

In re Philadelphia Newspapers, LLC, et al.¹: Lenders Purchase Debtors' Assets Pursuant to Chapter 11 Plan in Response to Denial of Right to Credit Bid

As discussed in our alert memo, dated March 25, 2010, the United States Court of Appeals for the Third Circuit held in In re Philadelphia Newspapers, LLC, et al.² that a dissenting class of secured creditors does not have an absolute right to credit bid where its collateral is being sold free and clear of the secured creditors' liens pursuant to a Chapter 11 plan ([please click here to view the March 25 alert memo](#)). We suggested in the March 25 alert memo that when faced with a denial of a right to credit bid, "[l]enders ... may well attempt to submit cash bids on their collateral in order to prevent the risk of undervaluation, reasoning that the proceeds of any successful bid will merely flow back to them on account of their secured claims." The prepetition lenders in Philadelphia Newspapers did just that when they submitted a cash bid at auction, and Philadelphia Newspapers LLC and its affiliated debtors (the "Debtors"), in consultation with the creditors' committee appointed in the Chapter 11 cases, determined such bid to be the highest and best bid for the assets being sold.

On June 29, 2010, the U.S. Bankruptcy Court for the Eastern District of Pennsylvania confirmed a Chapter 11 plan (the "Plan") providing for the sale of substantially all of the Debtors' assets to an entity controlled by certain of the Debtors' prepetition lenders (the "Lenders," and such entity purchasing the Debtors' assets, the "Purchaser") for approximately \$105 million in cash and the assumption of certain liabilities. The Plan provides a mechanism whereby Lenders can elect to receive a cash distribution in partial satisfaction of their secured claims, in lieu of receiving equity in the Purchaser. In addition, certain of the Debtors' real property excluded from the sale to the Purchaser will be transferred to a separate LLC, and the equity interests in such LLC will be transferred to the Lenders in partial satisfaction of their claims under the Plan.

The infusion of cash by the Lenders (together with an exit financing facility provided by certain Lenders) will allow for payment of certain administrative expenses and other

¹ In re Philadelphia Newspapers, LLC, et al., Case No. 09-11204 (SR) (Bankr. E.D. Pa. June 29, 2010).

² In re Philadelphia Newspapers, LLC, et al., 599 F.3d 298 (3d Cir. 2010).

priority claims, secured claims of those Lenders electing to take a cash distribution in lieu of equity in the Purchaser under the Plan, and certain miscellaneous secured claims and will also allow for the establishment of a small fund used to fund a liquidating trust under the Plan and make a de minimis distribution to general unsecured creditors. Further, certain of the Debtors' unsecured creditors will receive approximately 2.7% of the equity in the Purchaser.

Implications

The Plan, once substantially consummated, will mark the end of bitter litigation between the Debtors and the Lenders regarding the Lenders' right to credit bid for their collateral being sold pursuant to the Debtors' Chapter 11 plan. The approach taken by the Lenders in the auction for the Debtors' assets represents a potentially effective response by lenders (who are concerned about the risk of judicial undervaluation of their collateral) to the Third Circuit's denial of an absolute right to credit bid in Philadelphia Newspapers. Ultimately, the Lenders were able to structure a bid for the Debtors' assets that will enable secured creditors to recover the bulk of the purchase price paid for the assets by the Purchaser, while still allowing for payment of administrative expenses and priority claims and allowing for a token distribution to unsecured creditors. This strategy was successful in large part due to the fact that the bid by the Lenders at auction was substantially higher than any competing bids and also because there were enough Lenders willing to put cash up to fund the purchase price, even though some of the cash will be distributed to other creditors under the Plan.

It remains to be seen whether secured creditors in other cases will pursue a similar strategy when faced with the denial of a right to credit bid. The effectiveness of such a strategy may well depend on the cohesion of the lender group and the terms of the underlying loan documentation with respect to the voting thresholds required to employ this type of strategy. It will be interesting to see if lenders going forward will draft loan documentation to address the potential scenario of making a cash bid for collateral being sold pursuant to a Chapter 11 plan in a circumstance where the lenders do not have an absolute right to credit bid.

Please feel free to contact any of your regular contacts at the firm or any of our partners and counsel listed under Bankruptcy and Restructuring in the "Practices" section of our website (<http://www.clearygottlieb.com>) if you have any questions.

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