Real Estate Committee

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Supreme Court Confirms Right of Secured Party to Credit-Bid in Attempted Cramdown Plan Providing for the Sale of Collateral Free and Clear of Liens

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In an opinion that Justice Scalia[1] described as "an easy case," the U.S. Supreme Court resolved a circuit court split by holding that a debtor may not obtain confirmation of a chapter 11 cramdown plan[2] pursuant to 11 U.S.C. § 1129(b)(2)(A)[3] over the objection of a secured creditor if the plan provides for the sale of collateral free and clear of the creditor's lien, but does not permit the creditor the right to credit-bid under § 363(k).[4] The *RadLAX* opinion overrules contrary opinions of the Third Circuit and the Fifth Circuit Courts of Appeal, holding that a cramdown plan providing for the sale of property free and clear of liens does not have to provide impaired secured creditors with the right to credit-bid.[5]

In *RadLAX*, the Seventh Circuit disagreed with the Third Circuit's and Fifth Circuit's decisions and held that a cramdown plan could not provide for the sale of a secured creditor's collateral without affording that creditor the right to credit bid. The Supreme Court resolved that split by overruling *Philadelphia Newspapers* and *In re Pacific Lumber Co.* The *RadLAX* ruling either restored an important protection for secured creditors or deprived debtors of a potentially significant strategic and substantive option—and the related leverage it provides—by preventing a debtor from confirming a plan providing for an auction or other sale of the debtor's property, without the significant—and often dispositive—impact of a secured creditor's right to credit-bid.

Factual Background

In 2009, the *RadLAX* debtors, owing more than $120 million on a loan for an unfinished construction project, filed petitions for relief under chapter 11.[6] The debtors submitted a plan to the bankruptcy court that proposed to sell substantially all of their assets at auction free and clear of all liens pursuant to procedures set out in a contemporaneously filed "Sale and Bid Procedures Motion,"[7] and a stalking-horse bidder submitted an initial bid of $47.5 million.[8] Under the proposed auction procedures, the bank would not be permitted to credit-bid.[9] Anticipating an objection, the debtors sought to confirm their plan under the cramdown provisions of § 1129(b)(2)(A).[10] The bankruptcy court denied the debtors' sale and bid procedures motion, holding that § 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.[11] The Court of Appeals for the Seventh Circuit affirmed, thus creating a circuit split, and the Supreme Court granted *certiorari*.

Relevant Statutory Provisions

Section 1129(b)(1) provides that a chapter 11 cramdown plan may be confirmed without the acceptance of an impaired class of secured creditors if the plan does not discriminate unfairly and is fair and equitable with respect to such class of secured creditors. Section 1129(b)(2)(A) provides that a cramdown plan must, *at a minimum*, meet one of three requirements in order to be deemed "fair and equitable" with respect to the class of nonconsenting secured creditors. 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;
>
> (ii) for the sale, subject to section 363(k)…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
>
> (iii) for the realization by such holders of the indubitable equivalent of such claims. 11 U.S.C. § 1129(b)(2)(A).

The Decision

In analyzing this issue, the Supreme Court applied the well-established canon of statutory construction that "the specific controls the general" to determine that a debtor may not rely on the indubitable equivalent language of clause (iii) to circumvent the specifically applicable requirements of clause (ii). The Court explained that clause (ii) is a specific provision detailing the requirements for selling property free and clear of a secured creditor's lien while preserving the secured creditor's right to credit-bid under § 363(k).[12] In contrast, clause (iii) is a broadly worded general provision providing the secured creditor with the "indubitable equivalent" of its claim, but saying nothing about a sale.[13] In a statute such as §1129(b)(2)(A), where a specific and a general authorization exist side-by-side, "[t]he general/specific canon explains 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)."[14] To allow clause (iii) to override, or swallow up, the specific requirement of clause (ii) would violate the cardinal rule that every part of a statute should be given effect, if possible.[15] The Court found no textual ambiguity in § 1129(b)(2)(A) and therefore there was no need to consider pre-Code practices, the merits of credit-bidding or the purposes of the Bankruptcy Code.[16]

The Supreme Court summarily rejected the debtors' reasoning, which relied primarily on the majority opinion in *Philadelphia Newspapers*, that clause (iii) permits precisely what clause (ii) proscribes, that is, a sale free and clear of liens without preserving the secured creditor's right to credit-bid under § 363(k). The Court found such a reading of the statute to be "hyperliteral and contrary to common sense."[17] The Court also rejected the debtors' contention that the Seventh Circuit conflated approval of bid procedures with plan confirmation.[18] The debtors claimed that they should be able to pursue their auction, leaving it for the bankruptcy judge to determine at confirmation whether the resulting plan satisfied clause (iii) by providing the bank with the "indubitable equivalent" of its secured claim.[19] The Court explained that as a matter of law, the distinction between approval of bid procedures and plan confirmation was irrelevant because bid procedures depriving the secured creditor's right to credit-bid under § 363(k) could not satisfy the requirements of § 1129(b)(2)(A).[20]

The *RadLAX* opinion is a victory for secured creditors because it restores what many believe is a fundamental right for parties holding secured claims: the credit-bid. Debtors, on the other hand, lost the potentially significant leverage provided by the threat of a cramdown plan that prevents a secured creditor from credit-bidding. Whether other debtors attempt to resurrect this strategy by relying on the "for cause" exception to the right to credit bid provided for by § 363(k) will be left to future proceedings. Nonetheless, the Supreme Court in *RadLAX* laid to rest any uncertainty as to this narrow aspect of the Bankruptcy Code, which the Court described as an "expansive (and sometimes unruly) area of law."[21] As such, the clarity provided by the *RadLAX* decision will assist bankruptcy practitioners in their effort to provide more definitive advice to clients in an area of law that as noted by the Supreme Court, often lacks that type of definition and clarity.

1.The decision was 8-0. Justice Kennedy did not participate.

2.A cramdown plan is one in which at least one class of creditors whose claims are impaired has not accepted the plan.

3.11 U.S.C. §§ 101-1532 of the Bankruptcy Code. Hereinafter, all statutory references are to the Bankruptcy Code.

4. *RadLAX Gateway Hotel LLC v. Amalgamated Bank*, No. 11-166, 2012 WL 1912197 at *6 (May 29, 2012).

5. *In re Philadelphia Newspapers LLC*, 599 F.3d 298, 318 (3d Cir. 2010); *Scotia Pacific Co. LLC v. Official Unsecured Creditors' Comm. (In re Pacific Lumber Co.)*, 584 F.3d 229 (5th Cir. 2009).

6. *RadLAX* at *2.

7. *Id.*

8. *Id.*

9. *Id.*

10. *Id.*

11. *Id.* at *3.

12. *RadLAX* at *4-5. A secured creditor's right to credit-bid at a bankruptcy sale under § 363(k) is not absolute. Under § 363(k), the bankruptcy court may still prohibit credit-bidding "for cause." In *RadLAX*, the bankruptcy court found that no cause had been established to preclude the secured creditor from credit-bidding and that part of the court's opinion was not appealed. *Id.* at *4, fn 3.

13. *Id.*

14. *Id.* at *5 (citation omitted).

15. *Id.* at *4.

16. *Id.* at 6.

17. *Id.* at 4.

18. *Id.* at 6.

19. *Id.*

20. *Id.*

21. *Id.* at *6.