Expert Views

The Rise of Indubitable Equivalent 'Cram-Up' Plans

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Editor's Note: Below is the latest in Reorg's Expert Views series: an article written by Stephen Selbst, Steven Smith and Silvia Stockman of Herrick, Feinstein LLP. Stephen Selbst is co-chair of Herrick's Restructuring and Finance Litigation department in New York. Steven Smith is a partner in the department, and Silvia Stockman is an associate in the department. This is the second in a two-part series on "cram-up" plans. The first installment can be accessed ***HERE****.*

Chapter 11 debtors attempting to reorganize by "cramming-up" a chapter 11 plan over the objection of their senior secured lenders commonly utilize Bankruptcy Code § 1129(b)(2)(A)(i), which permits the confirmation of such a plan where such creditors retain their liens and receive deferred cash payments. Despite the utility of this provision, the lenders' retention of their liens could, and often does, preclude the use of the reorganized debtor's assets for a working capital facility or otherwise. Thus, debtors have turned to § 1129(b)(2)(A)(iii), which provides that a plan can be "crammed-up" if the lenders realize the "indubitable equivalent" of their secured claim.

Notably, "indubitable equivalent" is not defined within the Bankruptcy Code, leaving its interpretation to the courts. The Fifth Circuit panel in *In re Pacific Lumber, Co.,* 584 F.3d 229, 246 (5th Cir. 2009) commented that "[w]hat measures constitute the indubitable equivalent of the value of the [lender's] collateral *are rarely explained* in caselaw, because most contested reorganization plans follow familiar paths outlined in Clauses (i) and (ii)" (emphasis added). However, ample case law now exists to provide critical guidance to restructuring professionals charged with formulating "cram-up" plans. This article explores the facts and circumstances present in some of those key cases.

"Cram-Up" Plans

A "cram-up" occurs when a bankruptcy court confirms a chapter 11 plan over the objection of a class of senior secured claims; a cram-up is far less common than a "cram-down" plan. A cram-up can be accomplished in two ways: (1) reinstatement under Bankruptcy Code § 1124 (for example, the de-acceleration of a debtor's prepetition loan, and continuation of the original terms and maturity of such loan), or (2) confirmation under Bankruptcy Code § 1129(b). Under § 1129(b), a plan will be confirmed if it does not "discriminate unfairly" and is "fair and equitable" with respect to each impaired class of claims or interests. Section 1129(b) provides three ways to satisfy the "fair and equitable" test: (1) allowing the creditor to retain its lien and provide for full payment of the allowed claim by deferring payments carrying a market interest rate secured by prepetition collateral (1129(b)(2)(A)(i)), (2) authorizing the sale of prepetition collateral free and clear of any liens, claims or encumbrances, with the secured creditor's lien attaching to the sale proceeds (1129(b)(2)(A)(ii)) or (3) providing the secured creditor with the "indubitable equivalent" of its secured claim (1129(b)(2)(A)(iii)).

Defining "Indubitable Equivalent"

"Indubitable equivalent" was first used long before the Bankruptcy Code was drafted in *In re Murel Holding Corp.,* 75 F.2d 941 (2nd Cir. 1935), a decision by Judge Learned Hand*. In that case*, the mortgagee commenced a foreclosure and the debtor filed for chapter XI, the predecessor to chapter 11. The mortgagee unsuccessfully sought relief from chapter XI's automatic stay and faced a plan that would reduce current interest payments by two-thirds and extend its debt maturity for 10 years. The Second Circuit held that the plan was not confirmable because it failed to adequately protect the secured lender's interest, finding it would deprive him of his money or the property without offering "a substitute of the most indubitable equivalence." Judge Hand did not expound upon the definition of what such an indubitable equivalent would be, nor was the term defined in the later-enacted Bankruptcy Code - leaving it open to future courts' interpretation. However, in recent years, courts have seen a rise in indubitable equivalent cases offering them the opportunity to define

the term's contours.

