Please feel free to contact us if we can provide further information on these matters.

Richard Levin
212-474-1978
rlevin@cravath.com

Paul H. Zumbro
212-474-1036
pzumbro@cravath.com

Robert H. Trust
212-474-1472
rtrust@cravath.com

Agent May Consent to a "Free-and-Clear" Sale or Credit Bid under Section 363 of the Bankruptcy Code over Objection of Dissenting Minority Secured Lenders

August 14, 2009

It has become increasingly popular for a debtor to utilize section 363 of the Bankruptcy Code to sell all or substantially all of its assets. Given the highly leveraged capital structure of many debtors, the agent for the secured lenders is often playing a primary role in the section 363 sale process by acting at the direction of the secured lenders to consent to a sale free and clear of interests or to use the secured lenders' claims as currency to buy the debtor's assets in a "credit bid".[1] A recent decision from the United States Court of Appeals for the Second Circuit held that a dissenting minority lender could not object to a "free-and-clear" sale in circumstances where the loan documents authorized the agent to act on behalf of the secured lenders and a majority in interest of the lenders consented.[2]

BACKGROUND

Section 363(f) of the Bankruptcy Code permits a debtor to sell assets out of the ordinary course of business free and clear of any lien or other interest in such property under specified circumstances. In the case of the sale of Chrysler's assets, the debtors relied in part on section 363(f)(2) of the Bankruptcy Code, which permits a sale free and clear of an entity's interest if the entity consents to the sale. In *In re Chrysler LLC*, the Court considered whether the consent requirement of section 363(f)(2) could be satisfied without the unanimous consent of the secured lenders.

The secured parties' relationship in *Chrysler* was governed by three related agreements: (1) a credit agreement, (2) a collateral trust agreement, under which the collateral securing Chrysler's obligations under the credit agreement was held by a designated trustee (the "collateral trustee") for the benefit of the secured lenders and (3) a security agreement, under which Chrysler and the other obligors granted to the administrative agent a security interest in substantially all of their assets.

Upon the commencement of Chrysler's chapter 11 cases, Chrysler moved to sell substantially all of its assets free and clear of interests under section 363. Chrysler argued that section 363(f)(2) of the Bankruptcy Code had been satisfied because secured lenders holding 92.5% of the outstanding principal amount of the loans under the credit agreement had directed the administrative agent, who, in turn, directed the collateral trustee, to consent to the sale of the debtors' assets. Three Indiana state funds holding less than 1% of the indebtedness (the "Indiana Funds") objected to Chrysler's sale motion. The Indiana Funds argued that the elements of section 363(f)(2) were not satisfied because the credit

[1] Section 363(k) of the Bankruptcy Code allows a secured creditor to offset an allowed secured claim against the purchase price of property in a section 363 sale, referred to as "credit bidding".

[2] *In re Chrysler LLC*, No. 09-2311, 2009 WL 2382766 (2d Cir. Aug. 5, 2009).

agreement required the unanimous consent of the secured lenders in order to "release all or substantially all of the Collateral", including in connection with a section 363 sale of the debtors' assets.

DECISION

The Bankruptcy Court dismissed the Indiana Funds' objection because the collateral trustee had the authority to act on behalf of the secured lenders in accordance with the loan documents, even though the secured lenders under the credit agreement did not unanimously consent to the sale. The United States Court of Appeals for the Second Circuit affirmed the Bankruptcy Court's decision on similar grounds.[3]

The courts concluded that, through a series of agreements, the collateral trustee had been empowered to take any action necessary to realize upon the collateral, including consenting to a sale of the collateral free and clear of all interests under section 363 of the Bankruptcy Code at the direction of the administrative agent. By the terms of the credit agreement, the administrative agent was authorized to act, including to direct the collateral trustee, at the request of lenders holding a majority of the indebtedness. The courts found that each of these elements had been satisfied in accordance with the terms of the loan documents in connection with the collateral trustee's consent to the sale. Accordingly, having agreed to the framework created by the credit agreement and related security documents, the Indiana Funds were bound by the decision of the majority of the lender group to consent to the sale of the debtors' assets under section 363.[4]

