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Alert

Fifth Circuit Finds Undersecured Creditor Waived Right to Credit Bid

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An undersecured creditor ("C") intending to credit bid at a sale of the debtor's unencumbered property must give "notice" of its intent to the bankruptcy trustee, held the U.S. Court of Appeals for the Fifth Circuit on April 23, 2015. *In re R.L. Adkins Corp.*, 2015 WL 1873137 (5th Cir. April 23, 2015). Affirming the bankruptcy and district courts' denials of C's belated request, the Fifth Circuit held that C "failed to exercise" its right to credit bid at a sale of its collateral. As discussed in this *Alert*, however, the case really dealt with a secured creditor's right under Bankruptcy Code ("Code") Section 1111(b) to "elect" a nominally large secured claim in exchange for waiving its unsecured deficiency claim.

Facts

The reorganization plan in this case provided for the sale of the debtor's mineral leases and several wells to a third party for cash. The plan recognized C's "lien on four of these mineral leases and one well," but "[f]our other creditors [also had] secured interests in the … well." *Id.* at *2. C was essentially in the position "of a third lien creditor on real property." *Id.* at *3. Despite C's electing "to promote its unsecured claim to secured status" under Code Section 1111(b), *id.* at *1, the Fifth Circuit agreed with the lower courts' rejection of C's election because the encumbered property was being "sold under the plan"—an explicit statutory exclusion from Section 1111(b) election rights. Code § 1111(b)(1)(B)(ii).

C never opposed confirmation of the plan, never appeared at the confirmation hearing and never appealed from the order confirming the plan. Because the plan recited that the asset sale was being done under Code Section 363 with an opportunity for secured creditors like C to credit bid, in the court's view, C had effectively waived not only its right to credit bid but also to obtain a ruling on its purported right to make the Section 1111(b)(2) election. It was only after the bankruptcy court had confirmed the reorganization plan that C asserted a lien on the property held by the asset purchaser.

Relevance of the Decision: Section 1111(b) Election or Credit Bid as Secured Lender Protections

The *Adkins* decision is noteworthy for at least two reasons. First, the asset purchaser correctly argued that the trustee's sale of the debtor's property "under § 363 … or … under the Plan … preclude[d] an undersecured lender from making the § 1111(b) election." 2015 WL 1873137, at *1.

The concurring judge in *Adkins* explained that C's "practical position seems at odds with its claim to having been 'denied' a right to credit bid. Given the nature of [C's] liens, exercising a credit bid … would not have been feasible … [C] might theoretically credit bid … but [was] unlikely to do so because [it] would have to pay off the senior liens before [it] could take possession … [C is apparently] trying to take advantage of the bankruptcy court's error in failing to rule on the § 1111(b) election before it confirmed

the Chapter 11 Plan." *Id.* at *3. In the concurring judge's view, the "argument that [C] waived its § 1111(b) election by failing to pursue it at the confirmation hearing is persuasive." *Id.*

Why did C seek to make the Section 1111(b) election? An undersecured creditor such as C has the opportunity under Section 1111(b)(2) to have its "*entire* secured claim treated as an allowed secured claim," regardless of the collateral's value, when there is *no* sale of the debtor's property. Chas. J. Tabb, *The Law of Bankruptcy* § 11.32, at 1162 (2d ed. 2009). But the "quid pro quo for making the election" is that "the undersecured creditor must give up its unsecured [deficiency] claim." *Id.* Had C been able to elect Section 1111(b)(2) treatment in *Adkins*, its allowed secured claim would have been $321,506, instead of the trustee's $38,753 valuation of C's collateral. The practical effect of this election, had it been available, would be to protect C against the risk that the trustee would cram down its secured claim at a low valuation. For purposes of cramdown under Code Section 1129(b)(2)(A)(i)(II), C would also have an allowed secured claim with the face amount of $321,506, requiring the reorganized debtor to pay C the full $321,506.28 over time. The Section 1111(b) election "ensures essentially that the debtor must resolve the secured claim for the maximum value from the collateral." 2015 WL 1873137, at *4. Code Section 1129(b)(2)(A), though, requires only that the *present value* of these deferred cash payments "as of the effective date of the plan" equal the judicially determined value of the lender's collateral, presumably $38,753 in the *Adkins* case. But C's secured claim would still be secured by a *lien* of $321,506. C could thus benefit if the debtor later defaulted or sold the property. As noted, however, under Code Section 1111(b)(1)(B)(ii), the trustee's sale of C's collateral precluded any election right C might have had.

Second, and more important, C's right to credit bid provided an alternative protection when it could not make the Section 1111(b) election. A recourse secured creditor like C can "bid in its claim when the collateral is [to be] sold" and "offset his full allowed claim against the purchase price." K. Klee, "All You Ever Wanted to Know About Cram Down Under the New Bankruptcy Code," 53 *Am. Bankr. L. J.* 133, 153 and n.127 (1979), citing Code § 1129(b)(2)(A)(ii). In *Adkins*, the Fifth Circuit recognized the U.S. Supreme Court's holding that "debtors may not sell their property free of liens without allowing a lienholder to credit bid." 2015 WL 1873137, at *1, citing *RadLAX Gateway Hotel, LLC v. Amalgamated Bank*, 132 S. Ct. 2065 (2012). As the concurring opinion in *Adkins* noted, "secured creditors are [thus] assured of being able to credit bid for their collateral and retain the benefit of their bargain … ." *Id.* at *4. C, however, failed to timely exercise its credit-bidding rights.

Practical Advice for Secured Lenders

- *Promptly Assert Section 1111(b) Election Right and Obtain Ruling Before Plan Confirmation Hearing*. "The court's decision will, after all, decisively affect the valuation [of the] creditor's secured claim and … the requisites for plan confirmation … ." *Id.* at *5.
- *Insist on Section 1111(b) Election Rights If Sale Is Uncertain*. Only when the estate actually sells collateral under Code Section 363(b) or "under the plan" will a lender be precluded from the Section 1111(b) election.
- *Seek Transparent, Public Auction and Ensure Right to Credit Bid*. Review bidding and notice procedures to ensure credit bidding protection and testing of "market for valuations." *Id.*

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If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or the author.

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