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Supreme Court Upholds the Right to "Credit bid" in ***RadLAX Gateway Hotel, LLC, et al. v. Amalgamated Bank***

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The secured lender industry experienced a collective sigh of relief on May 29 after the Supreme Court ruled in *RadLAX Gateway Hotel, LLC, et al. v. Amalgamated Bank* that credit bidding remains a viable option to protect collateral in a cramdown bankruptcy plan. Expressly inscribed in Sections 363(k) and 1129(b)(2)(A) of the Bankruptcy Code, credit bidding has long been understood as a fairly uncontroversial right; until recently. In the past three years, both the Third and Fifth Circuits concluded that a debtor could sell assets free of liens in a Chapter 11 plan without permitting credit bidding. (*In re Philadelphia Newspapers, LLC*, 599 F.3d 298 (3rd Cir. 2010) and *In re Pacific Lumber Co.*, 584 F.3d 228 (5th Cir. 2009)). Recognizing the negative impact these decisions could have on the lending industry, the Supreme Court agreed to hear the issue.

To confirm a Chapter 11 plan over the objection of a secured creditor, a plan proponent must satisfy one of three requirements, set out in Section 1129(b)(2)(A), for the plan to be considered "fair and equitable" with regard to the dissenting secured creditor. The plan must provide (in the disjunctive) that (i) the secured creditor retains its lien on the property and receives deferred cash payments, (ii) the property is sold free and clear of the lien "subject to section 363(k)," and the creditor receives a lien on the proceeds of the sale, or (iii) the secured creditor receives the "indubitable equivalent" of its claim. The principle behind each of the subsections above is that fair treatment of a dissenting secured creditor requires it remain protected to the full value of its collateral: either by maintaining its current lien on the collateral, receiving the proceeds from a fair market value sale of the collateral, or exchanging its current collateral for collateral of equivalent value and risk.

As referred to in subsection (ii) above, Section 363(k) provides that, unless the court orders otherwise, the secured creditor may credit bid at the sale of its collateral. The right to credit bid strikes a balance between the secured creditor's ability to protect against the risk that its collateral will be sold at a depressed price, and the debtor's desire to sell the collateral free and clear of the creditor's lien. If the secured creditor does not believe that its collateral is being sold for a fair price, it may purchase the collateral for what it considers to be the fair market price (up to the amount of its debt) without committing additional cash to protect its position. Oft argued, forcing a secured creditor to commit new money to protect its interest is nonsensical considering the creditor receives the sale proceeds—in essence the creditor would write a check to itself, while suffering the various transaction costs associated with its bid (including short-term financing if cash on hand is insufficient).

The Debtor in *RadLAX* proposed a plan which auctioned its assets, free and clear of any liens, to the highest bidder. The plan would satisfy the secured portion of the secured creditor's (Amalgamated Bank's) claim through the sale proceeds (minus the administrative claim of the Debtor's financial advisor and investment banker) and the balance of the cash on hand, if any, after payment of tax claims, mechanics' liens, and other priority claims. For the unsecured portion of Amalgamated Bank's claim, the plan provided that the creditor receive 5% of the profits over three years, to be calculated after deducting a 12% return on the purchaser's investment. One unique characteristic affecting the Debtor's confirmation efforts was the fact that the one interested bidder refused to participate in the auction unless credit bidding was disallowed. In response, the Debtor's proposed auction procedures did not permit Amalgamated Bank to credit bid—a proposal to which Amalgamated Bank vigorously

objected.

From the start, the Debtor recognized that subsection (ii) expressly requires credit bidding when a debtor attempts to sell an encumbered asset free and clear of a secured creditor's lien. To avoid this roadblock, the debtor argued that its plan was "fair and equitable" under subsection (iii), citing the holdings of the Third and Fifth Circuits—that a debtor may sell assets free of liens in a Chapter 11 plan without credit bidding by providing the secured creditor with the "indubitable equivalent" of its secured claim under Section 1129(b)(2)(A)(iii). The Debtor contended that the cash proceeds generated from the sale provided the bank with the "indubitable equivalent" of its secured claim. The Bankruptcy Court and the United States Court of Appeals for the Seventh Circuit disagreed, holding that Section 1129(b)(2)(A) does not permit debtors to sell an encumbered asset free and clear of a lien without permitting the secured creditor to credit bid; the Supreme Court affirmed in an 8-0 decision.

The Supreme Court explained that the Debtor's reading of subsection (iii) to permit precisely what subsection (ii) proscribed, was "hyperliteral and contrary to common sense" and violated a well established canon of statutory interpretation—that the specific governs the general. The Court determined that subsection (iii) was a catch-all provision and that even though it was broad enough to include auction sales, it did not apply because auction sales were specifically addressed in subsection (ii). A general enactment is understood to affect only such cases within its general language that are not within the provisions of a more particular enactment. The Court explained that subsection (ii) was a detailed provision that directly enumerated the requirements for selling collateral free of liens, while subsection (iii) was a broadly worded provision that said nothing about such a sale.

In the end, the Court concluded that this was an easy case; the statute made clear that a debtor may not confirm a Chapter 11 cramdown plan that provides for the sale of collateral free and clear of a lien, but does not permit the secured creditor to credit bid at the sale. It is important to note that an open issue remains as to the extent to which the bankruptcy court can curtail the right to credit bid under the express language of section 363(k) and how that might affect a secured creditor in a cramdown plan situation.

Nevertheless, the *RadLAX* decision should comfort the lending industry, which has relied on the credit bid right to protect its collateral interest, especially in rescue financing situations where such lenders must approach the transaction with utmost caution. Lenders drawn into bankruptcy cases by their borrowers should seek out experienced counsel to help protect their rights as the bankruptcy process unfolds.

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