<sup>11</sup> *In re Phila. Newspapers*, 599 F.3d at 302 n.4 ("A credit bid allows a secured lender to bid its debt in lieu of cash."); see also *infra* pp. 15–16.

<sup>12</sup> *In re Phila. Newspapers*, 599 F.3d at 302. The debtors' motion expressly sought to prohibit credit bidding:

**Credit Bid:** The Plan Sale is being conducted under [§§] 1123(a) and (b) and 1129 of the Bankruptcy Code, and not [§] 363 of the Bankruptcy Code. As such, no holder of a lien on any assets of the Debtors shall be permitted to credit bid pursuant to [§] 363(k) of the Bankruptcy Code.

Debtors' Motion for an Order Approving Sale Procedures, *supra* note 10, at 9; see also *In re Phila. Newspapers*, 2009 WL 3242292, at \*2.

crammed down under § 1129(b)(2)(A)(iii) as an alternative to § 1129(b)(2)(A)(ii), as long as the § 1129(b)(2)(A)(iii) requirement that creditors receive the “indubitable equivalent” of the value of their collateral was satisfied.<sup>13</sup>

The secured lenders objected to the proposed bid procedures, arguing that § 1129(b)(2)(A) must be interpreted to protect secured creditors’ absolute right to credit bid.<sup>14</sup> The bankruptcy court agreed with the secured lenders and denied the debtors’ motion for approval of the bid procedures.<sup>15</sup> The bankruptcy court “reasoned that while the Plan proceeded under the ‘indubitable equivalent’ prong of § 1129(b)(2)(A)(iii), it was structured as a § 1129(b)(2)(A)(ii) plan sale in every respect other than credit bidding,” and the court “determined that any sale of the Debtors’ assets required that a secured lender be able to participate in a sale by credit bidding its debt.”<sup>16</sup> Thus, under the bankruptcy court’s opinion, the lenders would be permitted to credit bid up to \$318 million at the auction sale of their collateral, receiving more value than they would otherwise under the debtors’ proposed bidding procedures.

On appeal, the District Court for the Eastern District of Pennsylvania reversed the bankruptcy court’s ruling, thereby precluding the secured lenders

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<sup>13</sup> *In re Phila. Newspapers*, 2009 WL 3242292, at \*3. As the bankruptcy court summarized,

The Debtors maintain that the language of the Bankruptcy Code sections they point to is clear, and that the same unambiguously confirms . . . that even if § 363 applies in the instance where cramdown confirmation of a reorganization plan is sought under 11 U.S.C. § 1129(b)(2)(A)(ii), it is still inapplicable to the instant facts, because the Debtors do not intend to request confirmation of their Plan under § 1129(b)(2)(A)(ii), but instead intend to demonstrate that their plan provides the Lenders with the “indubitable equivalent” of their claims, thus independently entitling their Plan to confirmation under § 1129(b)(2)(A)(iii).

*Id.*

<sup>14</sup> Objection of the Steering Group of Prepetition Secured Lenders and Citizens Bank of Pennsylvania, as Agent for the Prepetition Secured Lenders, to Debtors’ Motion for an Order: (A) Approving Procedures for the Sale of Certain of the Debtors’ Assets; (B) Scheduling an Auction; (C) Approving Assumption and Assignment Procedures; (D) Approving Form of Notice; and (E) Granting Related Relief at 10, *In re Phila. Newspapers, LLC*, No. 09-11204SR, 2009 WL 3242292 (Bankr. E.D. Pa. Sept. 18, 2009); *see also In re Phila. Newspapers*, 2009 WL 3242292, at \*4; Joinder of the Official Committee of Unsecured Creditors in the Objection of the Steering Group of Prepetition Secured Lenders and Citizens Bank of Pennsylvania, as Agent for the Prepetition Secured Lenders, to Debtors’ Motion for an Order: (A) Approving Procedures for the Sale of Certain of the Debtors’ Assets; (B) Scheduling an Auction; (C) Approving Assumption and Assignment Procedures; (D) Approving Form of Notice; and (E) Granting Related Relief at 1–2, *In re Phila. Newspapers, LLC*, No. 09-11204SR, 2009 WL 3242292 (Bankr. E.D. Pa. Sept. 29, 2009).

<sup>15</sup> *In re Phila. Newspapers*, 2009 WL 3242292, at \*11.

<sup>16</sup> *In re Phila. Newspapers*, 599 F.3d at 302.

from credit bidding.<sup>17</sup> The district court found that the plain meaning of the statute “provides three distinct alternative arrangements for satisfaction of plan confirmation in the context of cramdown of a dissenting class of secured creditors and that the Debtors may select any of these to proceed to confirmation.”<sup>18</sup> The Third Circuit later affirmed the district court’s reversal of the bankruptcy court,<sup>19</sup> but not without an extensive and spirited dissent by Judge Ambro.<sup>20</sup> Other critics of the majority’s decision were quick to express their surprise and disapproval. Ralph Brubaker, a noted bankruptcy scholar, disparaged the “surprise ‘discovery’ of this unprecedented cramdown power over 30 years after enactment of § 1129(b).”<sup>21</sup> He criticized the district court’s “plain meaning” theory and commented that the majority’s reading of the statute “had evidently escaped everyone for over 30 years.”<sup>22</sup>

Because of the Third Circuit’s unprecedented decision in *In re Philadelphia Newspapers*, the secured creditors resorted to an alternative solution. Having been denied the opportunity to credit bid,<sup>23</sup> the secured lenders faced the plausible outcome that their collateral might only receive the low stalking horse bid.<sup>24</sup> Fearing excessive undervaluation,<sup>25</sup> the senior lenders submitted a cash bid and prevailed at the public auction after bidding against a local philanthropist.<sup>26</sup> Their winning cash bid was \$105 million, almost \$70 million higher than the original stalking horse bid.<sup>27</sup>

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<sup>17</sup> *In re Phila. Newspapers, LLC*, 418 B.R. 548, 552 (E.D. Pa. 2009), *aff’d*, 599 F.3d 298.

<sup>18</sup> *Id.* at 567.

<sup>19</sup> *In re Phila. Newspapers*, 599 F.3d at 318.

<sup>20</sup> *Id.* at 319 (Ambro, J., dissenting).

<sup>21</sup> Ralph Brubaker, *Cramdown of an Undersecured Creditor Through Sale of the Creditor’s Collateral: Herein of Indubitable Equivalence, the § 1111(b)(2) Election, Sub Rosa Sales, Credit Bidding, and Disposition of Sale Proceeds*, 29 BANKR. L. LETTER, Dec. 2009, at 1, 7.

<sup>22</sup> *Id.*

<sup>23</sup> Order (A) Approving Second Amended Procedures for the Sale of Certain of the Debtors’ Assets; (B) Scheduling an Auction; (C) Approving Form of Asset Purchase Agreement; (D) Approving Assumption & Assignment Procedures; (E) Approving Form of Notice; & (F) Granting Related Relief at add. 1(f), *In re Phila. Newspapers, LLC*, No. 09-11204SR, 2009 WL 3242292 (Bankr. E.D. Pa. Sept. 17, 2010) (“**Credit Bid**: The Senior Agent, one or more of the Prepetition Secured Lenders, and any Newco created by any of the Prepetition Secured Lenders (including PN Purchaser Co, LLC) shall not have the right to credit bid at the Second Auction and any credit bid submitted shall not be a Qualified Bid for any purposes whatsoever.”).

<sup>24</sup> *In re Phila. Newspapers, LLC*, No. 09-11204SR, 2009 WL 3242292, at \*2 (Bankr. E.D. Pa. Oct. 8, 2009).

<sup>25</sup> The stalking horse bid would only generate \$36 million despite the \$318 million owed to the secured lenders. *Id.* at \*2; *see also supra* text accompanying note 3.

<sup>26</sup> Joseph A. Slobodzian, *Senior Lenders Win 2d Auction for Phila. Papers*, PHILLY.COM, Sept. 23, 2010, [http://articles.philly.com/2010-09-23/news/24980119\\_1\\_philadelphia-papers-senior-lenders-bruce-toll](http://articles.philly.com/2010-09-23/news/24980119_1_philadelphia-papers-senior-lenders-bruce-toll).

<sup>27</sup> Order Confirming Fifth Amended Joint Chapter 11 Plan as of Sept. 24, 2010 at 20, *In re Phila. Newspapers, LLC*, No. 09-11204SR, 2009 WL 3242292 (Bankr. E.D. Pa. Sept. 30, 2010).

This result was a major blow to the secured lenders, as they had to pool together over \$100 million to fund their cash bid. However, the secured lenders still fared considerably well for creditors in their circumstances. The bankruptcy court confirmed the sale and the debtors' plan on September 30, 2010;<sup>28</sup> the lenders took ownership of the *Philadelphia Inquirer*, *Philadelphia Daily News*, and *Philly.com* on October 8, 2010.<sup>29</sup>

### B. An Absolute Right to Credit Bid?

The Third Circuit represents one side of a split in the courts as to whether a secured creditor has an almost absolute right to credit bid on the sale of its collateral under § 1129(b)(2)(A). While all courts agree that § 363(k) provides a single exception to credit bidding rights when “the court for cause orders otherwise,”<sup>30</sup> only a few courts have proposed that secured creditors have an absolute right to credit bid.<sup>31</sup>

Other courts, as demonstrated by the Third Circuit in *Philadelphia Newspapers*,<sup>32</sup> reject the notion that secured creditors have an almost absolute right to credit bid. The Fifth Circuit, hearing *In re Pacific Lumber* on appeal, also denied secured lenders the opportunity to credit bid.<sup>33</sup> Under the proposed reorganization plan in *Pacific Lumber*, the secured creditors' collateral would be sold without providing the secured creditors a right to credit bid.<sup>34</sup> The secured creditors challenged the plan under § 1129(b)(2)(A), claiming that the plan was not “fair and equitable” under § 1129(b)(2)(A)(ii) because the secured creditors' collateral was sold free and clear of liens, without the

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<sup>28</sup> *Id.* at 22.

<sup>29</sup> Christopher K. Hepp, *New Owners Take Control of Inquirer, Daily News, and Philly.com*, PHILA. INQUIRER, Oct. 9, 2010, at A01.

<sup>30</sup> 11 U.S.C. § 363(k) (2006).

<sup>31</sup> In 1994, the Bankruptcy Court for the Southern District of New York held that creditors have the “unconditional right” to credit bid under § 1129(b)(2)(A). *In re Kent Terminal Corp.*, 166 B.R. 555, 566–67 (Bankr. S.D.N.Y. 1994) (“If a plan proposes the sale of a creditor’s collateral free and clear of liens, the lienholder has the unconditional right to bid in its lien.”). The following year, in 1995, the District Court for the Eastern District of Pennsylvania also implied that creditors have an almost absolute right to credit bid. *In re River Vill. Assocs.*, 181 B.R. 795, 805 (E.D. Pa. 1995) (“Congress did not intend to deprive creditors of the right to bid their full claim under a reorganization plan.”). Most recently, the Seventh Circuit concurred with the idea of a creditor’s near absolute right to credit bid. *See River Rd. Hotel Partners, LLC v. Amalgamated Bank (In re River Rd. Hotel Partners, LLC)*, No. 10-3597, 2011 U.S. App. LEXIS 13131 (7th Cir. June 28, 2011), *petition for cert. filed*, 80 U.S.L.W. 3112 (U.S. Aug. 5, 2011) (No. 11-166).

<sup>32</sup> *In re Phila. Newspapers, LLC*, 599 F.3d 298, 301 (3d Cir. 2010).

<sup>33</sup> *Bank of N.Y. Trust Co., NA v. Official Unsecured Creditors’ Comm. (In re Pac. Lumber Co.)*, 584 F.3d 229, 245–46 (5th Cir. 2009).

<sup>34</sup> *Id.* at 239.

creditors being provided an opportunity to credit bid.<sup>35</sup> On appeal, the Fifth Circuit rejected the secured creditors' claim that they had a right to credit bid at the auction, reading § 1129(b)(2)(A)(iii) to offer a "distinct basis" for confirming the plan as an alternative to § 1129(b)(2)(A)(ii).<sup>36</sup> The Fifth Circuit reasoned that the sale could instead occur under the "indubitable equivalent" standard provided in § 1129(b)(2)(A)(iii), thereby circumventing the credit bidding clause of § 1129(b)(2)(A)(ii).<sup>37</sup> However, the authorization of such a plan was unprecedented, even though these cramdown provisions had been in effect for over thirty years.<sup>38</sup>

Although Judge Ambro wrote a well-written, lengthy dissent in *Philadelphia Newspapers*,<sup>39</sup> the Seventh Circuit is the only appellate court to deviate from the Third and Fifth Circuits' interpretations. In *In re River Road*, the Bankruptcy Court for the Northern District of Illinois denied a motion to approve bid procedures factually similar to those in *Philadelphia Newspapers* and succinctly opined:

The majority in *Philadelphia Newspapers* approved the Debtors' proposed interpretation of [§] 1129(b)(2)(A)(iii). This court, however, finds Judge Ambro's well-reasoned dissent in *Philadelphia Newspapers* more persuasive. The Debtors, therefore, may not use [§] 1129(b)(2)(A)(iii) to sell their assets free and clear of liens. The Debtors must comply with the specific requirements of [§] 1129(b)(2)(A)(ii).<sup>40</sup>

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<sup>35</sup> *Id.*

<sup>36</sup> *Id.* at 245.

<sup>37</sup> *Id.* at 245–46.