The *DBSD* Decision

In 2009, the Bankruptcy Court for the Southern District of New York examined an indubitable equivalent plan in *In re DBSD North America, Inc.*, 419 B.R. 179, 207-08 (Bankr. S.D.N.Y. 2009). DBSD faced $51 million in fully secured first lien debt and proposed that the lender receive the "indubitable equivalent" of its claim through an amended credit facility with the following features: (1) a first lien on substantially all assets, (2) principal equal to its allowed claim, (3) a four-year maturity with a 12.5% interest rate (which was less than the 14.5% default rate and 16% rate effective under a forbearance) and (4) payment-in-kind rather than cash interest. The new notes were secured by most of the debtor's assets but excluded certain assets. The plan also limited the first lien creditors' remedies, loosened or eliminated covenants, and loosened cross-defaults. Although the first lien lender rejected the plan, the court concluded it was fair and equitable, finding that it provided the lender with the indubitable equivalent of its claim because: (1) the creditor was substantially oversecured, and (2) the 12.5% interest rate was appropriate because it included a larger margin above the prime rate than the prepetition facility interest rate.

The *Bryant* Decision

In 2010, the Bankruptcy Court for the Eastern District of Arkansas examined an indubitable equivalent plan in *In re Bryant*. 439 B.R. 724 (Bankr. E.D. Ark. 2010). Two lenders - the Bank of England (BAE), which held a first lien on the debtors' home and was owed $170,000, and the Farm Service Agency (FSA), which held a junior lien on the home and a first lien on the remaining real estate and was owed $425,000 - challenged the debtor's plan, which proposed to (1) pay BAE's claim with 5.5% interest over 12 years and (2) surrender a portion of the debtors' farming equipment to the FSA (while retaining the remainder of their personal property and all of their real property) and to pay $34,000 over five years at 5% interest. In assessing whether the extended repayment period was fair and equitable, the court looked to the market standards to determine what was reasonable and concluded that the plan provided BAE with the indubitable equivalent of its secured claim. The court commented that there is no prohibition on a debtor using different means - including cash payments, payments over time, abandonment of collateral or substitution of collateral - to provide a secured creditor with the indubitable equivalent of its claim. The court reasoned that the plan provided for BAE to retain its lien, provided for the payment of a fair interest rate - the upward adjustment of 2.25% to prime was sufficient to compensate BAE for the lengthened repayment term because it was oversecured, the debtors were able to make payments, and the collateral was improved farmland unlikely to depreciate - and thus concluded that BAE would receive the value of its claim.

The *Philadelphia Newspapers* and *RadLAX Gateway Hotel* Decisions

In 2010, the Third Circuit opined on whether a plan sale, under § 1129(b)(2)(A)(ii), is another means to satisfy the indubitable equivalent standard under § 1129(b)(2)(A)(iii). The case originated from Philadelphia Newspapers LLC's 2006 acquisition of the *Philadelphia Inquirer*, *Philadelphia Daily News* and philly.com for $515 million. Two years later, Philadelphia Newspapers defaulted on its debt and sought bankruptcy protection. The debtor's plan proposed that its assets would be sold in an auction that would generate approximately $37 million in cash for the lenders, who would also receive the debtor's headquarters (valued at $29.5 million). Notably, the debtor's bid procedures motion sought to preclude the lenders from credit bidding, a right they would ordinarily be entitled to exercise in sales implemented pursuant to section 363 of the Bankruptcy Code. In October 2009, the bankruptcy court denied the motion, concluding that although the plan proceeded under the indubitable equivalent prong of § 1129(b)(2)(A)(iii), the plan sale was structured as a § 1129(b)(2)(A)(ii) sale and failed under that latter standard. The debtors appealed.

The Eastern Pennsylvania District Court reversed, holding that the Bankruptcy Code did not require secured lenders to have the right to credit-bid at a *plan* sale. The district court further noted that (1) the indubitable equivalent prong was an "invitation for debtors to craft an appropriate treatment of a secured creditor's claim, separate and apart from the provisions of subsection (ii)," and (2) "a plan sale is potentially another means to satisfy this indubitable equivalent standard." The lenders argued that § 1129(b)(2)(A)(iii) was ambiguous and that other provisions of the Bankruptcy Code

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confirmed the lenders' right to credit-bid. But the district court disagreed, holding that the lenders only had the right to credit-bid under subsection (iii) if it was specifically set forth in the statute. The lenders also argued that even if subsection (iii) did not contain an explicit right to credit-bid, that right was necessary to provide them with the indubitable equivalent of their claims because a credit bid sets the value of the collateral. But the court rejected that argument, holding that the plan itself, and not the auction, must generate the indubitable equivalent.

