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Supreme Court Decision Affirms Secured Creditors' Rights to Credit Bid
By: Daniel Y. Gielchinsky

On May 29, 2012, the Supreme Court issued its opinion in the *RadLAX Gateway Hotel, LLC v. Amalgamated Bank* case. The Court resolved the question of whether a debtor may confirm a plan of reorganization that prohibits a secured creditor from credit bidding the amount of its claim as part of an auction sale. A credit bid allows a secured lender to use the debt owed to it as "currency" to bid for the debtor's assets in which it has a security interest.

The decision and its rationale are important both within the bankruptcy community and beyond due to its potential impact upon long standing notions of the rights of a secured creditor in bankruptcy. While the underlying assets involved in this case were two hotels, the Court's holding likely will be applied in the future to multiple fact patterns involving real estate and other types of collateral.

Justice Scalia delivered the unanimous opinion of the Court, and described *RadLAX* as an "easy case." The Court ruled that a bankruptcy plan of reorganization may not be confirmed over the secured creditor's objection if the plan provides for the sale of assets free and clear of the secured creditor's lien and does not provide the secured creditor with the right to credit bid. By affirming the holding of the Seventh Circuit, the Supreme Court resolved a split between the Seventh Circuit, on one hand, and the Third and Fifth Circuits, on the other hand, over whether secured creditors could be stripped of the right to credit bid in plan sales.

The debtor, *RadLAX*, had argued that the Supreme Court should reverse the decision of the Seventh Circuit, which prohibited it from implementing a sale process that would have provided for the sale of substantially all of its assets free and clear of liens, without allowing the secured credit an opportunity to credit bid. The *RadLAX* chapter 11 plan specified that no secured creditor would be permitted to credit bid at auction, which is a significant departure from past bankruptcy practice. The secured creditor objected to the proposed bid procedures on the grounds that the sale of its collateral, free of liens, required that the lender be permitted to credit bid the amount of its outstanding indebtedness. The bankruptcy court agreed with the secured creditor and denied confirmation of *RadLAX's* plan. On a direct appeal, the Seventh Circuit affirmed the bankruptcy court's decision. *RadLAX* subsequently appealed the decision to the U.S. Supreme Court, which affirmed the decision of the Seventh Circuit.

At issue was the interpretation of section 1129(b)(2)(A) of the Bankruptcy Code, which provides three routes to confirmation of a reorganization plan:

i. The retention of the liens with deferred cash payments made to the secured creditor;

ii. A free-and-clear assets sale subject to credit bidding; or

iii. The provision of the "indubitable equivalent" of the secured interests to the creditors.

RadLAX argued that because of the use of the word "or" in the statute, the "indubitable equivalent" prong was intended by Congress as an alternative to credit bidding, and that it was therefore permitted to confirm a plan of reorganization without allowing the secured creditor to credit bid. The Seventh Circuit disagreed, and held that the requirement that a secured creditor

must receive the “indubitable equivalent” of its claims means the secured creditor necessarily has the ability to credit bid the full amount of its outstanding claim.

The Supreme Court found that *RadLAX's* interpretation of the statute and reliance on the use of the word "or" was “hyperliteral and contrary to common sense.” The Court explained that subsection (ii) of section 1129(b)(2)(A) deals specifically with sales under a plan, while subsection (iii) is a broadly worded provision that does not deal with sales. Relying on the canon of statutory construction that the specific governs the general, the Supreme Court held that where a plan proposes a sale of a secured lender’s collateral, the plan is subject to subsection (ii) of section 1129(b)(2)(A), and therefore must include the secured creditor's right to credit bid.

Although the Supreme Court's decision was no surprise to many, it was disappointing to certain bankruptcy practitioners and scholars. A great deal of the parties' briefs and scholarly discussion surrounding the credit bidding issue focused on the policy reasons behind credit bidding and the shifting real estate climate's impact on how bankruptcy cases are administered. Because the Court's holding was premised solely on the interpretation of the statute, there was no need to consider the policy reasons behind credit-bidding which are for the consideration of Congress, not the courts." Nevertheless, in resolving the split amongst the circuits over this issue, the Supreme Court has clarified the application of section 1129(b)(2)(A) to plan sales by holding that secured creditors have an absolute right to credit bid when a plan of reorganization seeks to sell their collateral free and clear of liens.

This holding provides certainty to the credit markets, particularly in valuing secured debt obligations. The decision also impacts upon how lenders and investors determine pricing for loans and debt instruments.