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E-ALERT | Bankruptcy

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SUPREME COURT UPHOLDS SECURED CREDITOR'S RIGHT TO CREDIT BID IN A SALE OF ITS COLLATERAL UNDER A "CRAMDOWN" PLAN

On May 29, 2012, the Supreme Court unanimously held that a debtor may not strip a secured creditor of the right to credit bid in a sale of its collateral when the debtor implements the sale under a nonconsensual "cramdown" plan of reorganization. The decision—which will come as welcome news to secured lenders—resolves a split in the circuits. The Third and Fifth Circuits had held that under certain circumstances a plan that prohibited credit bidding could be "fair and equitable" for purposes of confirming a cramdown plan if it provided the secured creditor with the "indubitable equivalent" of its claim under Section 1129(b)(2)(A)(iii) of the Bankruptcy Code.[1] The Supreme Court rejected this line of cases when it affirmed a Seventh Circuit decision holding that any sale of collateral under a cramdown plan of reorganization must comply with Section 1129(b)(2)(A)(ii), which expressly preserves the secured creditor's right to credit bid.

The case is *RadLax Gateway Hotel, LLC v. Amalgamated Bank*, No. 11-1666 (May 29, 2012). Justice Scalia delivered the opinion for an 8-0 court (with Justice Kennedy taking no part in the decision). A copy of the slip opinion may be found here.

FACTUAL BACKGROUND AND PROCEEDINGS BELOW

The debtors—RadLax Gateway Hotel, LLC and RadLax Gateway Deck, LLC—owned the Radisson Hotel at Los Angeles International Airport and an adjacent lot on which they planned to build a parking lot. They financed the purchase and renovation of the hotel and the construction of the lot with a $142 million loan secured by a blanket lien on all of their assets. When the debtors filed for bankruptcy, they owed approximately $120 million on the secured loan.

The debtors submitted a plan of reorganization that proposed to dissolve the debtors and sell substantially all of their assets pursuant to bid procedures set out in a contemporaneously filed bid procedures motion. Under the proposed bid procedures, the secured lender did not have the right to offset the amount of the secured debt against the purchase price of the assets—i.e., to "credit bid" its claim—but would instead be forced to bid cash. The lender objected to the proposed bid procedures.

The United States Bankruptcy Court for the Northern District of Illinois denied the proposed bid procedures, holding that the purported elimination of the lender's right to credit bid did not comply with the requirements for cramdown confirmation under Section 1129(b)(2)(A). The bankruptcy court certified an appeal to the Seventh Circuit, which affirmed, holding that Section 1129(b)(2)(A)

[1] *See Citizens Bank of Penn. v. Philadelphia Newspapers, LLC (In re Philadelphia Newspapers, LLC)*, 599 F.3d 298 (3d Cir. 2010); *Scotia Pacific Co., LLC v. Off. Comm. Unsecured Creditors (In re Pacific Lumber Co.)*, 584 F.3d 229 (5th Cir. 2009).

does not permit debtors to sell an encumbered asset free and clear of a lien without permitting the lienholder to credit bid.[2]

THE STATUTORY CONTEXT—CRAMDOWN CONFIRMATION

Section 1129(b)(1) of the Bankruptcy Code permits a debtor to confirm a plan of reorganization without the consent of each class of creditors affected by the plan only if the plan does not "discriminate unfairly" and is "fair and equitable" with respect to each class of nonconsenting claims.

Section 1129(b)(2)(A) provides that a plan is "fair and equitable" with respect to a class of nonconsenting secured claims if the plan treats the claims in one of three ways: (i) the secured creditor retains the lien securing its claim and receives deferred cash payments with respect to its claim having a present value equal to its interest in the collateral; (ii) the secured creditor's collateral is sold, "subject to Section 363(k)," free and clear of the secured creditor's lien, but with the lien attaching to the proceeds of the sale; or (iii) the secured creditor receives the "indubitable equivalent" of its secured claim. Section 363(k) of the Bankruptcy Code, which applies to sales of the debtor's property outside the ordinary course of business, provides that "unless the court for cause orders otherwise" a secured creditor may bid at an auction of property subject to its lien and "may offset [its] claim against the purchase price of such property."

The RadLax debtors argued, following the reasoning of the Third Circuit in *Philadelphia Newspapers*, that the general "indubitable equivalent" prong of 1129(b)(2)(A)(iii) authorized a cramdown sale in which the secured creditor had no right to credit bid, notwithstanding the specific—and directly contradictory—sale provision of 1129(b)(2)(ii). Cash proceeds generated by the auction, if turned over to the secured creditor, would provide the creditor with the "indubitable equivalent" of its claim.

THE DECISION—A MATTER OF INTERPRETATION

Justice Scalia wrote that the question presented "an easy case" under the Court's well-settled principles of statutory construction and that the debtor's "hyperliteral reading" of the Bankruptcy Code provision was "contrary to common sense." Applying the canon of construction that a specific statutory provision governs a general one, it was clear that "clause (ii) is a detailed provision that spells out the requirements for selling collateral free of liens, while clause (iii) is a broadly worded provision that says nothing about such a sale." Accordingly, any sale must be made "subject to section 363(k)," and the "indubitable equivalent" prong of clause (iii) provides no basis to deprive a secured creditor of its right to credit bid in a sale of its collateral.

Justice Scalia found that the debtors' contrary textual argument would contradict the meaning of section 1129(b)(2)(A) because it would permit under clause (iii) precisely what is prohibited under clause (ii)—an asset sale without the right to credit bid. While he further noted that the general/specific canon was not absolute and could be overcome by contrary textual indications, the debtors were unable to identify any contrary indications that supported their reading.

Because there was no textual ambiguity, the Court focused solely on the statutory text and had no reason to consider the underlying purpose of the Bankruptcy Code, pre-Code practices, or policy arguments regarding the merits of credit bidding. The policy questions, in particular, had been emphasized by some of the lower courts and *amicus curiae* like the Loan Syndications and Trading Association. Justice Scalia did note in passing, however, that eliminating the right to credit bid would work a particular hardship on the federal government, which is frequently a secured creditor and

[2] *River Road Hotel Partners, LLC v. Amalgamated*, 651 F.3d 642 (7th Cir. 2011).

"often lacks appropriations authority to throw good money after bad in a cash-only bankruptcy auction."

Finally, Justice Scalia quickly dismissed the debtor's argument that the Seventh Circuit had "conflated approval of bid procedures with plan confirmation." The debtors argued that they could pursue the auction under their proposed procedures and leave the question of satisfaction of 1129(b)(2)(A) for resolution later at the confirmation stage. But under the Court's interpretation of the statute this approach was "simply a nonstarter": "[a]s a matter of law, no bid procedures like the ones proposed here could satisfy the requirements of 1129(b)(2)(A), and the distinction between approval of bid procedures and plan confirmation is therefore irrelevant."

The *Pacific Lumber* and *Philadelphia Newspapers* decisions created uncertainty in the secured lending and distressed investing markets and gave debtors potential leverage over secured lenders in plan negotiations. The Supreme Court's decision in *RadLax* removes that uncertainty and decisively affirms the secured lender's right to credit bid in any sale of its collateral under a plan.

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