<sup>38</sup> Before 2009, only two bankruptcy courts had suggested that a plan might be approved under § 1129(b)(2)(A)(iii) as offering the indubitable equivalent, even though it could not be approved under § 1129(b)(2)(A)(ii). *In re Criimi Mae, Inc.*, 251 B.R. 796, 807 (Bankr. D. Md. 2000) ("[B]ecause of the disjunctive construction of [§] 1129(b)(2)(A), if debtors can meet the test of indubitable equivalence, the plan can be confirmed without compliance with subsection (ii)."); *In re Martindale*, 125 B.R. 32, 37–38 (Bankr. D. Idaho 1991) (denying confirmation and suggesting that a plan that does not permit credit bidding cannot be approved under § 1129(b)(2)(A)(ii), but might be approved under § 1129(b)(2)(A)(iii) as providing the indubitable equivalent). Neither of these opinions actually confirmed a plan that denied the creditors a right to credit bid. The Fifth Circuit itself conceded that its *Pacific Lumber* decision to allow a sale under § 1129(b)(2)(A)(iii) was without precedent: "The nature of this cramdown and the refusal to apply § 1129(b)(2)(A)(ii) to authorize a credit bid are unusual, perhaps unprecedented decisions." *In re Pac. Lumber*, 584 F.3d at 243.

<sup>39</sup> *In re Phila. Newspapers, LLC*, 599 F.3d 298, 319–38 (3d Cir. 2010) (Ambro, J., dissenting).

<sup>40</sup> Order Denying Debtors' Bid Procedures Motion at 3, *In re River Rd. Hotel Partners, LLC*, No. 09B30029, 2010 WL 6634603 (Bankr. N.D. Ill. Oct. 5, 2010).

The Seventh Circuit affirmed the bankruptcy court's opinion on direct appeal.<sup>41</sup> In a compelling opinion that finally ripens the issue for Supreme Court review, the Seventh Circuit, in *River Road*, found "that the Code requires that cramdown plans that contemplate selling encumbered assets free and clear of liens at an auction satisfy the requirements set forth in *Subsection (ii)* of the statute."<sup>42</sup>

In other circuits, the dispute over the right to credit bid remains hazardingly undecided. For now, secured lenders must prepare for the possibility of a blow from other courts. Consequently, these lenders should aim to protect their right to collect the full value of their collateral by adopting prophylactic strategies.

There are two plausible readings of § 1129(b)(2)(A), each of which drastically affects the allocation of risk between secured creditors and their debtors. Under the first construction, the statute can be read to present three disjunctive alternatives, any of which may satisfy the "fair and equivalent" standard test. The district court and the Third Circuit in *Philadelphia Newspapers* applied the disjunctive reading,<sup>43</sup> which was previously used by only the Fifth Circuit.<sup>44</sup> The second construction was first championed by the bankruptcy court<sup>45</sup> and Judge Ambro's dissent in *Philadelphia Newspapers*<sup>46</sup> and later followed by Judge Black<sup>47</sup> and the Seventh Circuit in *River Road*.<sup>48</sup> Under this second construction, the statute can be read to offer two alternatives and a third catch-all that addresses situations that the first two alternatives do not plainly cover. The two specific alternatives are compartmentalized because the facts and circumstances dictate which of the two alternatives should be used. The catch-all provision applies only if neither alternative pertains to the

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<sup>41</sup> *River Rd. Hotel Partners, LLC v. Amalgamated Bank (In re River Rd. Hotel Partners, LLC)*, No. 10-3597, 2011 U.S. App. LEXIS 13131, at \*2 (7th Cir. June 28, 2011), *petition for cert. filed*, 80 U.S.L.W. 3112 (U.S. Aug. 5, 2011) (No. 11-166).

<sup>42</sup> *Id.* at \*32.

<sup>43</sup> *In re Phila. Newspapers*, 599 F.3d at 305; *In re Phila. Newspapers, LLC*, 418 B.R. 548, 567 (E.D. Pa. 2009), *aff'd*, 599 F.3d 298.

<sup>44</sup> *Bank of N.Y. Trust Co., NA v. Official Unsecured Creditors' Comm. (In re Pac. Lumber Co.)*, 584 F.3d 229, 245-46 (5th Cir. 2009).

<sup>45</sup> *In re Phila. Newspapers, LLC*, No. 09-11204SR, 2009 WL 3242292, at \*2 (Bankr. E.D. Pa. Oct. 8, 2009).

<sup>46</sup> *In re Phila. Newspapers*, 599 F.3d at 326-27 (Ambro, J., dissenting).

<sup>47</sup> Order Denying Debtors' Bid Procedures Motion at 3, *In re River Rd. Hotel Partners, LLC*, No. 09B30029, 2010 WL 6634603 (Bankr. N.D. Ill. Oct. 5, 2010).

<sup>48</sup> *River Rd. Hotel Partners, LLC v. Amalgamated Bank (In re River Rd. Hotel Partners, LLC)*, No. 10-3597, 2011 U.S. App. LEXIS 13131, at \*32 (7th Cir. June 28, 2011), *petition for cert. filed*, 80 U.S.L.W. 3112 (U.S. Aug. 5, 2011) (No. 11-166).

instant situation. The Third Circuit summarized this catch-all reading as follows:

[A]ny [c]hapter 11 plan proposing the transfer of assets encumbered by their original liens must proceed under *subsection (i)*, any plan proposing the free and clear sale of assets must proceed under *subsection (ii)*, and only those plans proposing a disposition not covered by *subsections (i) and (ii)*, most notably the substitution of collateral, may then proceed under *subsection (iii)*.<sup>49</sup>

The application of these two constructions demonstrates that there is no single “plain meaning” of the statute. Although the statute is vague, an analysis using the statute’s legislative history, the canons of statutory interpretation, and the Code drafters’ commentary reveals that Congress enacted § 1129(b)(2)(A) to prohibit sales of collateral free of liens when lien holders are not permitted to credit bid on their collateral.

This Comment supports the plausible catch-all reading of § 1129(b)(2)(A) ignored by the majorities in *Philadelphia Newspapers* and *Pacific Lumber*. First, this Comment will analyze how these majorities erred by only considering one of several plausible readings of § 1129(b)(2)(A). One interpretation, herein called the “disjunctive reading,” holds that § 1129(b)(2)(A) provides three disjunctive alternatives, such that any of the treatments will independently satisfy the “fair and equitable” requirement. Another interpretation, herein called the “catch-all reading,” proposes that § 1129(b)(2)(A) provides two specific approaches and a third catch-all approach which is applied only if the facts and circumstances are not covered by the prior two approaches. Although both interpretations purport to arise from a plain meaning interpretation of the statute, this Comment argues that the Third and Fifth Circuits erred because they only acknowledged the disjunctive reading of the statute. Second, this Comment will examine the strengths and weaknesses of each interpretation, consider statutory intent and policy implications, and conclude that the circuit courts in *Philadelphia Newspapers* and *Pacific Lumber* erred in holding that a secured creditor does not have an absolute right to credit bid on its collateral. Finally, in anticipation of future setbacks from other courts, this Comment will suggest both preemptive and reactive strategies that creditors can implement to best protect their rights to the full value of their secured collateral, thus mitigating the blow dealt by the Third and Fifth Circuits.

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<sup>49</sup> *In re Phila. Newspapers*, 599 F.3d at 306 (emphasis added).

### C. Background Legal Doctrines

The Bankruptcy Reform Act of 1978 provides a test for court confirmation of a chapter 11 plan involving dissenting secured claims.<sup>50</sup> As codified in § 1129(b)(1), a plan must be confirmed if it “does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan.”<sup>51</sup>

Courts must determine what is “fair and equitable” when confirming a chapter 11 nonconsensual plan. Congress assisted bankruptcy courts in making their determinations by providing an extensive list of requirements to demonstrate what is “fair and equitable.”<sup>52</sup> “Most courts determine compliance with the fair and equitable requirement” by using the list in § 1129(b)(2).<sup>53</sup>

The list of requirements includes a provision specifically regarding “secured creditor cramdown,” which is delineated in § 1129(b)(2)(A).<sup>54</sup> The provision applies exclusively to one class of creditors—secured, dissenting creditors<sup>55</sup>—and guarantees payment in full of the secured claim.<sup>56</sup> It also provides three ways for a cramdown to occur:

The three alternatives to effectuate cramdown on secured creditors under § 1129(b)(2)(A) are: (i) retention of liens and receipt of payments equal to the value of the creditor’s interest in property of the estate; (ii) liens on the proceeds from the sale of the collateral and receipt of payment equal to the value of such

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<sup>50</sup> Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549, 2637 (current version at 11 U.S.C. § 1129(b)(1) (2006)).

<sup>51</sup> 11 U.S.C. § 1129(b)(1) (2006); *see also* 124 CONG. REC. 32,407 (1978) (statement of Rep. Don Edwards) (“Paragraph (1) makes clear that this alternative confirmation standard, referred to as ‘cram down,’ will be called into play only on the request of the proponent of the plan. Under this cram down test, the court must confirm the plan if the plan does not discriminate unfairly, and is ‘fair and equitable,’ with respect to each class of claims or interests that is impaired under, and has not accepted, the plan. The requirement of the House bill that a plan not ‘discriminate unfairly’ with respect to a class is included for clarity; the language in the House report interpreting that requirement, in the context of subordinated debentures, applies equally under the requirements of [§] 1129(b)(1) of the House amendment.”).

<sup>52</sup> *See* 11 U.S.C. § 1129(b)(2); 124 CONG. REC. 32,407 (1978) (statement of Rep. Don Edwards) (“Paragraph (2) provides guidelines for a court to determine whether a plan is fair and equitable with respect to a dissenting class.”).

<sup>53</sup> 7 COLLIER, *supra* note 7, ¶ 1129.04[1].

<sup>54</sup> 11 U.S.C. § 1129(b)(2)(A).

<sup>55</sup> 124 CONG. REC. 32,407 (1978) (statement of Rep. Don Edwards) (“Subparagraph (A) applies when a class of secured claims is impaired and has not accepted the plan.”).

<sup>56</sup> 7 COLLIER, *supra* note 7, ¶ 1129.04[2].

proceeds; or (iii) realization by the holders of secured claims of the “indubitable equivalent” of their claims.<sup>57</sup>

The first approach, codified in § 1129(b)(2)(A)(i), permits a court to confirm a plan if it provides:

(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 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 . . . .<sup>58</sup>

When plans are confirmed under this provision, secured creditors do not release their liens on their collateral. Instead, the liens remain attached to their corresponding collateral, even if the collateral is transferred under the plan.<sup>59</sup> This subsection requires that the secured creditor receive cash payments bearing interest at the rate deemed appropriate by the court.<sup>60</sup>

The second approach, delineated in § 1129(b)(2)(A)(ii), expressly provides an illustration for the sale of collateral of a secured creditor. This provision permits a court to confirm a plan if it provides:

(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 . . . .<sup>61</sup>

The sale of collateral of a secured creditor is expressly governed by § 363(k), effectively granting secured creditors whose collateral is sold under this provision the right to credit bid, or purchase their collateral by offsetting their claim against the purchase price. Section 363(k) reads:

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<sup>57</sup> 6 WILLIAM L. NORTON, JR. & WILLIAM L. NORTON III, NORTON BANKRUPTCY LAW AND PRACTICE 3D § 113:11, at 113-27 (2008).

<sup>58</sup> 11 U.S.C. § 1129(b)(1)(A)(i).

<sup>59</sup> 7 COLLIER, *supra* note 7, ¶ 1129.04[2][a] (quoting 11 U.S.C. § 1129(b)(2)(A)(i)(I)).

<sup>60</sup> *Id.*; see also 11 U.S.C. § 1129(b)(2)(A)(i)(II).

<sup>61</sup> 11 U.S.C. § 1129(b)(1)(A)(ii).

(k) At a sale [other than in the ordinary course of business] of property that is subject to a lien that secures an allowed claim, unless the court for cause orders otherwise the holder of such claim may bid at such sale, and, if the holder of such claim purchases such property, such holder may offset such claim against the purchase price of such property.<sup>62</sup>

This illustration in § 363(k) allows secured creditors to bid at the sale of their collateral up to the full amount of their claims without cash.<sup>63</sup> The creditor is able to offset up to the full value of its claim, even if the creditor was previously deemed undersecured.<sup>64</sup> For example, if a creditor has a \$200 million claim, but the value of its secured claim is only \$50 million, it can still bid any amount up to \$200 million. This is particularly useful to creditors when the value of the collateral is greater than the value of the secured portion of its claim. Furthermore, if the creditor has the highest bid, the creditor “may offset its claim against the purchase price of the property.”<sup>65</sup> Thus, the creditor can often purchase its own collateral “without having to part with new funds.”<sup>66</sup>

The credit bidding mechanism delineated in § 1129(b)(2)(A)(ii) is useful to secured creditors because it grants them “an effective veto over a low sales price.”<sup>67</sup> The purpose of credit bidding is to ensure that the market properly values the creditor’s collateral.<sup>68</sup> Credit bidding allows secured creditors to trump other bids that are lower than the value of the property, thus ensuring that an auction yields a fair and equivalent price.<sup>69</sup> When an auction sale does not appear to be yielding a fair price, the credit bidding mechanism allows a

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<sup>62</sup> *Id.* § 363(k).

<sup>63</sup> 3 COLLIER, *supra* note 7, ¶ 363.09.

<sup>64</sup> *Id.*; *see also* Cohen v. KB Mezzanine Fund II (*In re* SubMicron Sys. Corp.), 432 F.3d 448, 459 (3d Cir. 2006) (“It is well settled among district and bankruptcy courts that creditors can bid the full face value of their secured claims under § 363(k).”).

<sup>65</sup> 3 COLLIER, *supra* note 7, ¶ 363.09; *see also* Bruce A. Markell, *Owners, Auctions, and Absolute Priority in Bankruptcy Reorganizations*, 44 STAN. L. REV. 69, 123 (1991) (“[T]he Code does recognize the possibility of a debtor taking advantage of a low valuation and offers protection to that creditor through the vehicle of a credit bidding. Thus, if such creditors believe that the sale price is too low, they may credit bid their claim at a higher amount, and purchase the property.”).

<sup>66</sup> 3 COLLIER, *supra* note 7, ¶ 363.09.

