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United States Supreme Court Resolves Judicial Circuit Split Over Secured Creditor's Right to Credit Bid in Cramdown Plans

In a 8-0 decision resolving a split between the Third and Seventh Circuit Courts of Appeals, the United States Supreme Court recently affirmed a secured creditor's right to credit bid in a sale of its collateral pursuant to a cramdown plan. In *RadLAX Gateway Hotel, LLC v. Amalgamated Bank*,[1] the Supreme Court upheld the Seventh Circuit's ruling that section 1129(b)(2)(A)(iii) of the Bankruptcy Code, the so-called "indubitable equivalent prong" of the cramdown requirements for secured creditors, could not be used to justify confirming a plan which sold secured lenders' collateral without allowing the lenders to credit bid.

The Court, in an opinion written by Justice Scalia, held that the canons of statutory construction did not permit the general "indubitable equivalent" option for cramdown of secured creditors to override the more specific option set forth in clause (ii) of section 1129(b)(2)(A). That cramdown option provides that a secured creditor can be crammed down if its collateral is sold, "subject to section 363(k)," and its security interest attaches to the proceeds of the sale. Section 363(k) allows a secured creditor to credit bid in a sale unless the court, for cause shown, rules otherwise. The Court would not permit confirmation of a plan that contemplated a sale of collateral free and clear of a security interest where the holder of that security interest could not credit bid.

[1] *RadLAX Gateway Hotel, LLC v. Amalgamated Bank*, 566 US ___ (2012).

Background

In 2007, RadLAX Gateway Hotel, LLC and an affiliate (the "Debtors") purchased a hotel near the Los Angeles International Airport. In order to finance the purchase and subsequent improvements to the property, including the construction of a parking facility, the Debtors obtained a $142 million loan secured by substantially all of their assets from Longview Ultra Construction Loan Investment Fund (the "Lenders"). The cost of constructing the parking facility ultimately exceeded projections, and when the Debtors were unable to obtain new financing to complete the project, they filed chapter 11 petitions with the Bankruptcy Court for the Northern District of Illinois, Eastern Division (the "Bankruptcy Court").

During the course of their chapter 11 proceedings, the Debtors proposed a plan pursuant to which all of their assets would be sold free and clear of the Lenders' liens and the proceeds distributed to the Lenders. In connection with the sale, the Debtors filed a motion to approve proposed bidding and auction procedures that did not allow the Lenders to credit bid at the sale. The Lenders objected on the grounds that a chapter 11 plan that proposed a sale of their collateral without allowing them to credit bid violated the cramdown requirements of section 1129(b)(2)(A) of the Bankruptcy Code.

Cramdown for Secured Creditors

Section 1129(a) of the Bankruptcy Code sets forth the elements of a confirmable plan of reorganization; each must be satisfied. Section 1129(a)(8) requires that each class of claims or interests under a plan either (i) accept the plan or (ii) be unimpaired under the plan. Section 1129(b) provides an exception, known as "cramdown," where all of the provisions of section 1129(a) are satisfied except for clause (a)(8). In those circumstances, the plan can be confirmed despite the non-acceptance by a particular class if, among other things, that class receives "fair and equitable" treatment.

When the non-accepting class consists of secured creditors, section 1129(b)(2)(A) provides that the plan is "fair and equitable" if it provides for: (i) the secured creditor to retain its lien and receive cash payments equal to the allowed amount of the secured claim; (ii) "the sale [of the collateral], subject to section 363(k)" of the Bankruptcy Code, with the liens of the secured creditor attaching to the proceeds (the "Sale Prong") or (iii) the secured creditor to receive the "indubitable equivalent" of its claim (the "Indubitable Equivalent Prong").[2] Section 363(k), on which the Sale Prong is predicated, generally provides the secured creditor with the right to credit bid, stating that "unless the court for cause orders otherwise the holder of [a secured] claim may bid at such sale, and, if the holder of such claim purchases the property, [it] may offset such claim against the purchase price of such property."[3]

The Lower Court Decisions

The Lenders argued that the Debtors' plan could not be confirmed because it did not comply with the Sale Prong, which specifically contemplates a secured creditor's right to credit bid. The Debtors replied that their plan could be confirmed under the Indubitable Equivalent Prong because by receiving the proceeds of the sale, the Lenders would receive the indubitable equivalent of their claims. The Debtors further argued that bankruptcy courts are required to confirm any

[2] *See* 11 U.S.C. § 1129(b)(2)(A).

