

CLIENT ALERT

Credit Bid Rights of Secured Creditors Protected by U.S. Supreme Court

June 8, 2012

On May 29, 2012, the United States Supreme Court resolved a split among Circuits by unanimously holding that a Chapter 11 debtor may not deny a secured creditor the right to credit bid its secured claim in connection with a plan of reorganization that provides for the sale of the secured creditor's collateral. *RadLAX Gateway Hotel, LLC v. Amalgamated Bank*, No. 11-166, slip op. at *10 (May 29, 2012).¹ This opinion erases any doubt secured lenders may have had about their protections under the Bankruptcy Code's cramdown provisions.

Background

The right of a secured creditor to credit bid in connection with a plan of reorganization has been in question since the Third Circuit's 2010 decision in *In re Philadelphia Newspapers, LLC*, 599 F.3d 298 (3d Cir. 2010). In that case, the Third Circuit affirmed a lower court ruling confirming a plan of reorganization that expressly prohibited a secured creditor from credit bidding at a sale of its collateral pursuant to the debtor's plan of reorganization.

The recent Supreme Court opinion arose out of a Seventh Circuit opinion that disagreed with the rule in *Philadelphia Newspapers*. In *RadLAX*, the debtors filed a plan of reorganization in the Bankruptcy Court for the Northern District of Illinois that provided for an auction sale of substantially all of the debtors' assets free and clear of all liens (the "Plan"). *Slip op.* at *2. Concurrently with the filing of the Plan, the debtors filed a sale and bid procedures motion that sought entry of a court order approving the procedure for the auction sale (the "Sale Procedures Motion"). *Id.* The Sale Procedures Motion provided for a sale to the highest bidder at the auction and included an initial stalking horse bid by a potential purchaser. *Id.* The Plan contemplated that the proceeds of the auction would be used to repay the secured lender. *Id.* While the Sale Procedures Motion permitted the secured lender to bid at the auction, the debtors' proposed sale procedures expressly prohibited the secured lender from credit bidding its secured debt at the auction. *Id.* at *2-*3. In other words, the secured lender would be required to bid cash, which, through the Plan, would then be repaid to the secured lender in satisfaction of its own secured claim.

The bankruptcy court held, and the Seventh Circuit affirmed, that the debtors' proposed sale procedures violated the specific requirement of Bankruptcy Code § 1129(b)(2)(A)(ii), which mandates that a secured creditor have the right to credit bid at any sale of its collateral pursuant to a plan of reorganization. *Id.*

The debtors appealed to the Supreme Court, asserting that a secured creditor does not have an absolute right to credit bid at a sale conducted pursuant to a plan of reorganization so long as the plan provides that the secured creditor is receiving the "indubitable equivalent" of its secured claim.

The debtors' argument was based on favoring the more general provisions of Bankruptcy Code § 1129(b)(2)(A), which governs the cramdown of reorganization plans, over the more specific provisions of that section governing a secured creditor's rights. Under § 1129(b)(2)(A) of the Bankruptcy Code, in order to cramdown a plan of reorganization on a dissenting class of

secured claims, the plan must be fair and equitable to such dissenting class and shall provide one of the three following treatments with respect to secured creditors in such class:

- (1) the holders of such secured claims must retain the liens securing their claims, and each holder of claims of the class shall receive deferred cash payments totaling at least the allowed amount of such claims, 11 U.S.C. § 1129(b)(2)(A)(i);
- (2) the plan provides for the sale of the secured creditors' collateral free and clear of all liens on such property, subject to the secured creditor's right to credit bid pursuant to section 363(k) of the Bankruptcy Code, and with such liens attaching to the proceeds of the sale, 11 U.S.C. § 1129(b)(2)(A)(ii); or
- (3) the plan provides for the realization by the secured creditors of the indubitable equivalent of their secured claims, 11 U.S.C. § 1129(b)(2)(A)(iii).

While the RadLAX Plan did not grant the secured creditor the right to credit bid as contemplated under § 1129(b)(2)(A)(ii), the debtors asserted that the use of the word "or" in describing the plan alternatives under § 1129(b)(2)(A) of the Bankruptcy Code meant that a plan which provided for the sale of the secured creditor's collateral could still be confirmed even without the right to credit bid – so long as the plan satisfied § 1129(b)(2)(A)(iii)'s requirement that the plan provide the secured creditor with the indubitable equivalent of its claim. *Id.* at *5. The bankruptcy court and the Seventh Circuit rejected this argument.

The Supreme Court's Decision

Given the split between the Third and Seventh Circuits, the Supreme Court granted certiorari and affirmed the Seventh Circuit's opinion in *RadLAX*. Calling this "an easy case," the Supreme Court employed traditional canons of statutory construction in rejecting the debtors' argument that clause (iii) could permit exactly what clause (ii) prohibits – confirmation of a plan that provides for the sale of assets free and clear of liens but denies a secured lender the right to credit bid. *Id.* at *5, 10. The Court described the debtors' flawed reading of the Code as "hyperliteral and contrary to common sense." *Id.* at *5.

The Court explained that the specific provision for credit bidding within clause (ii) trumps the "general language" of clause (iii). *Id.* at *7. Further, the Court underscored that a debtor could not sell property free and clear as contemplated by clause (ii) without complying with the subsection's requirement that credit bidding be allowed. "The terms of the specific authorization must be complied with." *Id.* at *6.

Implications

Secured creditors can take comfort in the Supreme Court's decision resolving a split among the Courts of Appeal concerning the right of a secured creditor to credit bid. Under the prior Third Circuit rule, a secured creditor would lack protection against the sale of its collateral at a depressed price unless it was willing to advance cash to recover its collateral at auction (which cash would then be transferred back to the lender only through the plan). Credit bidding enables a secured lender to protect its investment in its collateral by establishing a floor at which it will accept bids on its collateral without having to go further out of pocket by bidding cash. Credit bidding also ensures the ability of a secured creditor to take the collateral back itself and either hold it or sell it in a manner that is not provided for in the bankruptcy case. The Supreme Court has now vindicated this right.

¹ Justice Kennedy did not take part in the decision.

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