<sup>67</sup> 6 NORTON, *supra* note 57, § 113:17, at 113–43; *see also* 7 COLLIER, *supra* note 7, ¶ 1129.04[2][b][ii] (“This gives the secured creditor protections against attempts to sell the collateral too cheaply; if the secured party thinks the collateral is worth more than the debtor is selling it for, it may effectively bid its debt and take title to the property.”).

<sup>68</sup> *See In re SubMicron Sys. Corp.*, 432 F.3d at 460.

<sup>69</sup> Alan M. Christenfeld & Barbara M. Goodstein, *Rulings Pose Questions About Right to Credit Bid*, 243 N.Y. L.J., Feb. 4, 2010 (Corporate Update).

secured creditor to bid up the price until it is fair.<sup>70</sup> Secured creditors need not successfully outbid other potential buyers to reap the benefit of credit bidding, as they already receive the proceeds of the sale.

In practice, a secured creditors' claim treated pursuant to § 1129(b)(2)(A)(ii) also undergoes treatment under either § 1129(b)(2)(A)(i) or § 1129(b)(2)(A)(iii). The approach provided for in § 1129(b)(2)(A)(ii) merely converts secured property into cash collateral.<sup>71</sup> Then, the liens on the cash collateral created by the sale receive treatment under clause (i) or clause (iii).<sup>72</sup>

The third and final approach, found in § 1129(b)(1)(A)(iii), permits a court to confirm a plan that provides: "for the realization by such holders of the indubitable equivalent of such claims."<sup>73</sup> This alternative "was designed to cover those plan proposals that are not included in the two preceding sections."<sup>74</sup> The Congressional Report for the Bankruptcy Reform Act of 1978 provides some direction on what meets the standard for "indubitable equivalence": "Abandonment of the collateral to the creditor would clearly satisfy indubitable equivalence, as would a lien on similar collateral."<sup>75</sup> The Congressional Report leaves no indication that a sale of collateral free and clear of liens might be confirmed under the indubitable equivalent approach.<sup>76</sup>

Undoubtedly, a "plan may be crammed down notwithstanding the dissent of a secured class only if the plan complies with clause (i), (ii), or (iii)."<sup>77</sup> However, the relationship between the three clauses remains unclear. Can a plan proponent unilaterally choose to sell a secured creditor's collateral subject to subsection 1129(b)(2)(A)(iii) instead of subsection 1129(b)(2)(A)(ii)?

The recent Third and Fifth Circuit decisions answered this with a resounding "yes"—a plan proponent *can* use clause (iii) to circumvent clause

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<sup>70</sup> Michael E. Rubinger & Gary W. Marsh, "Sale of Collateral" Plans Which Deny a Nonrecourse Underscored Creditor the Right to Credit Bid: Pine Gate Revisited, 10 BANKR. DEV. J. 265, 273 (1994).

<sup>71</sup> Jack Friedman, *What Courts Do to Secured Creditors in Chapter 11 Cram Down*, 14 CARDOZO L. REV. 1495, 1531 (1993). ("Thus the sale of the collateral under clause (ii) is simply a means of converting secured property of the estate into cash collateral, which then implicates either clause (i) or clause (iii).").

<sup>72</sup> 11 U.S.C. § 1129(b)(2)(A)(ii) (2006) (dictating "the treatment of such liens on proceeds under clause (i) or (iii) of this subparagraph."); see also Friedman, *supra* note 71, at 1531.

<sup>73</sup> 11 U.S.C. § 1129(b)(2)(A)(iii).

<sup>74</sup> 6 NORTON, *supra* note 57, § 113:18, at 113-43.

<sup>75</sup> 124 CONG. REC. 32,407 (1978).

<sup>76</sup> *Id.*

<sup>77</sup> *Id.*

(ii).<sup>78</sup> In agreement, *Collier on Bankruptcy* suggests, “Section 1129(b)(2)(A) lists three possible treatments of a secured claim; any one of them will independently satisfy the fair and equitable requirement.”<sup>79</sup> Additionally, *Collier on Bankruptcy* recently stated,

A plan providing for the sale of assets free and clear of a security interest may be confirmed if it provides the secured creditor with the realization of the indubitable equivalent of its secured claim under § 1129(b)(2)(A)(iii), even though the plan deprives the secured creditor of the right to credit bid under §§ 363(k) and 1129(b)(2)(A)(ii).<sup>80</sup>

Currently, the Third and Fifth Circuit stand alone in allowing debtors to circumvent clause (ii). Others have cogently argued that a debtor cannot avoid the requirement that a plan cramming down a sale free and clear of liens be subject to § 363(k). In addition to Judge Ambro’s persuasive dissent in *Philadelphia Newspapers* and the compelling Seventh Circuit opinion in *River Road*,<sup>81</sup> *Norton Bankruptcy Law and Practice* suggests that § 1129(b)(2)(A) was not designed to allow a plan proponent to avoid the credit bidding requirement in clause (ii).<sup>82</sup> This view proposes that the indubitable equivalent clause is merely a catch-all instead of an alternative and thus cannot be used to

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<sup>78</sup> See *In re Phila. Newspapers, LLC*, 599 F.3d 298, 318 (3d Cir. 2010); *Bank of N.Y. Trust Co., NA v. Official Unsecured Creditors’ Comm. (In re Pac. Lumber Co.)*, 584 F.3d 229, 245 (5th Cir. 2009) (“This court has subscribed to the obvious proposition that because the three subsections of § 1129(b)(2)(A) are joined by the disjunctive ‘or,’ they are alternatives.”).

<sup>79</sup> 7 COLLIER, *supra* note 7, ¶ 1129.04[2] (“The plan proponent may seek to satisfy the claim in full by giving the creditor a note in the amount of the secured claim secured by the same collateral. The plan proponent may also seek to sell the collateral free of the lien, and transfer the lien to the proceeds of sale. Finally, the proponent may seek to give the creditor the ‘indubitable equivalent’ of its claim.”); see also *Wade v. Bradford*, 39 F.3d 1126, 1130 (10th Cir. 1994) (proponent need not provide indubitable equivalent if any of other two clauses of § 1129(b)(2)(A) are met).

<sup>80</sup> 1 COLLIER PAMPHLET EDITION 942 (Alan N. Resnick & Henry J. Sommer eds., 2010) (citing *In re Phila. Newspapers*, 599 F.3d at 298); accord *In re Pac. Lumber*, 584 F.3d at 229.

<sup>81</sup> *In re Phila. Newspapers*, 599 F.3d at 326 (Ambro, J., dissenting) (“Although the language of clause (iii) is broad . . . it is a ‘catch-all’ not designed to supplant clauses (i) and (ii) where they plainly apply.”); *River Rd. Hotel Partners, LLC v. Amalgamated Bank (In re River Rd. Hotel Partners, LLC)*, No. 10-3597, 2011 U.S. App. LEXIS 13131, at \*2 (7th Cir. June 28, 2011) (“The infinitely more plausible interpretation of [§] 1129(b)(2)(A) would read each subsection as stating the requirements for a particular type of sale and ‘construing each of the [ ] subparagraphs . . . [as conclusively governing] the category of proceedings it addresses.’ Under such a reading, plans could only qualify as ‘fair and equitable’ under Subsection (iii) if they proposed disposing of assets in ways that are not described in Subsections (i) and (ii).” (omissions and insertions in original)), *petition for cert. filed*, 80 U.S.L.W. 3112 (U.S. Aug. 5, 2011) (No. 11-166).

<sup>82</sup> 6 NORTON, *supra* note 57, § 113:18, at 113-44. (“The provision was designed to cover those plan proposals that are not included in the two proceeding sections.”).

authorize a debtor to cram down a plan that sells secured lenders' assets free and clear of liens and denies them the right to credit bid.

*D. Interpreting § 1129(b)(2)(A)*

The emerging circuit split reveals a division as to the true plain meaning of § 1129(b)(2)(A). The weakness of the interpretation by the majorities in *Philadelphia Newspapers* and *Pacific Lumber* is that it did not consider other language in § 1129(b)(2)(A) that calls into question whether there is a single “plain meaning” of the statute. The language is ambiguous. Interpretation of an ambiguous statute requires consideration of other material such as legislative history, but the majorities' fixation on “plain meaning” precluded such consideration. This resulted in incomplete statutory analysis. Ignoring legislative history led the Third and Fifth Circuits to an unprecedented and unpopular result.

*1. Plain Meaning Analysis Reveals No Single Plain Meaning of § 1129(b)(2)(A)*

Applying the principles of statutory interpretation reveals that § 1129(b)(2)(A) is ambiguous, and thus, the Third and Fifth Circuit's “plain meaning” analysis was insufficient to interpret the statute. Statutory interpretation first considers the plain meaning of the statute, examining the common meaning of the statute's language. The Supreme Court instructed that courts should apply a literal interpretation of a statute unless it is unambiguous.<sup>83</sup> A provision is “ambiguous” if it is “reasonably susceptible of different interpretations.”<sup>84</sup> Therefore, for a provision to be unambiguous—and thus, for consideration of the statute's plain language meaning to be a sufficient analysis—the statute cannot be reasonably susceptible to different interpretations. The majorities in *Philadelphia Newspapers* and *Pacific Lumber* erroneously concluded that the plain meaning of § 1129(b)(2)(A) is

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<sup>83</sup> Conn. Nat'l Bank v. Germain, 503 U.S. 249, 253–54 (1992) (“[C]ourts must presume that a legislature says in a statute what it means and means in a statute what it says there. When the words of a statute are unambiguous, then this first canon is also the last: ‘judicial inquiry is complete.’” (quoting *Rubin v. United States*, 449 U.S. 424, 430 (1981))), cited in *In re Phila. Newspapers*, 599 F.3d at 304; see also *Andersson v. Sec. Fed. Sav. & Loan of Cleveland (In re Andersson)*, 209 B.R. 76, 78 (B.A.P. 6th Cir. 1997) (“[S]tatutory interpretation is a holistic endeavor which must begin with the language of the statute itself. Resort to an examination of legislative history is appropriate only to resolve statutory ambiguity, and in the final analysis, such examination must not produce a result demonstratively at odds with the purpose of the legislation.”).

<sup>84</sup> Nat'l R.R. Passenger Corp. v. Atchison, Topeka & Santa Fe Ry. Co., 470 U.S. 451, 473 n.27 (1985).

unambiguous, and they consequently failed to consider other axioms of statutory interpretation.

*a. Erroneously Recognizing Only One of Two Plausible Readings*

The circuit courts in *Philadelphia Newspapers* and *Pacific Lumber* erred in concluding that the plain meaning of § 1129(b)(2)(A) is unambiguous. The statute is, rather, open to two plausible interpretations. As Judge Ambro's dissent identifies, the mere fact that the lower courts in *Philadelphia Newspapers* came to opposite conclusions on the "plain meaning" of the statute indicates "that the provision is ambiguous when read in isolation and does not have a single plain meaning."<sup>85</sup> Although "§ 1129(b)(2)(A) is phrased in the disjunctive,"<sup>86</sup> courts and lenders had never interpreted the statute to grant three distinct alternatives. Since the enactment of the Bankruptcy Act of 1978, lenders have interpreted the statute to provide an absolute right to credit bid in the sale of their collateral under a cramdown.

*b. Considering the Plain Meaning of Some, but Not All Language*

The majorities also erred in holding that the language was unambiguous because they improperly limited their analysis to some, but not all, of the language contained in § 1129(b)(2)(A). A proper reading of the statute must consider other statutory language.

*i. Exclusive vs. Non-exclusive "Or"*

The Third and Fifth Circuits incorrectly assumed that the "or" in § 1129(b)(2)(A) is non-exclusive. In *Pacific Lumber*, the Fifth Circuit interpreted the use of "or" between the clauses of subsections 1129(b)(2)(A)(ii) and (iii) to mean that the clauses must be disjunctive alternatives.<sup>87</sup> In *Philadelphia Newspapers*, the majority also limited its analysis to the "use of the word 'or'" to separate the three clauses.<sup>88</sup> The majority pointed to the Bankruptcy Code's rules of construction provided in § 102, where the Code

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<sup>85</sup> *In re Phila. Newspapers*, 599 F.3d at 322 (Ambro, J., dissenting).

<sup>86</sup> *Id.* at 305 (majority opinion) ("The Lenders concede, as they must, that § 1129(b)(2)(A) is phrased in the disjunctive. The use of the word 'or' in this provision operates to provide alternatives—a debtor may proceed under subsection (i), (ii), or (iii), and need not satisfy more than one subsection.").

<sup>87</sup> *Bank of N.Y. Trust Co., NA v. Official Unsecured Creditors' Comm. (In re Pac. Lumber Co.)*, 584 F.3d 229, 245 (5th Cir. 2009).

<sup>88</sup> *In re Phila. Newspapers*, 599 F.3d at 305.

instructs that “‘or’ is not exclusive.”<sup>89</sup> The majority in *Philadelphia Newspapers* noted that “courts have followed this uncontroversial mandate,” and it cited several cases that did in fact hold that the “or” in § 1129(b)(2)(A) gives debtors a unilateral choice between three options.<sup>90</sup>

However, because courts do not always interpret “or” as non-exclusive, the courts should have looked further than the word’s presence to determine its meaning.<sup>91</sup> *Collier on Bankruptcy* suggests that such a “non-exclusive” reading is permissible only “if context and practicality allow.”<sup>92</sup> Sometimes, context and practicality do not allow the court to interpret “or” as non-exclusive. Illuminating this exception, Judge Ambro’s dissent included an impressive list of examples in the Bankruptcy Code in which “or” is interpreted as exclusive instead of disjunctive.<sup>93</sup>

Here in § 1129(b)(2)(A), context and practicality urge the reading of “or” as exclusive. Clause (ii) presents a practical approach that must be followed in the context of selling collateral for the sale to meet the “fair and equitable treatment” requirement. First, when collateral is sold, the sale is subject to § 363(k), and a secured creditor’s “liens . . . attach to the proceeds of such sale.”<sup>94</sup> In practice, clause (ii) converts secured property into cash collateral.<sup>95</sup> After conversion, the liens on the cash collateral created by the sale receive

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<sup>89</sup> See 11 U.S.C. § 102(3) (2006); *In re Phila. Newspapers*, 599 F.3d at 305 (citing H.R. REP. NO. 95-595, at 315 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6272; S. REP. NO. 95-989, at 28 (1978), reprinted in 1978 U.S.C.C.A.N. 5787, 5814) (“The statutory note to § 102(5) further explains that ‘if a party ‘may do (a) or (b), then the party may do either or both. The party is not limited to a mutually exclusive choice between the two alternatives.’”).