[3] 11 U.S.C. § 363(k).

cramdown plan that provides secured creditors with the indubitable equivalent of their claims, including a plan that contemplates a sale that does not comply with the Sale Prong. The Bankruptcy Court ultimately agreed with the Lenders, issuing an oral ruling that the plan could not be confirmed under 1129(b)(2)(A), denying the motion to approve sale procedures and certifying the matter for direct appeal to the Seventh Circuit Court of Appeals.

The Seventh Circuit affirmed the Bankruptcy Court's ruling, holding that denying the Lenders the right to credit bid removed an important check against their collateral being undervalued, which could result in a sale that might not yield the indubitable equivalent of their claims.[4] The Seventh Circuit also found that the Debtors' interpretation of the Indubitable Equivalent Prong violated principles of statutory construction because it would render the other prongs of section 1129(b)(2)(A) superfluous.[5]

Judge Ambro's *Philadelphia Newspapers* Dissent & the Supreme Court Decision

In reaching its conclusion, the Seventh Circuit relied on a dissenting opinion issued by Circuit Judge Ambro in *Philadelphia Newspapers*.[6] In that case, the debtors filed a plan that provided for substantially all of their assets to be sold at a public auction, free and clear of all liens. The auction procedures required all bidders to fund the purchase with cash, thereby denying the secured creditors the ability to credit bid. The Third Circuit concluded that the plain and unambiguous language of section 1129(b)(2)(A) permits a debtor to conduct a sale under the Indubitable Equivalent Prong without permitting a secured lender to credit bid.

In a lengthy dissent, Judge Ambro reasoned that Congress intended for the Sale Prong to be the exclusive method through which a debtor can cramdown a plan when selling collateral free of liens.[7] Judge Ambro stated that Congress did not intend for the three alternatives of section 1129(b)(2)(A) to be applied universally to any plan. Rather, each alternative is a distinct route with specific requirements that must be applied depending on how the plan proposes to treat the claims of secured creditors.[8] Although the term "indubitable equivalent" is broad, it was not designed to supplant the Sale Prong.

Justice Scalia later reached the same conclusion in *RadLAX* by, like Judge Ambro, relying on a canon of statutory construction that provides specific provisions of a statute trump its general provisions. The Sale Prong (the specific provision) controls the Indubitable Equivalent Prong (the general provision) when a debtor seeks to confirm a plan contemplating a sale of secured creditors' collateral over their objection. The Supreme Court emphatically rejected the Debtors' interpretation of section 1129(b)(2)(A) stating, "We find the debtors' reading of §1129(b)(2)(A)—under which [the Indubitable Equivalent Prong] permits precisely what [the Sale Prong] proscribes—to be hyperliteral and contrary to common sense."[9]

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

[5] *Id*. at 653.

[6] *In re Philadelphia Newspapers*, 599 F.3d 298 (3d Cir. 2010).

[7] *Id*. at 328.

[8] *Id*. at 327.

[9] *RadLAX Gateway Hotel, LLC v. Amalgamated Bank*, No. 11-166, slip op. at 5 (US May 29, 2012).

Impact of the *RadLAX* Decision

By resolving the split between the Third and Seventh Circuits and decisively upholding secured creditors' rights to credit bid in sales pursuant to a cramdown plan, the Supreme Court has restored a level of certainty for secured creditors that was upset by the ruling in *Philadelphia Newspapers*. Before *Philadelphia Newspapers*, secured creditors generally had the expectation that they would be able to credit bid to protect the value of their collateral based on section 363(k) and 1129(b)(2)(A) of the Bankruptcy Code. *RadLAX* is a positive development in the caselaw surrounding credit bidding because it protects secured creditors' expectations with respect to their collateral. The *RadLAX* decision allows secured creditors to rely on their right to credit bid to ensure their collateral is not undervalued to their detriment.

This memorandum is intended only as a general discussion of these issues. It should not be regarded as legal advice. We would be pleased to provide additional details or advice about specific situations if desired.

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