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Supreme Court Upholds Right to Credit-Bid in 363 Sales Embedded in Reorganization Plans

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In the recent case of RadLAX Gateway Hotel, LLC v. Amalgamated Bank*, 2012 WL 1912197 (May 29, 2012), the Supreme Court in a unanimous 8-0 opinion, delivered by Justice Scalia, held that the Bankruptcy Code statutory scheme mandates that secured creditors must be allowed to credit-bid in 363 sales of assets where the sale is incorporated into a plan of reorganization. While many in the finance and bankruptcy space view the right of a secured creditor to credit-bid as sacrosanct and uncontroversial, several recent circuit court opinions suggested that credit-bidding was not required for a 363 sale in connection with a plan of reorganization so long as the debtor provided such creditor alternatively with the "indubitable equivalent" of its claim. The Supreme Court resolved any uncertainty in favor of the right of a secured creditor to credit-bid.*

Debtors' Plan Proscribed Credit-Bidding

In 2007, the debtors purchased the Radisson Hotel at Los Angeles International Airport. To finance the purchase, renovation of the hotel and construction of a parking garage, the debtors obtained a $142 million loan, secured by a blanket lien on all of the debtors' assets. Amalgamated Bank (the "Bank") served as trustee for the loan. The debtors filed for bankruptcy in August 2009, with over $120 million remaining unpaid on the loan. In 2010, the debtors filed a plan of reorganization under Chapter 11. The proposed procedures for the auction of the debtors' assets forbade the Bank from "credit-bidding," that is, using the debt owed as a credit against the bid price. Instead, the plan forced the Bank to bid cash. Upon a challenge by the Bank, the bankruptcy court held that the plan did not satisfy the requirements of Bankruptcy Code § 1129(b)(2)(A) and certified an appeal directly to the Seventh Circuit. In June 2011, the Seventh Circuit affirmed, holding that § 1129(b)(2)(A) does not permit a debtor to sell an encumbered asset free and clear of a lien without permitting the lienholder to credit-bid. Its decision was in direct conflict with the Third

Circuit's 2010 decision in *In re Philadelphia Newspapers*, 599 F.3d 298 (3d Cir. 2010), and the Fifth Circuit's 2009 decision in *In re Pacific Lumber Co.*, 584 F.3d 229 (5th Cir. 2009) which had concluded that credit-bidding was not required. The Supreme Court granted certiorari.

The Supreme Court Employed a Statutory Analysis

Based on straightforward statutory interpretation, the Supreme Court affirmed the Seventh Circuit's decision, holding that "debtors may not sell their property free of liens under § 1129(b)(2)(A) without allowing lien-holders to credit-bid." The Court looked to the text of § 1129(b)(2)(A), which governs "cram down" provisions in plans, that is, those powers that permit a plan to be confirmed over the objection of a class of secured creditors. Section 1129(b)(2)(A) outlines three scenarios under which a plan will be deemed fair and equitable. First, the secured creditor may retain its lien on the asset and receive deferred cash payments. 11 U.S.C. § 1129(b)(2)(A)(i). Second, the property may be sold free and clear of the lien, "subject to section 363(k)," and the creditor receive a lien on the sale proceeds. 11 U.S.C. § 1129(b)(2)(A)(ii). Section 363(k) allows secured creditors to participate in the auction and to offset the amount of their lien against the purchase price, that is, to credit-bid. 11 U.S.C. § 363(k). Third, the plan may provide the secured creditor with the "indubitable equivalent" of its claim. 11 U.S.C. § 1129(b)(2)(A)(iii).

The debtors maintained that § 1129(b)(2)(A) offers three distinct options for confirming a plan over a secured creditor's objection and that they did not need to afford the Bank the right to credit bid. The debtors argued that their plan was fair and equitable under the "indubitable equivalent" requirement of clause (iii) because the Bank would receive the cash proceeds from the sale at the auction. The Court rejected the debtors' statutory interpretation as "hyperliteral and contrary to common sense." The Court read § 1129(b)(2)(A) in light of the "well established canon of statutory interpretation . . . that the specific governs the general." Essential to the Supreme Court's decision was the detailed manner of protection for credit bidding in the text of clause (ii) of § 1129(b)(2)(A). The Court further reasoned that the "indubitable equivalent" provision in clause (iii) is residual in scope and should not be allowed to swallow up and render superfluous the detailed provision mandating credit-bidding to secured creditors in connection with a sale of assets.

No Discussion of Policy

While much of the briefing and oral argument was devoted to policy arguments for and against credit-bidding, the Supreme Court did not dwell on these arguments in its opinion. The Court reasoned that there was no need to address policy because it found the statutory text clear and without ambiguity. The Court noted that "the pros and cons of credit-bidding are for the consideration of Congress, not the courts." However, the Court did acknowledge, in a footnote, that credit-bidding protects secured creditors by allowing them to purchase collateral at fair market price without needing to spend additional cash to protect the loan. Perhaps in response to briefing on this point by the Solicitor General, the Court further noted that credit-bidding is particularly important to the federal government, which is frequently a secured creditor and, because of restrictions on appropriations, often cannot bid cash and "throw good money after bad."

A Victory for Secured Creditors

The decision is an important one for secured creditors. Credit-bidding protects secured creditors against the risk that a 363 sale will fail to realize the full value of the collateral, which the creditor may then lose to a lowball bidder. Without the ability to credit-bid, the secured creditor could be forced to give up its lien and receive in return only the insufficient proceeds of such a sale. Credit-bidding provides the creditor with the option of taking possession of the collateral if there are no higher bids in excess of the owed debt. As the

Seventh Circuit recognized in the decision below, "by granting secured creditors the right to credit bid, the Code promises lenders that their liens will not be extinguished for less than face value without their consent." *In re River Road Hotel Partners*, LLC, 651 F.3d 643, 650 (7th Cir. 2011). The Supreme Court's decision ensures that secured creditors will not be precluded from exercising their long-standing right to credit-bid absent an act of Congress.

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