<sup>90</sup> *In re Phila. Newspapers*, 599 F.3d at 305–06; see, e.g., *In re Pac. Lumber*, 584 F.3d at 245 (citing two cases from the Fifth Circuit and one each from the Tenth Circuit and Eastern District of Pennsylvania that affirm the disjunctive nature of § 1129(b)(2)(A)).

<sup>91</sup> *River Rd. Hotel Partners, LLC v. Amalgamated Bank (In re River Rd. Hotel Partners, LLC)*, No. 10-3597, 2011 U.S. App. LEXIS 13131, at \*21 n.5 (7th Cir. June 28, 2011) (“[T]he mere presence of the term ‘or’ is insufficient to resolve this issue.”), *petition for cert. filed*, 80 U.S.L.W. 3112 (U.S. Aug. 5, 2011) (No. 11-166).

<sup>92</sup> 2 COLLIER, *supra* note 7, ¶ 102.06 n.1 (using § 1112(b) as an example where “[i]t would be impossible for the court to do both”), quoted in *In re Phila. Newspapers*, 599 F.3d at 324 (Ambro, J., dissenting).

<sup>93</sup> *In re Phila. Newspapers*, 599 F.3d at 324 (Ambro, J., dissenting) (“Numerous sections of the Bankruptcy Code employ the disjunctive ‘or’ in a context where the alternative options render the ‘or’ exclusive. See, e.g., 11 U.S.C. §§ 365(g)(2)(B)(i)–(ii) (assumption of executory contract before or after conversion), 506(d)(1)–(2) (voiding liens for disallowed claims for one of two reasons), 1112(b)(1) (conversion or dismissal of a chapter 11 case), 1325(a)(5)(B)–(C) (requirements for confirmation of a chapter 13 plan), 1325(b)(3)(A)–(C) (means test categories), 1325(b)(4)(A)(i)–(ii) (same).”).

<sup>94</sup> 11 U.S.C. § 1129(b)(2)(A)(ii).

<sup>95</sup> Friedman, *supra* note 71, at 1531.

treatment under clause (i) or clause (iii).<sup>96</sup> The two-step procedure for fair and equitable treatment of sales suggests that the “or” separating clauses (i), (ii), and (iii) is not disjunctive because the treatment in clause (i) and clause (iii) are incorporated into the second step of clause (ii)’s two-step procedure. For example, under clause (ii)’s fair and equitable treatment, a debtor sells a secured creditor’s collateral under the first step of clause (ii), providing § 363(k) credit bidding rights; then, after the secured creditor’s lien attaches to the proceeds from the sale, the debtor must proceed under either clause (i) or clause (iii). Thus, after the sale, the liens can remain on the proceeds only if the secured creditor receives interest payments pursuant to clause (i). In the alternative, the proceeds will be abandoned to the secured creditor, providing the “indubitable equivalent” of the claim pursuant to clause (iii). Clause (ii)’s incorporation of the two other clauses in the later step suggests that a debtor cannot jump to the later step, circumventing the first step that promises credit bidding rights. This refutes the proposition that clauses (i), (ii), and (iii) could serve as three disjunctive alternatives.

ii. “Includes” vs. “Provides”: Reading the Plain Meaning of the Wrong Language

The Third and Fifth Circuits misread the operative word in § 1129(b)(2)(A), causing them to interpret the plain meaning of the wrong language. The misapplication of the plain meaning theory to the wrong word in this instance disguised the considerable ambiguity that otherwise exists in § 1129(b)(2)(A). Closely examining the correct operative word reveals that two reasonable interpretations exist, one of which was wholly dismissed by the Fifth Circuit because of its improper application of the plain meaning theory to the wrong language.

The majorities applied the verb “includes,” from § 1129(b)(2), in place of the operative verb “provides,” in § 1129(b)(2)(A).<sup>97</sup> Section 1129(b)(2) reads, “For the purposes of this subsection, the condition that a plan be fair and equitable with respect to a class *includes* the following requirements: (A) With respect to a class of secured claims, the plan *provides* – (i) . . . ; (ii) . . . ; or (iii) . . . .”<sup>98</sup>

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<sup>96</sup> 11 U.S.C. § 1129(b)(2)(A)(ii) (“[T]he treatment of such liens on proceeds under clause (i) or (iii) of this subparagraph . . . .”); see also Friedman, *supra* note 71, at 1531.

<sup>97</sup> See 11 U.S.C. § 1129(b)(2), (b)(2)(A); see, e.g., Bank of N.Y. Trust Co., NA v. Official Unsecured Creditors’ Comm. (*In re Pac. Lumber Co.*), 584 F.3d 229, 245 (5th Cir. 2009).

<sup>98</sup> 11 U.S.C. § 1129(b)(2) (emphasis added).

The Fifth Circuit focused on the word “includes” to suggest that the three clauses were non-exhaustive.<sup>99</sup> The Code’s rules of construction, codified in § 102, state, “[I]ncludes’ and ‘including’ are not limiting . . . .”<sup>100</sup> Applying “includes” as the operative word of the sentence, the Fifth Circuit ruled that the three alternatives were “not even exhaustive.”<sup>101</sup> Thus, because other alternatives were feasible yet were left out by the statute, the Court found that the three stated alternatives could not be treated as if each alternative only applied in a specific situation, i.e., “compartmentalized alternatives.”<sup>102</sup>

Although the Fifth Circuit correctly applied the meaning of “include” as defined in § 102, “includes” is not the operative word controlling the three provisions. Instead, “provides” is the verb that immediately precedes them.<sup>103</sup> “Includes” broadly relates to both plans cramming down secured and unsecured creditors, whereas “provides” only circumscribes plans cramming down secured creditors. As Judge Ambro noted in his dissent, “[O]nce we delve into (b)(2)(A), we are solely concerned with the treatment of a class of secured claims, and the relevant verb is ‘provides,’ whereby Congress prescribes specific treatments for specific scenarios of secured claim[s].”<sup>104</sup> The Fifth Circuit interpreted the plain meaning—but it interpreted the wrong language.

The Fifth Circuit’s error significantly impacted its reading of the statute. The Fifth Circuit dismissed a reading of the statute with three “specific treatments for specific scenarios”<sup>105</sup> because it read the statute as non-exclusive.<sup>106</sup> However, whereas “includes” would suggest that the three alternatives are non-exclusive, “provides” is not defined in the rules of construction in § 102. Instead, “provides” may suggest that the three provisions specifically delineated are the *only* means of satisfying the “fair and equitable” requirement for secured creditors. For example, the word “provided” was

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<sup>99</sup> *In re Pac. Lumber*, 584 F.3d at 245.

<sup>100</sup> 11 U.S.C. § 102(3).

<sup>101</sup> *In re Pac. Lumber*, 584 F.3d at 245.

<sup>102</sup> *Id.* at 245–46 (“As alternatives, these provisions are not even exhaustive. The introduction to § 1129(b)(2) states that the ‘condition that a plan be fair and equitable *includes* the following requirements. . . .’ . . . The Bankruptcy Code specifies that the term ‘includes’ ‘is not limiting.’ 11 U.S.C. § 102(3). Even a plan compliant with these alternative minimum standards is not necessarily fair and equitable. The non-exhaustive nature of the three subsections is inconsistent with treating them as compartmentalized alternatives.” (internal citations omitted)).

<sup>103</sup> *See* 11 U.S.C. § 1129(b)(2)(A).

<sup>104</sup> *In re Phila. Newspapers, LLC*, 599 F.3d 298, 325 (3d Cir. 2010) (Ambro, J., dissenting).

<sup>105</sup> *See id.*

<sup>106</sup> *See In re Pac. Lumber*, 584 F.3d at 245–46.

interpreted to set up three specific, exclusive alternatives in § 1325(a)(5).<sup>107</sup> A similar interpretation of “provides” in § 1129(b)(2)(A) suggests three exclusive prongs that cannot be substituted by alternatives not delineated in the statute.

Because the alternatives can be reasonably interpreted as exclusive, the Fifth Circuit’s unsupported claim that “[t]he non-exhaustive nature of the three subsections is inconsistent with treating them as compartmentalized alternatives” crumbles on its face.<sup>108</sup> The plain meaning can reasonably allow treating the three subsections as alternatives “prescrib[ing] specific treatments for specific scenarios.” This creates a plain meaning interpretation different from the reading expounded by the majorities. The Third and Fifth Circuits erred by ignoring this alternate plain meaning interpretation and hastily concluding that the statute was unambiguous.

### iii. Overlooking “Requirements”

Though the majorities in *Pacific Lumber* and *Philadelphia Newspapers* assumed that “includes” is the controlling language,<sup>109</sup> they neglected to interpret the text following “includes.” Once again, the majorities only selectively applied the plain meaning theory to the statute, causing them to improperly conclude that the statute unambiguously provided three non-exclusive alternatives. Section 1129(b)(2) states, “[T]he condition that a plan be fair and equitable with respect to a class *includes* the following *requirements* . . . .”<sup>110</sup> The word “requirements” implies that the three treatments are not three “examples,” as the majority suggests, but instead “specific requirements to be applied to distinct scenarios.”<sup>111</sup>

By definition, a requirement is not optional. Interpreting the provisions as “requirements” suggests that each provision entails a specific set of circumstances that *require* a specific treatment to permit cramdown.<sup>112</sup> The Third and Fifth Circuits declined to apply the plain meaning theory to interpret

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<sup>107</sup> *In re Phila. Newspapers*, 599 F.3d at 325 (Ambro, J., dissenting).

<sup>108</sup> *In re Pac. Lumber*, 584 F.3d at 245–46.

<sup>109</sup> See discussion *supra* Part D.1.b.ii.

<sup>110</sup> 11 U.S.C. § 1129(b)(2) (2006) (emphasis added).

<sup>111</sup> *In re Phila. Newspapers*, 599 F.3d at 325 n.9 (Ambro, J., dissenting).

<sup>112</sup> Brubaker, *supra* note 21, at 7 (“Use of the word ‘requirement,’ therefore, invokes the ‘necessity’ of an ‘essential requisite’ (see dictionary on your desk) with which the plan cannot dispense. Yes, the statute delineates three disjunctive means of satisfying this ‘requirement,’ but use of the disjunctive does not resolve the question of which of these disjunctive means specifies the ‘requirement’ in any particular case.”).

the provisions as “requirements,” instead considering the clauses as mere examples. Judge Ambro argued a different conclusion:

The words “free and clear of such liens” in the clause modify the noun “sale” and lead me to believe that clause (ii) is not merely an example, but an entire category of sales that is prescribed a specific treatment. Treating “sale . . . free and clear of such liens” as an example as opposed to a prescription may explain why my colleagues decline to apply the canons of statutory interpretation I apply below.<sup>113</sup>

Under this interpretation, any sale that attempts to sell collateral free and clear of secured creditors’ liens would be required to meet the specific treatment delineated in § 1129(b)(2)(A)(ii), instead of §§ 1129(b)(2)(A)(i) or (iii). Furthermore, this interpretation holds that “the requirement that a plan is fair and equitable ‘includes’ several factors,” some of which are specifically delineated in the statute, and are always “necessary, but not always sufficient, to satisfy the fair and equitable test.”<sup>114</sup> Thus, while the requirements are “intentionally open ended,” the provisions specified as fair and equitable treatments are not open ended.<sup>115</sup>

Meanwhile, the interpretation put forth by the majorities suggests that the three provisions are “open ended alternatives” to satisfy the fair and equitable requirement.<sup>116</sup> Thus, there are two reasonable plain meaning constructions of the statute, and canons of statutory interpretation and legislative history must be used to clarify which construction was intended by Congress.

*c. Considering the Policy of Some, but Not All, of the Statute*

The majority in *Philadelphia Newspapers* attempted to justify its narrow reading of the statute by considering the policy underlying the fair and

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<sup>113</sup> *In re Phila. Newspapers*, 599 F.3d at 325 n.11 (Ambro, J., dissenting).

<sup>114</sup> Kenneth N. Klee, *All You Ever Wanted to Know About Cram Down Under the New Bankruptcy Code*, 53 AM. BANKR. L.J. 133, 142, 154 n.134 (1979).

<sup>115</sup> *Id.* at 142 n.72 (“The Code contains a rule of construction that ‘includes’ is not limiting. 11 U.S.C. § 102(3). This implies that the use of the term ‘includes’ is intentionally open ended.”).

