Viewpoint

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River Road Decision Vindicates Philadelphia Newspapers Dissent

By Benjamin D. Feder

Justice Oliver Wendell Holmes famously wrote, "A page of history is worth a volume of logic." This aphorism to some extent explains the strong adverse reaction of many bankruptcy lawyers towards last year's decision on credit bidding by the Third U.S. Circuit Court of Appeals in the *Philadelphia Newspapers* Chapter 11 case. The Third Circuit majority read 11 U.S.C. Section 1129(b)(2)(A), the "cramdown" provisions of the U.S. Bankruptcy Code, as permitting an auction of the lenders' collateral to take place pursuant to a plan of reorganization while denying the lenders the right to credit bid their debt, blithely ignoring longstanding commercial practice in favor of a mechanistic invocation of the so-called "plain meaning" rule of statutory interpretation.

The criticism, of course, was not limited to disinterested legal observers. Third Circuit Judge Tom Ambro, a bankruptcy practitioner of many years, penned a widely noted dissent, charging that the result flew in the face of both the established principle that property rights in bankruptcy look to applicable non-bankruptcy law, and the expectation that the Bankruptcy Code expressly protects such non-bankruptcy rights—particularly the right of a secured creditor to look to its collateral in the event of non-payment.

It was therefore a welcome development for critics of *Philadelphia Newspapers* that the Seventh Circuit's recent unanimous opinion on credit bidding in *River Road Hotel Partners LLC* expressly adopted Judge Ambro's dissent analysis.

In *River Road*, the debtors sought to rely on *Philadelphia Newspapers* in putting forward a plan of reorganization that proposed an auction of the secured lenders' collateral, but would have expressly denied the lenders the right to credit bid their debt. The rationale in both cases rested on a formalistic reading of Section 1129(b)(2)(A) of the Bankruptcy Code. That section describes three different means by which a plan of reorganization can be found to be "fair and equitable" and thus capable of being confirmed without the consent of a secured lender class (i.e., "crammed down"):

(i) lender retention of liens securing the obligations and receipt of the present value of its secured claim,

(ii) sale of collateral free and clear of liens but subject to credit bidding, or

(iii) the realization by the creditor of the "indubitable equivalent" of its secured claim.

Notwithstanding the express reference in subsection (ii) of Section 1129(b)(2)(A) to the right to credit bid in connection with a sale "free and clear" of liens, the Third Circuit in *Philadelphia Newspapers* held that a sale "free and clear" could also take place without allowing the lenders to credit bid under subsection (iii), the "indubitable equivalent" prong. The *River Road* debtors asked the bankruptcy court to follow the Third Circuit's conclusion that the "plain meaning" of the use of the disjunctive "or" in the statute shows that subsection (ii) is not the "exclusive means" by which a secured lender's collateral may be sold "free and clear" under a plan of reorganization and that, so long as the debtor or other plan proponent could show that the "indubitable equivalent" prong were being satisfied, the opportunity to credit bid need not be provided.

The bankruptcy judge, Judge Bruce Black of the Northern District of Illinois, declined the invitation. Black expressly rejected the reasoning of the *Philadelphia Newspapers* majority, stating that he found the dissent from Ambro, "well-reasoned [and] more persuasive." At the *River Road* debtors' request, Black certified an appeal directly to the Seventh Circuit. The court affirmed Black's decision, stating that "like the bankruptcy court, we find the statutory analysis articulated by Judge Ambro in his *Philadelphia Newspapers* dissent to be compelling."

The Seventh Circuit decision first takes aim at the contention that there exists a single "plain meaning" interpretation of Section 1129(b)(2)(A) that directs the result.

> Nothing in the text of Section 1129(b)(2)(A) directly indicates whether Subsection (iii) can be used to confirm any type of plan or if it can only be used to confirm plans that propose disposing of assets in ways that can be distinguished from those covered by Subsections (i) and (ii). Hence, there are two plausible interpretations of the statute: one that reads Subsection (iii) as having global applicability and one that reads it as having a more limited scope.

The Seventh Circuit then considered whether Congress, having specified in Section 1129(b)(2)(A)(ii) the means by which a debtor could confirm a plan when proposing to sell a secured lender's assets free and clear, i.e., by expressly protecting the lender's right to credit bid, would then negate such protection in the immediately following subsection by permitting the debtor to conduct a "free and clear" sale without allowing for credit bidding. "The infinitely more plausible interpretation," the court held,

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would only permit "free and clear" collateral sales as specified in subsection (ii). "Under such a reading, plans could only qualify as 'fair and equitable' under Subsection (iii) if they proposed disposing of assets in [a] way that [is] not described in [Subsection (ii)]."

The opinion of the Seventh Circuit in *River Road* notes the "incongruity" between the debtors' proposed reading of Section 1129(b)(2)(A), and other sections of the Bankruptcy Code that recognize this elemental protection of a lender's security interest. Under Section 363(k), the right to credit bid unequivocally exists whenever property of the bankruptcy estate is sold outside of the ordinary course of business prior to plan confirmation. Similarly, in the Seventh Circuit's view, when property is sold pursuant to a plan, as in *River Road*, Section 1129(b)(2)(A)(ii) should only permit plan confirmation over a secured lender's objection so long as the lender has the right to credit bid at a sale of the collateral, effectively providing it with the precise benefit for which it initially contracted. "In essence, by granting secured creditors the right to credit bid, the [Bankruptcy] Code promises lenders that their liens will not be extinguished for less than face value without their consent."

The Seventh Circuit's vigorous seconding of Ambro's approach shows plainly why judges publish dissenting opinions. Ambro, writing from a practitioner's pragmatic viewpoint, clearly found it hard to accept the *Philadelphia Newspapers* majority's refusal to look beyond what it viewed as the sole plausible reading of Section 1129(b)(2)(A) and consider any sense of Congressional purpose or the underlying principles of the Bankruptcy Code as evidenced by complementary Code sections. As he wrote, "In effect, a single 'or' becomes the bell, book and candle that excommunicates Congressional intent from the Bankruptcy Code...[and] upset[s] three decades of secured creditors' expectations[.]" The Seventh Circuit's decision in *River Road* vindicates Ambro's arguments.

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