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Supreme Court Upholds Secured Creditor’s Right to Credit Bid in a Bankruptcy Case

4 June 2012

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The United States Supreme Court emphatically upheld a secured creditor’s right to credit bid in bankruptcy cases. In *RadLAX Gateway Hotel, et al. v. Amalgamated Bank*, 566 U.S.___ (May 29, 2012), the Court found the case an "easy" one to resolve: when a secured creditor is denied the right to credit bid its debt in the sale of its collateral as a part of a bankruptcy plan, it will not receive the "indubitable equivalent" of its secured claim in the form of cash generated from the sale. The Court's unanimous decision should help restore certainty in lending.

The Debtors purchased a hotel and real estate for development but ran out of funds. The Debtors commenced chapter 11 bankruptcy cases and proposed a bankruptcy plan to sell substantially all assets pursuant to a related motion to establish bidding procedures. The bidding procedures did not permit the lender to credit bid and forced the lender to bid cash. In addition, the bankruptcy plan provided that the secured claim would receive the cash generated from the sale and the plan would be “crammed down” over the secured creditors’ objection. The bankruptcy court denied the sale procedures motion, certified the ruling for direct appeal to the Seventh Circuit (which affirmed), and the Supreme Court granted certiorari.

The Supreme Court heard the appeal to resolve a split among the Circuits. The Third Circuit, in *In re Philadelphia Newspapers, LLC*, 599 F.3d 298 (3d Cir. 2010), and the Fifth Circuit, in *In re Pacific Lumber Co.*, 584 F.3d 229 (5th. Cir. 2009), had ruled that debtors could hold auctions for properties without allowing secured creditors to credit bid and deem payment of the cash generated by the sale as fair and equitable treatment of the secured claim. This allowed plans to be “crammed down” over a secured creditor’s objection.

The Court applied a well-established canon of statutory interpretation to the cram-down provisions of the Bankruptcy Code: the specific governs the general. The Court stated:

A Chapter 11 plan confirmed over the objection of a “class of secured claims” must meet one of the three requirements in order to be deemed “fair and equitable” with respect to the non-consenting creditor’s claim. The plan must provide:

> ‘(i)(I) that the holders of such claims retain the liens securing such claims, whether the property subject to such liens is retained by the debtor or transferred to another entity, to the extent of the allowed amount of such claims; and (II) that each holder of a claim of such class receive on account of such claim deferred cash payments totaling at least the allowed amount of such claim, of a value, as of the effective date of the plan, of at least the value of such holder’s interest in the estate’s interest in such property;
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> (ii) for the sale, subject to section 363(k) of this title, of any property that is subject to the liens securing such claims, free and clear of such liens, with such liens to attach to the proceeds of such sale, and the treatment of such liens on proceeds under clause (i) or (iii) of this subparagraph; or
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> (iii) for the realization by such holders of the indubitable equivalent of such claims.” 11 U.S.C §1129(b)(2)(A).’

Under clause (i), the secured creditor retains its lien on the property and receives deferred cash payments. Under clause (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. Section 363(k), in turn, provides that “unless the court for cause orders otherwise the holder of such claim may bid at such sale, and, if the holder of such claim purchases such property, such holder may offset such claim against the purchase price of such property” – i.e., the creditor may credit-bid at the sale, up to the amount of its claim. Finally, under clause (iii), the plan provides the secured creditor with the “indubitable equivalent” of its claim.

In its unanimous opinion of only 12 pages, the Court made short shrift of the Debtors’ argument that, while its plan cannot satisfy clause (ii) because it expressly prohibits the lender to credit bid under Section 363(k), the plan can satisfy clause (iii) since clause (iii) does not expressly foreclose the possibility of a sale without credit bidding, and therefore, the lender can receive the “indubitable equivalent” of its secured claim in the form of cash generated from the auction. The

Court stated: “[w]e find the debtors’ reading of Section 1129 (b) (2) (A)—under which clause (iii) permits precisely what clause (ii) proscribes—to be hyperliteral and contrary to common sense.” This is because clause (ii) is a detailed provision that spells out the requirements for selling collateral free and clear of liens, while clause (iii) is a broadly worded provision that says nothing about such a sale. Therefore, the general language of clause (iii) will not be held to apply to a matter specifically dealt with in clause (ii).

The Court noted that the ability to credit bid helps protect a creditor against the risk that its collateral will be sold at a depressed price, by enabling the creditor to purchase the collateral without committing additional cash to protect the loan. Interestingly, the Court also noted that the right to credit bid “is particularly important for the Federal Government, which is frequently a secured creditor in bankruptcy and which often lacks appropriations authority to throw good money after bad in a cash-only bankruptcy auction.” This obviously reflects the Court’s concern for the economic impact of a policy of not allowing secured creditors, including governmental creditors, to credit bid.

In summary, the Court’s unanimous decision could not more clearly protect the rights of secured creditors to credit bid in a bankruptcy case. The right is important to protect against the risk of a sale of a lender’s collateral to a third party at depressed values. As acknowledged by the Court, common sense dictates that a secured creditor should be allowed to offset what it is owed by credit bidding against the property that serves as its collateral. This offset is also beneficial to the debtor by the corresponding reduction of the secured claim. Further, the ruling restores certainty in the credit markets by providing lenders the benefit of their bargain.

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