<sup>116</sup> *See, e.g.*, 6 NORTON, *supra* note 57, § 113:11, at 113-9 n.6 (“Code § 1129(b)(2) states that the requirement that a plan be fair and equitable ‘includes’ several alternatives. Under Code § 102(3), the phrase ‘includes’ is construed to mean not limiting. Therefore, it would appear that while Congress has fashioned several requirements for fair and equitable treatment under Code § 1129(b)(2), those requirements constitute open ended alternatives as well.”). *But see* Kenneth N. Klee, *supra* note 114, at 154 n.134 (“The requirements of 11 U.S.C. § 1129(b)(2)(A) are necessary, but not always sufficient, to satisfy the fair and equitable requirement.”).

equitable requirement in § 1129(b)(1).<sup>117</sup> The majority opined that the three alternatives delineated in § 1129(b)(2)(A) were simply “examples” to “guide courts in interpreting [the fair and equitable] standard.”<sup>118</sup> The Third Circuit noted that the indubitable equivalent “option” delineated in subsection 1129(b)(2)(A)(iii) “invites debtors ‘to craft an appropriate treatment of a secured creditor’s claim, separate and apart from the provisions of subsection (ii).’”<sup>119</sup> In recognizing this invitation to debtors when cramming down a creditor, the Third Circuit concluded, “[w]e have no statutory basis for concluding that such flexibility, consistent with both the language and purpose of the Code, should be curtailed.”<sup>120</sup>

However, § 1129 functions as the very mechanism that curtails the debtor’s “flexibility” to cram down a plan against its creditors. Although § 1129(b)(2)(A) lists three ways a debtor may satisfy the fair and equitable requirement, this section cannot be read in isolation from the cramdown requirements’ purpose, which is to elevate lenders’ rights over the non-consensual components of a debtor’s plan.<sup>121</sup>

The majorities selectively analyzed language and policy, consequently ignoring another reasonable interpretation. Because there can be two reasonably interpreted plain meanings of § 1129(b)(2)(A), the court should have looked to other methods of statutory construction in addition to the plain meaning analysis.

## 2. *Supplementing the Plain Meaning Axiom with Other Canons of Statutory Construction*

Often, identifying one single plain meaning of a piece of legislation is a futile effort. After analyzing statutory interpretation trends in recent bankruptcy decisions, the Honorable Thomas F. Waldron noted the challenge:

Judges should consider the operative language, the language of other provisions, and structural cues in the statute. But then it is equally appropriate to pan back from the statute itself to its context, including legislative history, prior law and practice, and policy considerations,

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<sup>117</sup> *In re Phila. Newspapers*, 599 F.3d at 309–10.

<sup>118</sup> *Id.*

<sup>119</sup> *Id.* at 310 (quoting *In re Phila. Newspapers, LLC*, 418 B.R. 548, 568 (E.D. Pa. 2009)).

<sup>120</sup> *Id.*

<sup>121</sup> *See infra* Part D.2.c.

to make an interpretation of the intended meaning. Otherwise, courts are likely to err and to bring on unintended consequences.<sup>122</sup>

The Supreme Court also directed,

[T]he plain-meaning rule is “rather an axiom of experience than a rule of law, and does not preclude consideration of persuasive evidence if it exists.” The circumstances of the enactment of particular legislation may persuade a court that Congress did not intend words of common meaning to have their literal effect.<sup>123</sup>

Therefore, as presented by the Supreme Court, the plain meaning rule is simply a starting point. Other persuasive evidence exists suggesting a different interpretation of § 1129(b)(2)(A), and this evidence should not be precluded from consideration. Canons of statutory construction are instructive and suggest that the dissent’s interpretation may be more appropriate than the majorities’ narrow interpretation. Besides the plain meaning rule, there are several other canons of statutory construction that aid in resolving the meaning intended by Congress. The Supreme Court employs many canons of interpretation,<sup>124</sup> but three are particularly useful to determine the congressional intent of § 1129(b)(2)(A): legislative history, avoiding surplusage, and unforeseen consequences. These canons of statutory construction expose which of the two plausible readings of § 1129 should be applied.

#### a. Legislative History

The legislative history of the Bankruptcy Reform Act of 1978 suggests that the majorities erred in concluding that § 1129(b)(2)(A) offers three disjunctive alternatives to a cramdown and permits a sale of a secured creditor’s collateral

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<sup>122</sup> Thomas F. Waldron & Neil M. Berman, *Principled Principles of Statutory Interpretation: A Judicial Perspective After Two Years of BAPCPA*, 81 AM. BANKR. L.J. 195, 213 (2007), quoting Jean Braucher, *The Challenge To The Bench And Bar Presented By The 2005 Bankruptcy Act: Resistance Need Not Be Futile*, 2007 U. ILL. L. REV. 93, 99 (2007).

<sup>123</sup> *Watt v. Alaska*, 451 U.S. 259, 265–66 (1981) (citations omitted) (quoting *Boston Sand Co. v. United States*, 271 U.S. 41, 48 (1928)).

<sup>124</sup> Waldron & Berman, *supra* note 122, at 212–13 (“If the text of the congressional legislation is ambiguous rather than being subject to plain meaning, the Supreme Court has employed a variety of principles to assist in determining congressional intent. These include, without priority or limitation, the following canons of interpretation: avoiding surplusage, practice under the prior version of the statute, neologisms, comparison with other sections, unforeseen consequences, *expressio unius est exclusio alterius* and legislative history. These principles are frequently used in combination to assist in determining congressional intent.” (internal citations omitted)).

without allowing the creditor to credit bid.<sup>125</sup> The Supreme Court has instructed that “we look first to the statutory language and then to the legislative history if the statutory language is unclear.”<sup>126</sup> The Supreme Court has also directed “that it is always appropriate to consult legislative history to interpret a statute however clear the words of the statute may appear.”<sup>127</sup> Despite clear instruction to consider Congressional intent, the majorities in *Philadelphia Newspapers* and *Pacific Lumber* failed to address the legislative history evincing Congress’s intent to protect secured creditors’ right to credit bid.<sup>128</sup>

Before the enactment of the Bankruptcy Code in 1978, secured creditors were not given special protections unavailable to unsecured creditors.<sup>129</sup> In fact, the Bankruptcy Code did not even provide a test for secured claims.<sup>130</sup>

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<sup>125</sup> The Bankruptcy Appellate Panel for the Ninth Circuit has also long held that legislative intent shows Congress did not intend the other two provisions of § 1129(b)(2)(A) to be used to sidestep the credit bidding requirement in clause (ii). *John Hancock Mut. Life Ins. Co. v. Cal. Hancock, Inc.* (*In re Cal. Hancock, Inc.*), 88 B.R. 226, 231 (B.A.P. 9th Cir. 1988). The Panel rejected a debtor’s plan when it attempted to use § 1129(b)(2)(A)(i) to circumvent the creditor’s right to credit bid at the sale of its collateral. *Id.* The Panel held, “Given the Congressional intent to allow a nonrecourse creditor the right to credit bid in a proposed ‘sale’ of the property pursuant to a plan of reorganization, the bankruptcy court properly determined that the debtor’s proposed plan of reorganization could not be confirmed.” *Id.* Thus, the Panel “affirm[ed a] secured creditor’s right to credit-bid regardless of which subsection of § 1129(b)(2)(A) [the] debtor seeks to invoke.” Markell, *supra* note 65, at 124 n.315 (citing *In re Cal. Hancock*, 88 B.R. at 230–31).

<sup>126</sup> *Blum v. Stenson*, 465 U.S. 886, 896 (1984), cited in *In re Phila. Newspapers, LLC*, 599 F.3d 298, 335 (3d Cir. 2010) (Ambro, J., dissenting).

<sup>127</sup> Kenneth N. Klee, *Legislative History of the New Bankruptcy Law*, 28 DEPAUL L. REV. 941, 957 n.141 (1979) (citing *Train v. Colo. Pub. Interest Research Grp., Inc.*, 426 U.S. 1, 10 (1976)).

<sup>128</sup> William P. Weintraub et al., *Third Circuit Bids Credit Bidding Adieu*, 19 NORTON J. BANKR. L. & PRAC. 265, 278 (2010) (“The majority decision fails to adequately address, however, the schism between a literal interpretation of [§] 1129(b)(2)(A) and legislative intent. The practical result of [the] majority’s decision . . . is hard to reconcile with what seems to be a clear indication that the drafters of the Bankruptcy Code intended to prevent debtors from stripping secured creditor’s liens without providing them with a right to credit bid. It is simply unlikely that Congress intended this distinction.”). Interestingly, the majority in *Philadelphia Newspapers* referenced statutory notes and legislative history to defend its interpretation of “or” even though § 102(3) is not ambiguous. See *supra* note 89; see also H.R. REP. NO. 95-595, at 315 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6272; S. REP. NO. 95-989, at 28 (1978), reprinted in 1978 U.S.C.C.A.N. 5787, 5814). The majority in *Philadelphia Newspapers* rejected the use of most other legislative history in interpreting the statute. The majority’s use of statutory history and notes to defend its reading of “or,” instead of simply applying its plain meaning, is one of the many inconsistencies that appear in the majority’s argument.

<sup>129</sup> Under the old law, secured creditors were only required to receive “adequate protection.” “Under present law a plan may be confirmed over the dissent of a secured creditor as long as the creditor is given ‘adequate protection,’ which includes an appraisal of the collateral and payment in cash of the appraised amount.” Klee, *supra* note 114, at 143 n.83.

<sup>130</sup> See *id.* at 143 (“[T]he test for secured claims is completely novel, affording protection for classes of secured claims that is not provided under present law.”).

However, legislative history demonstrates that when Congress revised the Bankruptcy Code in 1978, the purpose of § 1129(b)(2)(A) was to afford secured creditors separate protections from unsecured creditors.<sup>131</sup>

*i. Floor Statements in the Congressional Record*

The floor statements of Representative Edwards and Senator DeConcini are the most instructive resource on the legislative intent of the revisions.<sup>132</sup> Representative Edwards was one of the principal draftsmen and supporters of the new Bankruptcy Code, and he served as its floor manager in the House of Representatives.<sup>133</sup> Representative Edwards spent years envisioning, drafting, and revising the new law.<sup>134</sup> Representative Edwards was assisted by Senator Dennis DeConcini.<sup>135</sup> Most cases interpreting § 1129(b)(2)(A) have referred to Representative Edwards's statements, and *Collier on Bankruptcy* has also interpreted this section with his floor statements.<sup>136</sup>

Even Representative Edwards suggested that § 1129(b)(2)(A) did not have a single plain meaning because he found it necessary to explain some of its provisions. In his floor statement, Representative Edwards referred to § 1129(b)(2)(A)(ii) as "self explanatory."<sup>137</sup> This suggests that clause (ii), when examined in isolation from clauses (i) and (iii), did indeed have a single plain meaning interpretation. Differently, Representative Edwards implied that clause (iii) was not self-explanatory by delineating several examples of what would constitute the "indubitable equivalent" and what would not.<sup>138</sup> Thus,

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<sup>131</sup> United States v. Ron Pair Enters., Inc., 489 U.S. 235, 240 (1989) ("Congress intended 'significant changes from current law in . . . the treatment of secured creditors and secured claims.'" (quoting H.R. REP. NO. 95-595, at 180 (1977))).

<sup>132</sup> "Because of the absence of a conference and the key roles played by Representative Edwards and his counterpart floor manager Senator DeConcini, we have treated their floor statements on the Bankruptcy Reform Act of 1978 as persuasive evidence of congressional intent." Begier v. IRS, 496 U.S. 53, 64 n.5 (1990). Note that Senator DeConcini gave identical remarks before the Senate floor to Representative Edwards' floor statements delivered before the House. Compare 124 CONG. REC. 32,392-418 (1978) (remarks of Rep. Don Edwards), with 124 CONG. REC. 33,992-4,018 (1978) (remarks of Sen. Dennis DeConcini). These floor statements are considered the best sources of legislative history on the Bankruptcy Reform Act of 1978. Klee, *supra* note 127, at 957 (directing interpreters of the legislative history to begin with the most recent floor statements of Congressman Edwards and Senator DeConcini).

<sup>133</sup> Klee, *supra* note 127, at 941 n.6.

<sup>134</sup> *Id.*

<sup>135</sup> *Id.*

<sup>136</sup> See 7 COLLIER, *supra* note 7, ¶ 1129.04.

<sup>137</sup> 124 CONG. REC. 32,407 (1978) (statement of Rep. Don Edwards) ("Clause (ii) is self explanatory.").

<sup>138</sup> *Id.* ("Abandonment of the collateral to the creditor would clearly satisfy indubitable equivalence, as would a lien on similar collateral. However, present cash payments less than the secured claim would not satisfy the standard because the creditor is deprived of an opportunity to gain from a future increase in value of

even to its draftsman the provision is not self-explanatory. Moreover, of the examples of indubitable equivalence listed, none of them contemplate a sale,<sup>139</sup> suggesting that Congress did not intend clause (iii) to cover sales.

Representative Edwards suggested that all sales of property under a debtor's plan must grant secured creditors the right to credit bid. Representative Edwards noted that “[s]ale of property under [§] 363 or under the plan is excluded from treatment under [§] 1111(b) because of the secured party's right to bid in the full amount of his allowed claim at any sale of collateral under [§] 363(k) of the House amendment.”<sup>140</sup> The majority in *Philadelphia Newspapers* dismissed this persuasive legislative history, arguing that there were instances in which a secured creditor did not have a right to credit bid on its collateral, citing the “for cause” exception in § 363(k).<sup>141</sup> Thus, the majority reasoned, “Given that this legislative history ignores these vital functions [such as the ‘for cause’ exception] of the Code, we cannot credit it over the plain language of the statute to confer an absolute right to credit bid on all asset sales under § 1129(b)(2)(A).”<sup>142</sup> In other words, the majority assumed that because the legislative history did not mention an express exception to the right to credit bid, the legislative history was an entirely unreliable source on the right to credit bid. However, as the language of the statute has already been shown to be ambiguous, Representative Edwards's statement is both relevant and persuasive in arguing that secured creditors have a significant right to credit bid at the sale of their collateral.

Although the plain meaning rule might be effective for interpreting other sections, Representative Edwards implied that some congressional intent was stylistically left out of the plain language of the statute. In his floor statement, he specifically noted that some creditor rights that were “fundamental” to the “fair and equitable” requirement were purposefully omitted from the statute for ease of reading.<sup>143</sup> Thus, § 1129(b) should be read expansively to broadly

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the collateral. Unsecured notes as to the secured claim or equity securities of the debtor would not be the indubitable equivalent.”)

