Supreme Court Affirms the Right of Secured Creditors to Credit Bid in a Sale under a "Cramdown" Plan of Reorganization

On May 29, 2012, in *RadLAX Gateway Hotel, LLC v. Amalgamated Bank,* the United States Supreme Court unanimously held that a debtor may not confirm a chapter 11 plan of reorganization providing for the "free and clear" sale of a secured creditor's collateral, without permitting the secured creditor to credit bid at the sale. This decision resolves a split among the Circuits that caused uncertainty for lenders and encouraged forum shopping among debtors. It will be welcome news to secured creditors concerned about protecting their interests in chapter 11 reorganizations and to distressed debt investors who pursue bankruptcy acquisition strategies.

The issue before the Court in *RadLAX* was whether the debtors had satisfied the requirements to "cram down" a plan of reorganization on a dissenting secured creditor under Bankruptcy Code section 1129. The Bankruptcy Code permits a debtor to confirm a plan of reorganization over a dissenting class of claims only if the plan is "fair and equitable" with respect to such class. A plan of reorganization is "fair and equitable" to a dissenting secured creditor class only if it satisfies one of three requirements set forth in section 1129(b)(2)(A): (i) the secured claim holders retain a lien on the collateral securing their claims and receive deferred cash payments equal to the value of their secured claims; (ii) the collateral is sold free and clear (with the holders' liens attaching to the proceeds of the sale), subject to the right of the holders to credit bid for the property under section 363(k) of the Bankruptcy Code; or (iii) the holders realize the "indubitable equivalent" of their secured claims.

RadLAX Gateway Hotel, LLC and its affiliates ("<u>RadLAX</u>") took out a secured loan in 2007 to finance the refurbishing of a hotel property and the construction of a parking deck adjacent to the hotel. RadLAX exhausted these loan proceeds before completing the project and was forced to halt construction. Unable to reach an accommodation with its secured lenders, and still owing at least $120 million on the loan, RadLAX filed for chapter 11 in August 2009. To exit from chapter 11, RadLAX proposed a plan of reorganization, accompanied by a motion to approve bid procedures for the sale of the debtors' property. The bid procedures contemplated an auction of the property, with an opening "stalking horse" bid of $47.5 million in cash, and expressly prohibited the secured lenders from credit bidding, *i.e.*, offsetting their secured debt against any purchase price they might bid at the auction. RadLAX's secured lenders objected to the bid procedures, arguing that clause (ii) of section 1129(b)(2)(A) granted secured creditors an absolute right (other than for cause shown[1]) to credit bid in any sale under a plan. The lenders asserted that the debtors' failure to provide them with this right to credit bid rendered the proposed plan unconfirmable. RadLAX disputed that the specific credit bidding requirement in clause (ii) necessarily applied to any sale under a plan. Relying on precedent from the Third and Fifth Circuits, RadLAX maintained that it could satisfy the cramdown requirements by demonstrating that the sale would allow the secured lenders to realize the "indubitable equivalent" of their secured claims as provided in clause (iii). The Bankruptcy Court sided with the secured lenders, holding that clause (ii) of section 1129(b)(2)(A) sets forth the exclusive means for cramming down secured creditors under a plan that contemplates the sale of their collateral. On direct appeal, the Seventh Circuit Court of Appeals affirmed.

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[1] Examples of such "cause" would be if the secured creditor's lien were in dispute or the secured creditor were a junior lienholder that had not provided for the satisfaction of the senior lien.

In their briefs and at oral argument before the Supreme Court, both sides made extensive arguments based on legislative purpose and policy along with the plain language of the statute. RadLAX claimed that granting secured creditors an absolute right to credit bid would chill the bidding at any auction and stymie the reorganization process before it has begun. The lenders, in contrast, maintained that credit bidding is vital to protecting the secured creditor's interest in the collateral it bargained for. Setting these policy arguments aside, the Supreme Court rested its decision solely on principles of statutory construction. Writing for the unanimous Court, Justice Scalia applied the well-established rule that a specific statutory provision will trump a more general provision. He described the debtors' argument — which would permit RadLAX to achieve under the general "indubitable equivalent" standard of clause (iii) what it could not accomplish under the more specific sale provisions of clause (ii) — to be "hyperliteral and contrary to common sense." In the Court's view, the straightforward application of the principles of statutory construction made for an "easy case": If the RadLAX debtors wished to sell their property in a cramdown plan of reorganization, clause (ii) of section 1129(b)(2)(A) plainly requires that the secured lenders be afforded the right to credit bid.

It is part of the design of the Bankruptcy Code that secured lenders may be compelled to give up their state law entitlement to take the collateral when a debtor needs the property to reorganize. When a debtor elects to sell property under section 363, however, the Bankruptcy Code expressly affirms this entitlement by giving secured creditors the right (subject to limited exceptions "for cause") to credit bid for their collateral. Recent opinions from the Third and Fifth Circuits, relied on by RadLAX, suggested that debtors could deprive secured creditors of this fundamental protection simply by deciding to sell their property under a plan of reorganization. The Supreme Court's decision lays this potential inconsistency to rest and ensures that, in any plan sale, secured creditors will enjoy the safeguard of the credit bid.

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