Are Second Lien Lenders Entitled to Object to a 363 Sale? According to a Recent Decision, the Answer Is A Resounding "Yes!"

Can second lien lenders be heard in connection with a 363 sale even if it would violate the spirit of their intercreditor agreement? According to a recent decision in *In re Boston Generating, LLC,* No. 10-14419 (SCC) (Bankr. S.D.N.Y.), if the intercreditor agreement does not contain a specific waiver, the answer is a resounding "yes."

By Ancela R. Nastasi and Keith N. Sambur

In *Boston Generating*, Case No. 10-14419 (SCC) (Bankr. S.D.N.Y. 2010), the debtors financed their pre-petition operations with two tranches of secured debt – a $1.45 billion facility secured by first priority liens on substantially all of the debtors' assets, and a $350 million facility secured by second priority liens on the same assets.

On the petition date, the debtors filed a motion seeking to sell substantially all of their assets at a price slightly less than the amount of the first lien debt. The debtors proposed to conduct the auction within 72 days.

The second lien lenders objected, claiming that the bid procedures would squelch a robust sale process, and that in turn, they would be precluded from obtaining any recovery. The second lien lenders also sought standing to object to the sale itself.

The first lien lenders supported the sale, and argued that the intercreditor agreement between them and the second lien lenders prohibited the second lien lenders from objecting. In support of their position, the first lien lenders cited the following provisions of the intercreditor agreement:

> Until the Discharge of First Lien Obligations has occurred . . . the First Lien Collateral Agent . . . shall have the exclusive right to enforce rights, exercise remedies and make determinations regarding the release, sale, disposition or restrictions with respect to the Collateral without any consultation with or the consent of the Second Lien Collateral Agent or any Second Lien Secured Party or any Second Lien Secured Debt Representative in respect thereof.

After careful analysis of the interecreditor agreement, Judge Chapman issued two separate rulings – both of which upheld the right of the second lien lenders to object.

Objectionable Bid Procedures? Second Lien Lenders Have A Right To Be Heard.

As for the second lien lenders' right to object to the bid procedures, Judge Chapman referenced two recent cases in which courts silenced junior lenders, but found both cases inapt. In distinguishing *In re Ion Media Networks, Inc.*, 419 B.R. 585 (Bankr. S.D.N.Y. 2009) and *In re Erickson Retirement Communities, LLC*, 425 B.R. 309 (Bankr. N.D. Tex. 2010), Judge Chapman relied primarily on two facts: first, the intercreditor agreement at issue in *Boston Generating* did not specifically prohibit objections by the second lien lenders to the bid procedures, and second, the second lien lenders were "very close to the money." Judge Chapman upheld the second lien lenders' right to object to the proposed bid procedures, relying, among other things, on the fact that their objection was not obstructionist, and helped to ensure that the debtors properly exercised their fiduciary duties to all creditors of the estate.

Objectionable Sale? Second Lien Lenders Have A Right To Be Heard

Although Judge Chapman believed that "the spirit of the subordination scheme" in the intercreditor agreement prevented the second lien lenders from being "heard" and attempting "to block the disposition" of the collateral, she also found that the terms of the intercreditor agreement were less than clear. Judge Chapman held that under New York law, the waiver of a secured lender's right to object to a 363 sale "must be clear beyond peradventure . . . ." Contrary to the American Bar Association's model interecreditor agreement – the text of which Judge Chapman included in her opinion – the intercreditor agreement at issue did not contain "an unequivocal" and "express" waiver of the second lien lenders' right to object. Accordingly, Judge Chapman upheld the right of the second lien lenders to object to the sale.[1]

Judge Chapman noted, however, that her interpretation of the intercreditor agreement was "a very close call." Additional facts she took into consideration included (1) that if approved, the sale of substantially all of the debtors' assets would "effectively deprive [the second lien lenders] of the opportunity to vote . . . on a plan of reorganization", and (2) that the second lien lenders were on the "'cusp' of a recovery" and were "not engaging in . . . obstructionist behavior."[2]

Specifically Addressing Bid Procedures And 363 Sales In The Intercreditor Agreement

While Judge Chapman allowed subjective considerations to influence her decision (such as the "non-obstructive" behavior on the part of the second lien lenders, and the fact that they were on the "cusp" of recovery), the central focus of her opinion was the objective text of the intercreditor agreement. Going forward, first lien lenders wishing to keep second lien lenders silent during a 363 sale process should make sure that their intercreditor agreement tracks the language of the American Bar Association's model intercreditor agreement.

Given Judge Chapman's ruling regarding the bid procedures, the intercreditor agreement should also specifically address whether and to what extent subordinated lenders are entitled to object to proposed bid procedures. **TSL**

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1. Ultimately, as Judge Chapman put it, this was a "hollow victory" because she went on to approve the sale. Certain second lien lenders have since appealed the order confirming the sale.
2. Perhaps critical to Judge Chapman's ruling was the fact that the first and second lien lenders stipulated that consent to a Bankruptcy Code section 363 sale by the first lien lenders did not constitute an exercise of remedies under the intercreditor agreement. As Judge Chapman noted: "This may have altered my conclusion herein regarding standing and whether or not the objections asserted by the Second Lien Agent and the Second Lien Lenders were a violation of the Intercreditor Agreement."