<sup>139</sup> *See id.*

<sup>140</sup> *Id.*

<sup>141</sup> *In re Phila. Newspapers, LLC*, 599 F.3d 298, 317 (3d Cir. 2010).

<sup>142</sup> *Id.*

<sup>143</sup> 124 CONG. REC. 32,407, 34,006 (1978) (“Although many of the factors interpreting ‘fair and equitable’ are specified in paragraph (2), others . . . were omitted from the House amendment to avoid statutory complexity and because they would undoubtedly be found by a court to be fundamental to ‘fair and equitable’ treatment of a dissenting class . . . . [T]he deletion is intended to be one of style and not one of substance.”).

protect creditors' right to fair and equitable treatment, including jealous protection of creditors' rights to credit bid.

ii. *Principles from a Principal Draftsman*

Kenneth Klee, who served as the associate counsel to the House Judiciary Committee and a principal draftsman of the Bankruptcy Reform Act of 1978, provides additional support for the proposition that Congress intended a cramdown sale of collateral to only occur under subsection 1129(b)(2)(ii), in his article, *All You Ever Wanted to Know About Cram Down Under the New Bankruptcy Code*. Although the article cannot wholly substitute for the telling evidence in the Senate and House Reports, the article captures much similar legislative intent, as Klee was a principal drafter of the 1978 Amendments.<sup>144</sup> Klee warned that “[t]he ‘cram-down’ standards appear to be simple, but the appearance is deceiving.”<sup>145</sup> Then, he identified exactly which clause must be used in the cramdown sale of collateral free and clear of a lien: “Under 11 U.S.C. § 1129(b)(2)(A)(i)(I) the lien must be retained whether the collateral is retained by the debtor or a successor to the debtor or is sold subject to the lien. *If the collateral is sold free and clear of the lien, then 11 U.S.C. § 1129(b)(2)(A)(ii) is the controlling provision.*”<sup>146</sup>

Klee also directed that sales of a creditor's collateral can only be crammed down if the creditor has an opportunity to credit bid: “A sale of collateral *must be made* under 11 U.S.C. § 363(k) which permits the lien holders to bid for the collateral and to offset their allowed claims that are secured by the collateral against the purchase price.”<sup>147</sup> The right to offset a claim against the purchase price eventually became known as the right to “credit bid.” Klee reiterated, “[T]he plan may propose to sell collateral free and clear of the lien held by members of the dissenting class as long as the class has a chance to bid in their claims and the lien attaches to the proceeds.”<sup>148</sup>

Klee clarified that the sale of a secured creditor's collateral affects the valuation of an undersecured creditor's claim through the mechanism of credit bidding. Typically, “as a general rule in a reorganization case, both a recourse and a nonrecourse lender will have an allowed unsecured claim to the extent

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<sup>144</sup> Klee, *supra* note 114, 133 n.\*\*.

<sup>145</sup> *Id.* at 156.

<sup>146</sup> *Id.* at 155 n.136 (emphasis added).

<sup>147</sup> *Id.* at 155 n.143 (emphasis added) (citing 11 U.S.C. § 1129(b)(2)(A)(ii)).

<sup>148</sup> Klee, *supra* note 114, at 155.

the value of the collateral is less than the allowed claim.”<sup>149</sup> However, Klee mentioned that the sale of collateral is an exception to this general rule: “[I]f the collateral securing the loan is sold[,] . . . the nonrecourse lender will have a chance at the sale to bid in the total amount of his claim against the purchase price.”<sup>150</sup> To support his conclusion, he cited “§§ 363(k) & 1129(b)(2)(A)(ii),”<sup>151</sup> suggesting that he only intended for collateral to be sold under clause (ii)’s specific sales provision, instead of clause (iii)’s “indubitable equivalence” provision.

To clarify what he considered to be complex situations that arise in a cramdown, Klee examined fourteen hypothetical examples of creditors who are crammed down under § 1129(b).<sup>152</sup> He suggested, “In the event a court is required to apply the cramdown test, the above examples may be of assistance.”<sup>153</sup> However, none of the fourteen examples illustrate a sale of a secured creditor’s collateral pursuant to clause § 1129(b)(2)(A)(iii)’s “indubitable equivalent” provision.<sup>154</sup> The only sales of a secured creditor’s collateral illustrated in the examples is made pursuant to §§ 363(k) and 1129(b)(2)(A)(ii), which would permit the creditor the right to credit bid. This suggests that § 1129(b)(2)(A) was not designed with the intent to allow sidestepping of the creditor’s right to credit bid at the sale of its collateral.

#### *b. Avoiding Surplusage*

By allowing § 1129(b)(2)(A)(iii) to override § 1129(b)(2)(A)(ii), the majorities improperly elevate a general provision over a specific provision and render § 1129(b)(2)(A)(ii) mere surplusage. Two canons of statutory interpretation suggest that a generalized provision cannot be used to override specific requirements in the same subsection. It would have been superfluous of Congress to create a specific clause, followed by a general clause that could sidestep the specific clause.<sup>155</sup> As the Supreme Court stated in *D. Ginsberg &*

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<sup>149</sup> *Id.* at 161.

<sup>150</sup> *Id.*

<sup>151</sup> *Id.* at 161 n.173.

<sup>152</sup> *Id.* at 171.

<sup>153</sup> *Id.*

<sup>154</sup> *See id.* at 146–71.

<sup>155</sup> *In re Phila. Newspapers, LLC*, 599 F.3d 298, 329 (3d Cir. 2010) (Ambro, J., dissenting) (“It seems Pickwickian to believe that Congress would expend the ink and energy detailing procedures in clause (ii) that specifically deal with plan sales of property free of liens, only to leave general language in clause (iii) that could sidestep entirely those very procedures. Unlike the majority, I do not read the language to signal such a result; I read the text to show congressional intent to limit clause (iii) to those situations not already addressed in prior, specifically worded clauses.”)

*Sons, Inc. v. Popkin* long before the Bankruptcy Reform Act of 1978 was passed, “Specific terms prevail over the general in the same or another statute which otherwise might be controlling.”<sup>156</sup> The Supreme Court also noted, “However inclusive may be the general language of a statute, it will not be held to apply to a matter specifically dealt with in another part of the same enactment.”<sup>157</sup> Additionally, a provision should not be read in a way that makes another, more specific provision a “practical nullity.”<sup>158</sup> The Supreme Court has instructed, “[A] statute should be interpreted so as not to render one part inoperative.”<sup>159</sup>

Congress designed § 1129(b)(2)(A) to delineate two specific provisions and one residual catch-all to satisfy the fair and equitable requirement for crammed down secured creditors. Clause (ii) specifically applies when a debtor proposes to cram down a sale free and clear of a secured creditor’s liens. Meanwhile, clause (iii) applies broadly to any cramdown transaction in which a secured creditor receives the “indubitable equivalent” of its claim.

By design, Congress implicitly excluded the “indubitable equivalence” option in transactions in which the secured creditor’s collateral is sold free and clear of liens. Clause (iii) should not be interpreted in a way that makes the clause (ii) a “practical nullity.” Therefore, § 1129(b)(2)(A) should be interpreted to require any cramdown plan that proposes a sale free and clear of liens to meet the requirements specified in clause (ii), including the secured creditor’s right to credit bid.

Some may argue that clause (iii), the indubitable equivalent standard, is itself a specific clause. However, clause (iii) does not include specific provisions pertaining to the sale of collateral free and clear of liens. Even if it is a specific clause, it is not applicable to sales of collateral. Clause (ii) is more specific than clause (iii) in governing sales of collateral free and clear of liens. As the Bankruptcy Court for the Southern District of New York reasoned in *In re Kent Terminal*, “As a rule of statutory construction, courts observe that where two provisions apply, the more specific governs. Certainly,

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<sup>156</sup> D. Ginsberg & Sons v. Popkin, 285 U.S. 204, 208 (1932).

<sup>157</sup> Fourco Glass Co., v. Transmirra Prods. Corp., 353 U.S. 222, 228 (1957).

<sup>158</sup> See United Sav. Ass’n of Tex. v. Timbers of Inwood Forest Assocs., 484 U.S. 365, 375 (1988).

<sup>159</sup> Mountain States Tel. & Tel. Co. v. Pueblo of Santa Ana, 472 U.S. 237, 249 (1985); see also TRW, Inc. v. Andrews, 534 U.S. 19, 31 (2001) (“It is ‘a cardinal principle of statutory construction’ that ‘a statute ought, upon the whole, to be so construed that, if it can be prevented, no clause, sentence, or word shall be superfluous, void, or insignificant.’” (quoting *Duncan v. Walker*, 533 U.S. 167, 174 (U.S. 2001))).

§ 1129(b)(2)(A)(ii) is more specific than clause (i) if property is sold free and clear of liens under a plan.”<sup>160</sup>

*c. Unforeseen Consequences*

Economic policy also supports an interpretation of § 1129 guaranteeing secured creditors the right to credit bid. Congress rightfully had an interest in protecting secured creditors’ rights when it passed the Bankruptcy Reform Act of 1978. Congress sought to encourage secured lending because “secured credit lowers the costs of lending transactions not only by increasing the strength of the lender’s legal right to force the borrower to pay, but also . . . by limiting the borrower’s ability to engage in conduct that lessens the likelihood of repayment.”<sup>161</sup> One of the protections the act granted to secured creditors was the right to credit bid on their collateral sold pursuant to a sale free and clear of liens, conducted under § 1129(b)(2)(A).<sup>162</sup> By granting secured creditors the right to credit bid on the sale of its collateral, Congress implied that this right was “necessary to ensure proper valuation of the collateral at a sale free of liens.”<sup>163</sup> This right is based upon the secured creditor’s right to receive the full amount of their claim.<sup>164</sup>

Policy also supports the interpretation of § 1129(b)(2)(A)(ii) as the only cramdown mechanism for debtors to conduct a sale of a creditor’s collateral. Debtors may have a motivation to deny credit bidding<sup>165</sup> and will only seek confirmation of a plan under clause (ii) if offering credit bidding rights is advantageous to them. However, such a plan directly contradicts the statutory intent of §§ 363(k) and 1129(b)(2)(A) to strengthen protections for secured creditors. Although “most courts jealously protect the secured creditor’s right to credit bid, and will deny confirmation if that right is significantly impaired,”<sup>166</sup> Congress intended to strengthen the protections for secured

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<sup>160</sup> *In re Kent Terminal Corp.*, 166 B.R. 555, 565 n.15 (1994).

<sup>161</sup> Ronald J. Mann, *Explaining the Pattern of Secured Credit*, 110 HARV. L. REV. 625, 683 (1997), cited in *In re Phila. Newspapers, LLC*, 599 F.3d 298, 337 (3d Cir. 2010) (Ambro, J., dissenting).

<sup>162</sup> See 11 U.S.C. § 1129(b)(2)(A) (2006).

<sup>163</sup> *In re Phila. Newspapers*, 599 F.3d at 337 (Ambro, J., dissenting).

<sup>164</sup> See Brubaker, *supra* note 21, at 13 (discussing a secured creditor’s right to a lien on the proceeds from a sale of its collateral).

<sup>165</sup> For examples of possible debtor motivations to deny credit bidding, specifically for nonrecourse creditors, see Rubinger & Marsh, *supra* note 70, at 266 (“Perhaps the debtor’s motivation in doing so is to effectuate a sale to a related entity at a bargain price. Or, the debtor’s motivation could be to conduct a sale which yields actual cash to be used in funding its plan. A credit bid is not nearly as attractive to the debtor since it is essentially a set-off of the secured creditor’s claim and does not yield any cash.”).

<sup>166</sup> 7 COLLIER, *supra* note 7, ¶ 1129.04[2][b][ii].

creditors via statute, instead of leaving creditor rights to judicial discretion. The indubitable equivalent provision in clause (iii), if not narrowly interpreted by the courts, might “provide carte blanche to creative debtors,” which conflicts with the purpose of § 1129(b)(2)(A) to protect secured creditors.<sup>167</sup>

The policy implications of the confirmation process itself also urge reading § 1129(b)(2)(A)(ii) as the only mechanism for debtors to cram down a sale of a creditor’s collateral. The negotiations that occur during the confirmation process are shaped by the bargaining power granted to creditors by the debtor’s burdensome cramdown requirements in § 1129. The significant fair and equitable requirements in § 1129 are evidence that Congress sought to encourage negotiation between debtors and creditors. As Klee noted, “The complexity of cram down should encourage the debtor to bargain with creditors to gain acceptance of a plan in a majority of cases.”<sup>168</sup> The majorities’ decisions greatly ease these requirements for the debtor, weakening creditors’ bargaining power in negotiations. If secured creditors are not entitled to credit bid, they can lose their leverage throughout the confirmation process, even before a cramdown is proposed. One commentator suggested, “[A] secured creditor may not be entitled to the proverbial ‘seat at the table’ in any plan negotiations where the plan involves a disposition of the secured creditor’s collateral.”<sup>169</sup> This will have its greatest effect on secured creditors with a large undersecured claim that once had “substantial leverage” in such negotiations.<sup>170</sup> Now, during plan negotiations, plan proponents have the leverage that comes with being able to threaten to cram down a plan denying credit bid rights. Secured creditors may become more likely to agree to a chapter 11 plan with less favorable terms, and lenders may concede other terms in negotiation.

Additionally, the right to credit bid is integral to the current sales process between debtors and creditors. Within the lending industry, debtors and creditors have settled expectations on negotiating debt instruments. Any change in the interpretation of the absolute right to credit bid may lead to higher lending costs as secured creditors will price more risk into lending decisions. The ultimate cost of habitually denying secured lenders the

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<sup>167</sup> Alfred S. Lury & Brett J. Berlin, *When Can Less than All of a Creditor’s Collateral Serve as the Indubitable Equivalent of the Creditor’s Secured Claim?*, 28 CUMB. L. REV. 333, 340 (1997–98).

<sup>168</sup> Klee, *supra* note 114, at 171.