The courts rejected the Indiana Funds' argument that the amendment and waiver provision of the credit agreement required that the administrative agent receive the consent of all lenders before it could authorize the collateral trustee to release all or substantially all of the collateral. Rather, the transfer of the debtors' assets to New Chrysler pursuant to section 363 of the Bankruptcy Code was simply a "collective action to enforce rights as authorized under the agreed-upon specific provisions of the parties' loan agreements"[5], which did not require any amendment, supplement or modification of the loan documents. The Second Circuit stated "[b]ecause the Sale required no amendment to loan documents, Chrysler was not required to seek, let alone receive, the [dissenting lenders'] written consent".[6] Moreover, the consent to the sale was not a "release" of collateral because the secured lenders' lien would attach to the proceeds of the sale, which remained as collateral to secure the loan made by the lenders.[7]

The courts appear to be saying that this contract-based "majority rule" approach overrides what could be argued to be individual statutory rights under the Bankruptcy Code.

EFFECT OF THE DECISION

Although the decision in Chrysler was based on specific provisions in the applicable loan documents, the language relied upon by the Court of Appeals and the Bankruptcy Court is

---

[3] In certain circumstances, an appeal may be taken directly to the court of appeals (bypassing the district court) if the court of appeals authorizes the direct appeal. 28 U.S.C. § 158(d)(2). The Second Circuit Court of Appeals granted a motion for direct appeal in *Chrysler*.

[4] *In re Chrysler*, 405 B.R. 84, 101-03 (Bankr. S.D.N.Y. 2009), *aff'd*, *Chrysler*, 2009 WL 2382766, at *8.

[5] *Chrysler*, 405 B.R. at 103.

[6] *Chrysler*, 2009 WL 2382766, at *9.

[7] *Chrysler*, 405 B.R. at 103.

fairly customary in U.S. syndicated credit facilities, in which collateral enforcement actions taken by the agent may typically be authorized by the majority in interest of the lenders. The courts appear to be saying that this contract-based "majority rule" approach overrides what could be argued to be individual statutory rights under the Bankruptcy Code.

Other recent bankruptcy court decisions are consistent with this approach. For example, a recent Delaware Bankruptcy Court decision reached a similar conclusion in the credit bid context, holding that the administrative agent had the authority to enter a credit bid on behalf of the secured lenders pursuant to section 363(k) of the Bankruptcy Code, over the objection of some of the secured lenders.[8] The court in *GWLS* concluded that credit bidding by the collateral agent, acting at the direction of the secured lenders holding a majority of the indebtedness in accordance with the loan documents, fell within the collateral agent's delegated powers to "dispose of or deliver the Collateral" on behalf of the secured parties pursuant to any applicable law, which the court determined included the Bankruptcy Code. Accordingly, the dissenting lender was forced to have its claim included in the credit bid along with the rest of the syndicate. The Bankruptcy Court in the Southern District of New York relied on *Chrysler* and *GWLS* in reaching a similar conclusion in approving a credit bid made by the agent for substantially all of the assets of Metaldyne Corporation over the objection of a dissenting lender.[9]

These recent decisions suggest that when secured lenders broadly delegate to an agent or trustee the power to take collateral enforcement actions or to exercise any other remedies against the collateral, an objecting secured creditor will likely be bound by the decision of lenders holding a majority of the indebtedness.

These recent decisions suggest that when secured lenders broadly delegate to an agent or trustee the power to take collateral enforcement actions or to exercise any other remedies against the collateral, an objecting secured creditor will likely be bound by the decision of lenders holding a majority of the indebtedness. When a secured lender enters into syndicated loan agreement containing provisions like the ones examined in *Chrysler* and *GWLS*, it is agreeing to a collective arrangement under which the agent or trustee may be authorized to exercise remedies under section 363 of the Bankruptcy Code, including to consent to the sale of all or substantially all of a debtor's assets free and clear of any liens or interests or to credit bid for a debtor's assets, without receiving the unanimous consent of the secured lenders.

This memorandum relates to general information only and does not constitute legal advice. Facts and circumstances vary. We make no undertaking to advise recipients of any legal changes or developments.

New York
Worldwide Plaza
825 Eighth Avenue
New York, NY 10019-7475
212.474.1000

London
CityPoint
One Ropemaker Street
London EC2Y 9HR
+44.20.7453.1000

www.cravath.com

[8] *In re GWLS Holdings, Inc.*, No. 08-12430, 2009 WL 453110 (Bankr. D. Del. Feb. 23, 2009) (appeal pending).

[9] *In re Metaldyne*, No. 09-13412 (Bankr. S.D.N.Y. Aug. 12, 2009) (unpublished opinion).