The Third Circuit affirmed in a 2-1 decision, with a spirited dissent from Judge Thomas L. Ambro. The divided panel examined the language, context and purpose of the cramdown provisions, and the majority concluded that the statutory language was unambiguous. The use of the word "or" in § 1129(b)(2)(A) provides alternatives - a debtor may proceed under (i), (ii) or (iii). The majority reasoned that the statute allowed a debtor to proceed under subsection (iii)'s indubitable equivalent standard with a sale of collateral that bars credit bidding. Judge Ambro, a former bankruptcy practitioner, disagreed, contending that Congress did not list the three alternatives as routes to cramdown confirmation that were universally applicable to any plan, but, instead, as distinct rules that apply specific requirements depending on how a given plan proposed to treat the claims of secured creditors. In other words, Judge Ambro explained that § 1129(b)(2)(A)(ii) governed *all* sales of collateral under a plan while subsection (iii) was simply inapplicable to such plans. Judge Ambro further contended that canons of statutory interpretation - in particular, that specific provisions prevail over general ones - and the context provided by the Bankruptcy Code as a whole supported his interpretation. Judge Ambro concluded that credit bidding was an integral part of a comprehensive arrangement enacted by Congress to avoid the pitfalls of undervaluation of secured claims, and thereby ensure that the rights of secured creditors were protected while maximizing the value of the collateral to the estate.

After *Philadelphia Newspapers*, the question confronting the U.S. Supreme Court in *RadLAX Gateway Hotel, LLC v. Amalgamated Bank,* 566 U.S. 639 (2012) was whether a cramdown plan could be confirmed if it provided for the sale of collateral *without* permitting credit bidding, but also purported to provide that the secured creditor would receive the indubitable equivalent of its claim under subsection (iii). The debtors - developers of a hotel at the Los Angeles airport who had borrowed heavily and then run out of funds - proposed to: (1) sell the hotel free and clear in an auction with a stalking-horse bidder and no credit bidding, and (2) provide the lenders with the "indubitable equivalent" of their claims from the sale proceeds per § 1129(b)(2)(A)(iii). The Seventh Circuit concluded that § 1129(b)(2)(A) barred such a plan for the reasons articulated in Judge Ambro's *Philadelphia Newspapers* dissent. The debtors contended that they were required to satisfy only one of the three alternatives, and that so long as its plan gave the secured creditor the indubitable equivalent of its claim, the debtors were not required to allow credit bidding. The lender countered that the debtors' interpretation of the statute would render subsection (ii)'s credit-bidding requirement meaningless, and that a sale of collateral that barred credit bidding was inconsistent with the protections the Bankruptcy Code provides for secured creditors. Since the *RadLAX* question had divided the courts of appeals - the Third and Fifth Circuits sided with the debtors (credit bidding was not required in a sale of collateral under a plan) while the Seventh Circuit came to the opposite conclusion - the Supreme Court granted *certiorari* to resolve the circuit split.

The Supreme Court confined its analysis to the text of § 1129(b)(2)(A) and, on May 29, 2012, issued a unanimous 8-0 decision that the Bankruptcy Code does not permit a debtor to bar credit bidding at such a sale. Like the Third Circuit majority, the Supreme Court concluded that the text of § 1129(b)(2)(A) was unambiguous. Unlike the Third Circuit, however, the Supreme Court concluded that the statutory text *precluded* debtors from attempting to bar credit bidding at a sale. The Court rejected the debtors' statutory interpretation as "hyper-literal and contrary to common sense," and reasoned that subsection (ii) spells out the requirements for selling collateral free of liens, while subsection (iii) is a broadly worded provision that says nothing about such a sale. Thus, the general language of subsection (iii) cannot be interpreted to apply to a matter specifically addressed in subsection (ii). Accordingly, the Court concluded that debtors cannot sell their property free of liens under § 1129(b)(2)(A) without allowing secured creditors to credit-bid, as required by subsection (ii). The Court rejected the Third Circuit majority's reasoning, explaining that debtors seeking to sell their property free of liens under § 1129(b)(2)(A) must satisfy the requirements of subsection (ii), not the requirements of *both* subsections (ii) and (iii).