<sup>169</sup> Daniel Guyder & Daniel Morse, *Extinguishing a Secured Creditor’s Right to Credit Bid in a Chapter 11 Cram Down*, 2010 PRATT’S J. BANKR. L. 65, 65.

<sup>170</sup> *Id.* at 70.

opportunity to credit bid will trickle down to debtors. Consequently, denying secured lenders' right to credit bid at an auction of its collateral may reduce overall availability of lending to debtors. This may also increase the cost of corporate reorganizations, as secured creditors will become more hostile to a § 1129 cramdown and litigate heavily to protect their rights.

The difficulty of discerning a statute's single plain meaning urges consideration of legislative history and canons of statutory interpretation. In addition, the policy implications of loosely interpreting the statute illustrate why Congress intended strict requirements on the free and clear sale of a secured creditor's collateral, including the requirement that the creditor be permitted to credit bid at the sale. All courts should recognize this right to credit bid in a cramdown sale.

*E. Picking up the Paper: How Creditors Can Protect Their Rights to The Full Value of Their Collateral*

Creditors must be proactive to counter the frightening "trend toward judicial disregard for the bankruptcy processes that protect priority."<sup>171</sup> This section analyzes preemptive strategies creditors can implement to best protect their rights to collateral and mitigate the blow from the *Philadelphia Newspapers* and *Pacific Lumber* decisions. Lenders in jurisdictions that already have denied an absolute right to credit bid, as well as lenders in jurisdictions that might follow suit, should implement these strategies.

The best and most obvious strategies are those that require secured creditors to put forth additional resources to protect their collateral. These include offering debtor-in-possession (DIP) financing,<sup>172</sup> aggressively litigating during the confirmation hearing process,<sup>173</sup> and, if unsuccessful, submitting cash bids during the auction sale.<sup>174</sup> While they are likely to be the most successful, these strategies will not be available to most creditors because of their high cost.

The earlier a secured creditor attempts to protect its right to receive the full value of its collateral, the less costly the attempt will be. Thus, as a less expensive alternative to the methods mentioned above, secured creditors

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<sup>171</sup> Barry E. Adler, *Does Reorganization Need Reform?: A Reassessment of Bankruptcy Reorganization After Chrysler and General Motors*, 18 AM. BANKR. INST. L. REV. 305, 318 n.18 (2010).

<sup>172</sup> See discussion *infra* Part E.3.a.

<sup>173</sup> See discussion *infra* Part E.4.

<sup>174</sup> See discussion *infra* Part E.5.

should implement preventative tactics earlier in the lending cycle to more affordably reduce the risk that they will receive less than the full value of their collateral.

### 1. *Investment Strategies*

Creditors must act more conservatively from the commencement of the lending cycle. Of course, creditors should avoid questionable investments. Meanwhile, for investments that they do undertake, lenders must carefully draft loan agreement documents that guarantee their ability to credit bid.<sup>175</sup> Additionally, lenders must price the new risk of being denied the opportunity to credit bid. In exchange for bearing this costly risk, creditors should consider raising lending costs.<sup>176</sup> By avoiding high-risk investments, carefully drafting loan agreements, and pricing the cost of bearing the new risk into their lending rates, creditors will be able to start the lending cycle with a more predictable outlook.

### 2. *Prepetition Strategies*

A secured creditor must continually assess the financial health of its debtors. Upon observing that its debtor is nearing financial distress, a creditor should initiate or threaten to initiate a foreclosure action in state court, instead of waiting for its debtor to file bankruptcy.<sup>177</sup>

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<sup>175</sup> Brett H. Miller et al., *Lenders Beware: The 3rd Circuit Has Other Ideas about Credit Bidding*, 15 WESTLAW J. BANK & LENDER LIABILITY, Apr. 26, 2010, at 1, 6 (“Before this decision came down, a lender negotiated a loan agreement knowing that it would have the right to credit bid its claim in a plan sale, thereby ensuring that either its claim is fully covered by the final purchase price or the lender would be able to take back the property from the debtor.”); Weintraub et al., *supra* note 128, at 278.

<sup>176</sup> See Eric W. Anderson & Joshua J. Lewis, *The Philadelphia Story: Third Circuit Denies Lenders’ Credit-Bid Rights*, AM. BANKR. INST. J., May 2010, at 14, 63; see also Carolyn P. Richter & Sabrina G. Fitze, *Philadelphia Newspapers’ Credit Bid Decision—How Does Losing the Absolute Right to Credit Bid in a Sale Under a Plan of Reorganization Impact Lenders and Borrowers?*, 2010 PRATT’S J. BANKR. L. 274, 280 (“If secured creditors can no longer absolutely rely on their ability to credit bid in extending credit to debtors, will this risk be passed on by lenders in the form of increased interest rates and reduction in credit availability?”).

<sup>177</sup> Daniel Morman & Kenneth A. Welt, *Foreclosure Sales Should Be Allowed in Court*, AM. BANKR. INST. J., Jul.–Aug. 2010, at 46, 46. Although “[i]t is readily accepted that sales of properties under § 363 of the Bankruptcy Code in bankruptcy court generate higher prices than those in foreclosure sales under state court procedure,” the higher prices are presumably a result of the requirement in § 363(k) that creditors have the right to credit bid at a § 363 sale in bankruptcy court. *Id.* Therefore, creditors fearing a denial of credit bidding rights under a cramdown plan should initiate a foreclosure sale in bankruptcy court, despite the reality that it will likely generate a lower price than a sale before the bankruptcy court.

Prepetition workout agreements between debtors and creditors are particularly useful for secured creditors fearing a denial of credit bidding rights. In any prepetition workout agreement, a creditor should seek an agreement with the debtor “not to contest relief from the stay in a subsequent bankruptcy proceeding.”<sup>178</sup> If this agreement is later enforced by a bankruptcy court, then creditors will have the opportunity to prevent a cramdown sale by seeking relief from the stay and initiating a § 363 sale, which will guarantee a credit bidding opportunity.<sup>179</sup> With this goal in mind, creditors must negotiate carefully. Debtors in the Third and Fifth Circuits may attempt to leverage their positions by threatening to pursue a cramdown sale denying credit bidding rights.<sup>180</sup>

Additionally, if a debtor appears likely to file bankruptcy, creditors should pressure the debtor to file outside of the Third and Fifth Circuits, where creditors may still have an absolute right to credit bid.<sup>181</sup>

### 3. *Strategies During Plan Creation*

After the debtor files a chapter 11 bankruptcy petition, a secured lender should consider three strategies: (1) providing DIP financing, (2) seeking a lift of the automatic stay, and (3) swapping its debt for equity.

#### a. *Debtor-in-Possession Financing*

Upon filing chapter 11 bankruptcy, debtors will require postbankruptcy financing to continue operations and to implement a restructuring plan. Secured creditors should pursue an opportunity to offer postpetition DIP financing. Such an agreement will improve the creditor’s leverage over the debtor,<sup>182</sup> and the creditor can seek to extract concessions from the debtor.<sup>183</sup>

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<sup>178</sup> JAMES M. LAWNICZAK, 2 ASSET BASED FINANCING: A TRANSACTIONAL GUIDE § 16.10[2] (2011).

<sup>179</sup> See 11 U.S.C. § 363(k) (2006).

<sup>180</sup> *But see In re Phila. Newspapers, LLC*, 418 B.R. 548, 553 (E.D. Pa. 2009) (restructuring negotiations with secured creditors and other prepetition lenders failed), *aff’d*, 599 F.3d 298 (3d Cir. 2010).

<sup>181</sup> Weintraub et al., *supra* note 128, at 278.

<sup>182</sup> See George W. Kunej, *Hijacking Chapter 11*, 21 EMORY BANKR. DEV. J. 19, 74 (2004) (“DIP lenders and their counsel have taken the sparse authorizing language of Bankruptcy Code § 364 and used it to perfect a transaction that garners them high fees, good return on investment, substantial control over the debtor’s management and operations, and enhanced prospects for repayment of their prepetition debt.”).

<sup>183</sup> Weintraub et al., *supra* note 128, at 279 (“Although the full import of the *Philadelphia Newspapers* decision cannot yet be determined, recent news reports indicate that secured lenders are already trying to extract concessions in DIP financing agreements to neutralize the plan strategy used by the Debtors in *Philadelphia Newspapers*.”).

However, postpetition DIP financing is only a feasible solution for large-scale lenders that have the capacity to extend additional credit. Moreover, DIP financing is only recommended if the creditor predicts a successful chapter 11 restructuring. Otherwise, if a creditor lacks confidence in a debtor's management, then it should hesitate to protect its collateral with DIP financing.

Optimally, a creditor should extract three concessions from the debtor in exchange for offering postpetition financing. These concessions will be incorporated directly as loan covenants into the new financing agreement. First, creditors should secure an agreement ensuring that, in exchange for postpetition financing, the creditor can credit bid in all circumstances where the collateral is to be sold.<sup>184</sup> Such a provision would require a debtor to waive its objection to the creditor's opportunity to credit bid. However, pursuing agreements with such a provision may be risky, as such agreements might not be enforceable if courts refuse to approve them.<sup>185</sup> While "[c]ourts generally allow a debtor in possession that obtains postpetition financing from a prepetition lender to waive, as part of the financing arrangement, any objections to the validity, priority, and amount of the lender's prepetition security interest,"<sup>186</sup> a debtor's waiver to challenge credit bidding might be more controversial.

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<sup>184</sup> Anderson & Lewis, *supra* note 176, at 63; Richter & Fitze, *supra* note 176, at 280; *see also* Kuney, *supra* note 182, at 64 ("Bankruptcy courts have allowed chapter 11 debtors to waive their rights against lenders for providing DIP financing. As consideration for DIP financing, debtors may, for example, waive the right to object to the validity, priority, and amount of the lender's prepetition claims. These waivers are routinely included in the DIP loan documents to provide an incentive to loan."); Weintraub et al., *supra* note 128, at 279. ("The concessions presumably take the form of an agreement that the secured lenders can credit bid in all circumstances where their collateral is to be sold."); Paul H. Zumbro & Robert H. Trust, *Paul H. Zumbro and Robert H. Trust on In re Philadelphia Newspapers, LLC*, 2010 LEXISNEXIS EMERGING ISSUES ANALYSIS 4956, at 4 (2010) ("[T]hey may, if they are providing debtor-in-possession financing or consenting to use of cash collateral, attempt to negotiate limits on the kind of plan the debtor may file.").

<sup>185</sup> Anderson & Lewis, *supra* note 176, at 63 ("Of course, courts may not approve any DIP order or cash collateral order restricting a debtor's ability to file and confirm a plan, but it seems reasonable for a DIP lender to insist that submission of a plan proposing to deny credit-bidding would constitute a default under the DIP facility or cash collateral order."); Weintraub et al., *supra* note 128, 279 ("The enforceability of these concessions and the willingness of bankruptcy courts to approve lender incentives . . . remains to be seen.").

<sup>186</sup> PETER ANTOSZYK, TRENDS IN DEBTOR IN POSSESSION FINANCING 1, 8 (2001). If the waiver of the debtor's claim is controversial, the lender can argue that "the order was not so much a 'settlement' as a term or condition of the bargain made between the debtor and creditor to encourage the creditor to extend further postpetition credit." *Id.* at 9 (quoting *In re Ellingsen MacLean Oil Co.*, 834 F.2d 599, 604 (6th Cir. 1997)).

Second, a postpetition financing agreement should also include a provision requiring a quick asset sale within the debtor's first 100 days after filing.<sup>187</sup> Such a provision would make the DIP loan conditioned on the creditor's ability to force an auction under § 363 before the plan process is finalized.<sup>188</sup> As discussed earlier, any sale under § 363 must allow a secured creditor the opportunity to credit bid on its collateral.<sup>189</sup> In addition to guaranteeing the creditor an opportunity to credit bid, a quick asset sale abridges the debtor's opportunity to find a favored buyer to cram down the lenders.<sup>190</sup> Of course, as any transaction outside the course of everyday business, a quick asset sale, even if provided for in a postpetition financing agreement, will require court approval.<sup>191</sup> Another provision a creditor should include in a DIP financing agreement is a "drop-dead clause," enhancing a creditor's rights in the instance of a debtor's default on the DIP financing loan. Essentially, the clause will create a mechanism for the creditor to lift the automatic stay on its original collateral. These clauses "provid[e] for a future lifting of the stay and authoriz[e] the lender to exercise its rights and remedies upon the debtor's default under the [DIP] loan documents without the need to gain bankruptcy approval at the time of a default."<sup>192</sup> The provision should be structured "so that previously approved recitals and stipulations in the loan documents limit the issues to be litigated to whether the debtor in fact defaulted under the terms of the [DIP financing] agreement."<sup>193</sup> Although the debtor's default on the DIP financing loan with a "drop-dead clause" will not automatically lift the stay, a court will only consider whether the debtor defaulted. After the court determines that the debtor defaulted on its DIP financing loan agreement, then the court will likely lift the automatic stay on the creditor's collateral. With the stay lifted, the creditor will be able to execute a sale under its own terms, including a right to credit bid.

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<sup>187</sup> Miller et al., *supra* note 175, at 6 ("[M]ore lenders might choose to build milestones into debtor in possession facilities that require asset sales within the first 100 days of the case in order to preserve the lenders' [§] 363(k) credit bid rights.").

<sup>188</sup> See Kuney, *supra* note 182, at 108 ("Often, DIP lenders will condition their loans on a quick sale. . . . [This action] result[s] in inducing—or even forcing—the debtor to sell all or substantially all of its assets as a going concern via a fast § 363(f) sale.").

<sup>189</sup> LAWNICZAK, *supra* note 178, § 16.11[4(d)].

<sup>190</sup> Miller et al., *supra* note 175, at 5; Darryl S. Laddin & Sean C. Kulka, *Rulings Shift Leverage Away from Secured Creditors: The Right to Credit-Bid May Dissolve if a Plan Provides the 'Indubitable Equivalent' of the Claim*, 32 NAT'L L.J., Feb. 15, 2010.

