



Secured Creditor's Right To Credit Bid Protected

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I. Introduction

In a big win for creditors, the U.S. Supreme Court unanimously ruled on May 29, 2012 that a secured creditor must be granted the right to credit bid up to the full amount of its claim where the debtor pursues a Chapter 11 plan that proposes to sell assets free and clear of liens. *RadLAX Gateway Hotel, LLC v. Amalgamated Bank*, No. 11-166 (U.S. May 29, 2012). The decision strengthens a secured creditor's ability to maximize repayment and recovery against its collateral, removes a Chapter 11 debtor's unfair advantage to attempt a sale of its assets at the creditor's expense, and provides creditors with assurance that their rights will be protected.

II. Background

In 2007, the jointly administered debtors sought to build a Radisson Hotel near the Los Angeles International Airport and borrowed \$142 Million. When funds ran out in 2009 and the debtors were unable to secure additional financing they filed Chapter 11. The debtors proposed plans to sell substantially all of their assets through an auction sale. Pursuant to the plans, the secured creditors would receive the "indubitable equivalent" of their claims and would not be permitted to credit bid at the sale. In connection with the proposed plan and sale, the debtors filed their motion to establish bidding procedures which specified that no credit bids were allowed. Using a credit bid, the creditor is able to purchase its collateral at auction by crediting the purchase price against the secured debt in lieu of paying cash. The secured creditors objected to the bidding procedures motion and argued that the sale could only be approved if credit bidding was allowed, and since credit bids were prohibited, the plans were unconfirmable.

The Bankruptcy Court for the Northern District of Illinois denied the debtors' bid procedures motion (thereby derailing the sales contemplated by the plan) and held that the secured lender must have the right to credit bid in accordance with the bankruptcy code. Thereafter, the debtors directly appealed the bankruptcy court's decision to the 7th Circuit, which affirmed the bankruptcy court's ruling.

In affirming, the 7th Circuit analyzed the plain language of bankruptcy code section 1129(b)(2)(A) and concluded that subsection (iii) (where a plan provides for the secured creditor to receive the indubitable equivalent of its claim), does not indicate whether it applies to every type of Chapter 11 plan or

only those that fall outside of a plan where the secured lender retains its lien on the property or receives deferred cash payments totaling at least the allowed amount of the claim and at least of a value of such holder's interest in the property. The 7th Circuit found the bankruptcy code cramdown provisions to be ambiguous and looked to statutory interpretation. The 7th Circuit ultimately decided that it could not permit the sale under a plan without the possibility of credit bidding.

III. Split of Authority Warranting Supreme Court Review

The 7th Circuit's holding was contrary to decisions on the same issue by the 3rd Circuit, *In re Philadelphia Newspapers*, (which encompasses the Delaware bankruptcy courts) and the 5th Circuit, *Scotia Pacific Co., LLC v. Official Unsecured Creditors' Comm. (In re Pacific Lumber Co.)* Those two courts have denied the right of secured lenders to credit bid finding that the proposed sales through a plan provides the creditor with the indubitable equivalent of its claim under bankruptcy code section 1129 (b)(2)(A)(iii). As a result, in *Philadelphia Newspapers* and *Pacific Lumber*, the secured lenders were forced to take the proceeds derived from the sale without the right to credit bid.

IV. The RadLAX Decision

Writing for the Court, Justice Scalia explained that a plan confirmed over the objection of a class of secured claims had to meet one of three requirements to be deemed "fair and equitable" with respect to the nonconsenting creditor's claim. Under clause (i) of Section 1129(b)(2)(A) of the Bankruptcy Code, the secured creditor's lien remains on the property and it receives deferred cash payments. Under clause (ii), the property is sold free and clear of the creditor's lien, and the creditor receives a lien on the sale proceeds. The sale, however, must be conducted pursuant to Section 363(k) of the Bankruptcy Code which provides that the creditor may credit bid at the sale, up to the amount of its claim.

Without providing the lender the right to credit bid, the debtors sought to confirm their plan under clause (iii) of Section 1129 (b)(2)(A). Under clause (iii), the plan has to provide the creditor with the "indubitable equivalent" of its claim. The debtors proposed a plan to sell their property free and clear of the lender's liens and repay the lender using the sale proceeds.

The Court observed that the ability to credit bid helped protect the creditor against the risk that its collateral would be sold for

a depressed price. It enabled the creditor to purchase the collateral for what it considered a fair market price (up to the amount of the debt) without committing additional cash. Clause (ii) is a detailed provision that sets forth the requirements for confirming a plan that seeks to sell property free and clear of liens. Clause (iii), however, is a more broadly worded provision and says nothing about a sale. The Court, relied on a well established canon of statutory interpretation that “the specific governs the general.” Interpreting the canon, the Court held that the general language of clause (iii), “although broad enough to include it, will not be held to apply to a matter specifically dealt with” in clause (ii).

V. Protection Afforded Secured Lenders

RadLAX protects the benefits of the secured lender’s bargain. When making a loan secured by real property or other collateral, a secured lender specifically bargains for the right to be repaid in full. If the borrower defaults, the secured lender has contracted the ability to foreclose on and take possession of its collateral. RadLAX ensures that such bargained for rights are protected and maintained in a bankruptcy case. If the secured lender believes the auction sale price proposed by a debtor is too low, the lender is able to credit bid up to the amount of the outstanding debt and purchase the property without any additional cash payments. As a result, debtors will no longer be able to use a plan sale to obviate the lender’s right to recover its collateral.



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