

Real Estate & Land Use

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Supreme Court Confirms Credit Bid Rights of Secured Creditors

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The United States Supreme Court, in the case of *Radlax Gateway Hotel, LLC v. Amalgamated Bank* ("Radlax"), ruled that secured creditors have the same right to credit bid in collateral sales under a plan of reorganization as they do in sales under Section 363 of the Bankruptcy Code ("Section 363 Sales"). In doing so, the Court rejected the argument that the Bankruptcy Code (the "Code") provided Chapter 11 debtors with the alternative of offering the secured creditor the "indubitable equivalent" of its claim, finding that the structure of the relevant Bankruptcy Code section precluded that interpretation.

The *Radlax* decision reaffirms the credit bidding rights of secured creditors, which provide a disincentive to "bottom feeders" to offer inadequate bids since they will be faced with the prospect of being outbid by the secured creditor. This may have the effect of encouraging more 363 Sales, which can liquidate assets faster, easier, and less expensively than a full blown plan confirmation process.

Background

When a secured creditor's borrower files Chapter 11, the borrower often (perhaps usually) proposes to "reorganize" by liquidating its assets, whether by a sale out of the ordinary course of business by a Section 363 Sale or by a sale pursuant to a confirmed Chapter 11 Plan of Reorganization. In either of those circumstances, the secured creditor seeks to maximize the sale price of its collateral, preferably through the negotiation process. But if negotiations are unsuccessful (or if the borrower and/or its creditor's committee refuses to negotiate and wants to proceed with a sale under its own terms), the borrower has some powerful weapons in its arsenal to proceed without the consent of the secured creditor. But the Code, in an effort to achieve some balance, also puts some arrows in the quiver of the secured creditor, by giving the secured creditor the right to credit bid its debt for the collateral. In the decision just issued by the United States Supreme Court in *Radlax*, that right of the secured creditor has just been strengthened.

When pursuing any sale in bankruptcy, the borrower will usually ask the court to allow the secured creditor's collateral to be sold free and clear of the secured creditor's lien, with that lien being transferred to the proceeds of sale. This allows the buyer to obtain clear title to the assets (thus presumably maximizing the price) while preserving the secured creditor's lien by transferring it from the collateral to the proceeds of sale. In theory, the secured creditor should ultimately obtain the sale proceeds since it now has a lien on the cash. But without the right to credit bid, if the secured creditor wishes to bid for the collateral itself, it is required to pay new cash to the bankruptcy estate to purchase its

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own collateral and then hope to get that money back. However, under that procedure, there is usually at least some delay in payment and often an attempt by the borrower/creditor's committee to slice off some piece of the cash for administrative and/or unsecured creditors. Secured creditors are understandably apprehensive about having to come up with fresh cash on an already bad loan, only to have that cash paid into the bankruptcy estate, and then trying to get it back.

In the context of a 363 Sale, the Code affords the secured creditor in that circumstance an alternative. Under section 363(k) of the Code, the secured creditor has the right to credit bid in such a sale so that it can buy the collateral and "pay" for it by reducing the amount of its debt. Commonly these days, the collateral is usually worth less than the amount of the debt (often far less) so the secured creditor can effectively outbid any other potential buyer. In this way the secured creditor can insure that the collateral is not sold for an insufficient price and can take the collateral back if the cash bids are below par. (The Bankruptcy Court has the power to prohibit credit bidding "for cause" under the circumstances of the case, so the right is not absolute.)

While this right is clearly given to the secured creditor in a 363 Sale, the situation was less clear when the sale was pursuant to a plan of reorganization. In that circumstance, there were two differing interpretations of the relevant Code section, one of which preserved the right to credit bid and the other allowed the borrower to circumvent that right by providing to the secured creditor the "indubitable equivalent" of its secured claim, which generally took the form of paying some proceeds of the sale to the creditor. The federal Courts of Appeals were in disagreement over which interpretation was correct.

The Supreme Court Decision

This week, the United States Supreme Court resolved the issue in favor of the secured creditor. In *Radlax*, an 8 to 0 decision (Justice Anthony Kennedy did not participate in the decision), the high court ruled that secured creditors have the same right to credit bid in collateral sales under a plan of reorganization as they do in 363 Sales. The Court rejected the argument that the Code provided Chapter 11 debtors with the "indubitable equivalent" alternative, finding that the structure of the relevant Bankruptcy Code section precluded that interpretation. In contrast to the oral argument before the Court in this case, which focused primarily on policy issues, the Court's decision paid little attention to issues of policy (other than a reference to the dilemma of the United States government in cases where it is a secured creditor and cannot obtain Congressional appropriation to make a cash bid) and instead confined itself purely to issues of statutory interpretation. The Court found that the statute was unambiguous and held that the secured creditor has the same credit bidding rights under a Plan of Reorganization as it would in a 363 Sale.

Significance

The *Radlax* decision reaffirms the credit bidding rights of secured creditors. This is a significant benefit for secured creditors since it provides a disincentive to "bottom feeders" to offer inadequate bids. Secured creditors can protect themselves without having to risk any additional cash. Debtors will find it harder to take the secured creditors rights away by conducting the sale through the plan process. Of course,

resourceful debtors may now focus their attention on convincing the Bankruptcy Court that good cause exists to prohibit credit bidding in that particular case, but that may be a tougher row to hoe than the road that the Supreme Court just closed.

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