<sup>191</sup> LAWNICZAK, *supra* note 178, § 16.11[1].

<sup>192</sup> Kuney, *supra* note 182, at 68. To be enforceable the provision should also provide for notice and an opportunity to be heard before lifting the stay; automatic "drop-dead clauses" are generally not enforceable. *See id.* at 68–69.

<sup>193</sup> *Id.* at 69; *see also* ANTOSZYK, *supra* note 186, at 9.

b. *Seeking a Lift of the Automatic Stay*

Instead of financing the debtor to provide a future opportunity to seek a lift of the automatic stay, a secured creditor can also immediately petition for a lift of the automatic stay.<sup>194</sup> A lift of the stay will permit the secured creditor to foreclose on its collateral. A secured creditor should seek to lift the stay if the debtor is not willing to work with the secured creditor, or vice versa.<sup>195</sup> A creditor should seek relief from the stay shortly after filing for chapter 11 bankruptcy.<sup>196</sup> Because courts may initially offer a debtor some leeway, repeated attempts to seek relief may be necessary until relief is granted.<sup>197</sup>

In most instances, the court may grant relief from the automatic stay “for cause, including the lack of adequate protection of an interest in property of such party in interest; [or] . . . if—(A) the debtor does not have an equity in such property; and (B) such property is not necessary to an effective reorganization.”<sup>198</sup> Thus, a secured creditor must demonstrate “cause.”<sup>199</sup> To show this, a lender should argue that the lender has not received adequate protection.<sup>200</sup> Alternatively, a lender could argue “cause” by demonstrating that a debtor does not have equity in the lender’s collateral; however, lenders should be wary of arguing for a low valuation, as they may find themselves inconsistently seeking a higher valuation later in the case.<sup>201</sup>

c. *Debt-for-Equity Swap*

A third option during the planning phase is for secured lenders to seek a debt-for-equity swap, in which “creditors exchange their debt claims for new

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<sup>194</sup> Laddin & Kulka, *supra* note 190.

<sup>195</sup> See LAWNICZAK, *supra* note 178, § 16.10[1]. Typically, if the creditor and debtor are willing to work together, it will “obtain bankruptcy court approval of its rights either through debtor-in-possession financing or a cash collateral order.” *Id.*

<sup>196</sup> *Id.*

<sup>197</sup> *Id.*

<sup>198</sup> 11 U.S.C. § 362(d)(1), (2) (2006). Section 362(d) includes two other grounds for relief from the stay, but they are limited in scope. The first ground only affects single asset real estate cases. *Id.* § 362(d)(3). The other ground, added recently by Congress in its 2005 Act, affects only claims secured by real property in which the filing “was part of a scheme to delay, hinder, or defraud creditors.” *Id.* § 362(d)(4).

<sup>199</sup> See *id.* § 362(d)(1).

<sup>200</sup> *Id.*

<sup>201</sup> LAWNICZAK, *supra* note 178, § 16.10[3][a] (“For example, the creditor may be arguing for a much higher value if the matter comes up on plan confirmation, where the secured party’s secured claim will be the value of the property. Even though a court determination of value for one purpose at an earlier time is not absolutely binding on what the same property is worth for a different purpose at a subsequent time, the court is still likely to remember what happened at the first hearing.”).

equity securities in the reorganized debtor.”<sup>202</sup> With this strategy, a secured creditor forgives debt in exchange for receiving shares.<sup>203</sup> A debt-for-equity swap entirely eliminates the risks of competitive bidding and provides an efficient means for a secured lender to acquire the debtor’s business.<sup>204</sup>

Like a secured creditor who employs credit bidding at an auction sale of its collateral, a lender exchanging its debt for equity avoids the risk of its collateral selling for a low price. Debt-for-equity swaps are useful “in these times of persistently stagnant credit markets” because they prevent sales “at cyclically low fire sale prices.”<sup>205</sup> Furthermore, debt-for-equity swaps are also regarded as “an effective means by which to effect a reorganization where the impaired creditors are betting that their collective fortunes will be furthered over time by overall improving business conditions.”<sup>206</sup> However, a secured creditor should hesitate to seek a debt-for-equity swap when it cannot forecast improving business conditions or an appreciation in the value of its collateral.<sup>207</sup> Additionally, the debtor-in-possession, or its insiders, may prevent a debt-for-equity swap from occurring.<sup>208</sup>

#### 4. *Aggressive Litigation of Valuation*

If a debtor has proposed a cramdown plan that denies credit bidding rights, secured creditors should appear during the confirmation hearing to aggressively protect their rights. The lender should not waive the opportunity to aggressively litigate the “indubitable equivalent” standard. Whether the indubitable equivalent standard can ever be met if credit bidding rights are denied is one obvious unanswered question. Secured creditors must prepare to litigate this issue: “[U]nlike the secured creditors in *Pacific Lumber*, a secured creditor should aggressively challenge the sufficiency of the marketing and valuation of its collateral, to preserve the argument that the restriction on credit

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<sup>202</sup> Leonard P. Goldberger, *Debt-for-Equity Moves Down the Food Chain*, 29 AM. BANKR. INST. J., Oct 2010, at 30, 30.

<sup>203</sup> *Id.*

<sup>204</sup> *Id.* (“The recent case of *Philadelphia Newspapers LLC* is a stark object lesson in the perils facing secured creditors that attempt to acquire control of a reorganizing debtor by bidding in their liens under § 363(k).”).

<sup>205</sup> *Id.*

<sup>206</sup> *Id.*

<sup>207</sup> *See id.*

<sup>208</sup> *See* *Outboard Marine Corp. v. Quantum Indus., LDC (In re Outboard Marine)*, No. 02 C 1594, 2003 WL 21697357, at \*3 (N.D. Ill. 2003). Debtors use equitable subordination as a mechanism for prevention. This entails “recharacterizing” the advance of money as equity instead of debt. To show this, the secured creditor must be shown to have engaged in inequitable conduct.

bidding failed to generate fair market value at the auction or the indubitable equivalent of its claim.”<sup>209</sup>

At a confirmation hearing in which a debtor attempts to proceed under § 1129(b)(2)(A)(iii), secured lenders should more aggressively dispute the valuation of the indubitable equivalent.<sup>210</sup> As the Fifth Circuit warned, “Whatever uncertainties exist about indubitable equivalent, paying off secured creditors in cash can hardly be improper if the plan accurately reflected the value of the [secured creditors’] collateral.”<sup>211</sup> The creditor should oppose the debtor’s valuation of the collateral. The debtor must show “that the valuation proposed by the debtor is not market value, and thus only a credit bid will give it the indubitable equivalent.”<sup>212</sup> If the lender can establish that it did not receive the indubitable equivalent, then the plan cannot later be confirmed under § 1129(b)(2)(A)(iii).<sup>213</sup> Creditors should center their independent valuation on the “Supreme Court’s 1999 decision casting a jaundiced eye toward insider plans that attempt to cram[ ]down secured lenders.”<sup>214</sup> The Third Circuit itself even suggested that a secured lender can dispute whether it receives the indubitable equivalent of its collateral when it is sold with an “absence of a credit bid.”<sup>215</sup> The Seventh Circuit went even further and reasoned, “[E]ven if we analyze Subsection (iii) of [§] 1129(b)(2)(A) in isolation, the text of the [indubitable equivalent] provision does not unambiguously indicate that plans such as those proposed by the Debtors [denying secured lenders the opportunity to credit bid] qualify for ‘fair and equitable’ status.”<sup>216</sup> Although the confirmation hearing may focus on the quantitative value of their claim, creditors should argue that they would not receive the indubitable equivalent, and the proposed sale would not be “fair and equitable,” because the value of their claim must account for all of the

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<sup>209</sup> Laddin & Kulka, *supra* note 190.

<sup>210</sup> See Weintraub et al., *supra* note 128, at 279.

<sup>211</sup> Bank of N.Y. Trust Co., NA v. Official Unsecured Creditors’ Comm. (*In re* Pac. Lumber Co.), 584 F.3d 229, 247 (5th Cir. 2009).

<sup>212</sup> Richter & Fitze, *supra* note 176, at 280; see also Christenfeld & Goodstein, *supra* note 69 (“[C]reditors should be prepared to provide their own market valuation at the confirmation hearing to bolster their argument that future appreciation of the collateral will provide better value to the creditors.”).

<sup>213</sup> Richter & Fitze, *supra* note 176, at 280.

<sup>214</sup> Zumbro & Trust, *supra* note 184, at 4.

<sup>215</sup> *In re* Phila. Newspapers, 599 F.3d 298, 317–18 (3d Cir. 2010) (“[A] lender can still object to plan confirmation on a variety of bases, including that the absence of a credit bid did not provide it with the ‘indubitable equivalent’ of its collateral.”).

<sup>216</sup> River Rd. Hotel Partners, LLC v. Amalgamated Bank (*In re* River Rd. Hotel Partners, LLC), No. 10-3597, 2011 U.S. App. LEXIS 13131, at \*6 (7th Cir. June 28, 2011), *petition for cert. filed*, 80 U.S.L.W. 3112 (U.S. Aug. 5, 2011) (No. 11-166).

rights available to secured creditors.<sup>217</sup> These rights include the right to take back their collateral and the right to credit bid. Aggressive litigation focusing on these rights may therefore be able to stop a creditor from facing a cramdown without its familiar right to credit bid at an auction sale of its collateral.

##### 5. *Cramdown Strategies (After Denial of a Request to Credit Bid)*

The best, and perhaps most obvious, solution for secured creditors who sought to credit bid at the sale of their collateral is to present a cash bid at the same sale. Secured lenders can potentially follow in the footsteps of the creditors in *Philadelphia Newspapers*, who were denied a right to credit bid, and instead made a cash bid at the auction, up to the value of their claims.<sup>218</sup> Cash bidding is a useful mechanism when the lender has been denied the opportunity to credit bid and the collateral yields an unfair price during the auction. Cash bidding is the best option because it mirrors the effect of credit bidding: the creditor can veto a low sales price by bidding up the price.<sup>219</sup>

Cash bidding requires liquidity. Unlike credit bidders, cash bidders must front the funds for their bid. Thus, to cash bid, lenders must have access to enough cash to present at the auction sale. If the lender does not have enough cash on hand to bid on its collateral, the lender must consider “a mechanism for funding a cash bid,”<sup>220</sup> including a “daylight loan.”<sup>221</sup> This option is “perhaps not as appealing during these difficult financial times,” but may be especially useful if the “lender believes that its collateral is appreciating.”<sup>222</sup> If the creditor purchases its collateral, it can later resell it for a higher price upon acquiring the asset.

In light of the economic downturn, presenting a cash bid is unlikely to occur because of the lack of liquidity in the lending market. Cash bidding is

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<sup>217</sup> Anderson & Lewis, *supra* note 176, at 63 (One way to argue that the absence of a credit bid did not provide the secured lender with the indubitable equivalent is for creditors to “argue that their ‘claim’ consists of their full bundle of rights against the debtors and their collateral, and, outside of bankruptcy, a critical component of their claim was the ultimate ability to foreclose upon and take back their collateral. Under this argument, denial of credit-bidding could not truly be the indubitable equivalent of the lenders’ claim because the right to credit is a key benefit of the lenders’ prepetition bargain.”).

<sup>218</sup> See *supra* text accompanying notes 23–27.

<sup>219</sup> Weintraub et al., *supra* note 128, at 279.

<sup>220</sup> Christenfeld & Goodstein, *supra* note 69.

<sup>221</sup> Zumbro & Trust, *supra* note 184, at 4.

<sup>222</sup> Laddin & Kulkin, *supra* note 190.

most realistic in situations where a single financial institution holds the debt.<sup>223</sup> This option is less realistic where multiple creditors hold the debt.<sup>224</sup> However, in *Philadelphia Newspapers*, the creditors, a consortium of financial institutions, pooled together funds to generate a competitive cash bid that allowed them to purchase substantially all of the debtors' assets.<sup>225</sup> The prospects of presenting a cash bid will likely improve with the end of the economic recession.

These strategies strengthen a secured creditor's bargaining power to ensure that it receives the full value of its collateral during a chapter 11 bankruptcy.

### CONCLUSION

In *Philadelphia Newspapers*, the secured creditors still managed to prevail at the auction sale of their collateral, despite being denied the opportunity to credit bid by the Third Circuit. The creditors' success came at the cost of financing expensive litigation and assembling a sizable cash bid. Meanwhile, in most other circuits, a debtor's ability to circumvent its secured creditors' right to credit bid under § 1129(b)(2)(A)(ii) remains unclear.

Courts must recognize that § 1129(b)(2)(A) is ambiguous and allows for two reasonable constructions. In light of the ambiguity, legislative history and canons of statutory interpretation should be applied to clarify which construction Congress intended. The legislative history of the Bankruptcy Reform Act of 1978 and the cardinal canons of statutory interpretation urge an interpretation of § 1129(b)(2)(A) that favors the secured creditors' right to credit bid at the free and clear sale of their collateral. If courts hold otherwise, secured creditors will be forced to take strategic actions to ensure that they receive the full value of their collateral in a chapter 11 filing. Those strategies

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<sup>223</sup> Richter & Fitze, *supra* note 176, at 279 ("In an auction, the impact may be less significant if a single financial institution with liquid assets holds the debt. Secured creditors that have liquidity can participate in an auction by bidding and paying cash at closing, trusting that the proceeds will be paid to it as the holder of the lien.").

<sup>224</sup> *Id.* (noting that when multiple debtors consider funding a cash bid through additional debt, a unanimous vote is typically required).

<sup>225</sup> See *supra* text accompanying notes 25–27.

will be very costly, including increased lending fees and litigation expenses. Until the circuit court decisions are overturned, the costly lender responses to *Philadelphia Newspapers* and *Pacific Lumber* will trickle down to all debtors.

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