The *River East Plaza* Decision

In 2012, the Seventh Circuit ruled on another indubitable equivalent plan in *In re River East Plaza, LLC*. 669 F.3d 826 (7th Cir. 2012). The debtor owned a building in Chicago valued at $13.5 million, which secured a $38.3 million mortgage loan from LNV Corp.. After River East defaulted, LNV commenced foreclosure proceedings, and River East filed for chapter 11. River East's plan proposed to provide LNV with the "indubitable equivalent" of its claim by substituting 30-year U.S. Treasury bonds with a face value of $13.5 million for LNV's existing collateral. River East argued that the value of the bonds would grow in 30 years to $38.3 million - the full-face value of LNV's claim - thus constituting the indubitable equivalent of LNV's secured claim. The bankruptcy court disagreed, holding that a secured creditor electing for § 1111(b) treatment could not be forced to accept substitute collateral and denied confirmation. The Seventh Circuit affirmed, holding that substituted collateral that is more valuable and no more volatile than a creditor's current collateral would satisfy the indubitable equivalent test even in the case of an undersecured debt. But the Seventh Circuit concluded that 30-year U.S. Treasury bonds were not the indubitable equivalent of LNV's collateral because (1) the bonds carried a substantial inflation risk and therefore a different risk profile, and (2) they impermissibly stretched out the time period over which LNV would be paid.

The *LightSquared* Decision

In 2014, the Bankruptcy Court for the Southern District of New York ruled on another indubitable equivalent plan in *In re Lightsquared, Inc.*, 513 B.R. 56 (Bankr. S.D.N.Y. 2014). The debtor's plan provided that the creditor would receive the "indubitable equivalent" of its claim through a seven-year note at 12% interest with a payment-in-kind provision, which was secured by a third-priority lien. The debtor argued that the new note was the "indubitable equivalent" because it would provide the creditor with payment in full that was secured by a lien on existing collateral and a lien on new collateral. The creditor countered that the value of the note was highly speculative, the proposal failed to account for postpetition interest, the economic terms of the note were inferior and the note would be subject to rigorous transfer restrictions, be less liquid and contain reduced covenant protections for the creditor. The bankruptcy court sided with the creditor and concluded that the new note was not the "indubitable equivalent" because: (1) the PIK interest was less favorable than cash interest, (2) the new note had a longer maturity than the prepetition facility, and (3) the plan provided for a much riskier third lien subordinate to at least $2.2 billion of senior debt.

"Dirt for Debt" Plans

Some debtors have proposed "dirt for debt" plans - where lenders receive some or all of their collateral in satisfaction of their claims - to satisfy the indubitable equivalent standard. These cases almost always raise collateral valuation issues. For example, in *In re Bate & Timber LLC*, 877 F.3d 188 (4th Cir. 2017), the Fourth Circuit upheld confirmation of a partial dirt-for-debt plan where a secured lender was given eight of the 79 tracts of land that originally secured its claim plus postpetition interest in cash. The following year, the Bankruptcy Court for the Eastern District of North Carolina confirmed a plan in *In re Wiggins,* No. 16-05606-5, 2018 WL 1137616, at *1 (Bankr. E.D.N.C. Feb. 28, 2018), where the secured creditor would receive a portion of four tracts of land securing its claim as an indubitable equivalent after performing a "highest and best use" appraisal. A year later, the Bankruptcy Court for the Southern District of Mississippi confirmed a plan in *In re Nat'l Truck Funding LLC*, 588 B.R. 175 (Bankr. S.D. Miss. 2018) under which the secured creditor had an option to (1) retain its liens on sale proceeds of the debtor's trucks and receive deferred cash payments or (2) receive the trucks as the indubitable equivalent of its claims. But not all courts favor "dirt for debt" plans. For example, in *In re Fleming*, No. CC-19-1166-GTaL, 2020 WL 1170722, at *1 (B.A.P. 9th Cir. Mar. 10, 2020), the Ninth Circuit found that a chapter 11 plan where the lender would receive $500,000 in cash, 49 units of real property valued at $3.7 million and five annual payments of $241,000 with interest at 5% did not provide the indubitable equivalent of its claim because it did not provide compensation for the time it would take to sell property and unfairly shifted the risk of selling it to the lender.

Conclusion

Undefined in the Bankruptcy Code, the amorphous "indubitable equivalent" has been left to the interpretation of the courts. And the rise of indubitable equivalent cases in the past decade has better outlined the path to a cram-up plan confirmation under Bankruptcy Code section 1129(b)(2)(A)(iii), although it also warns future debtors of the potential

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challenges. Yes, debtors and their advisors must be cautious of the impact of interest rates and be well-versed in valuation in order to formulate a viable indubitable equivalent plan. But, at bottom, perhaps we should simply analyze the words "indubitable" and "equivalent" like we would analyze a statute: by understanding and relying upon their plain meaning. "Indubitable" means "not open to question" and "equivalent" means "equal in value." Thus, a plan that provides a secured creditor with a distribution that is not open to question and equal in value to its prepetition claim should be well-positioned for a successful confirmation.

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