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June 5, 2012

Supreme Court Upholds Secured Creditors' Right to Credit-Bid

The Court's unanimous decision in RadLAX Gateway Hotel LLC v. Amalgamated Bank *settles dispute over the credit-bid right, retaining this important creditor protection.*

In a significant victory for secured creditors, on May 29 the U.S. Supreme Court in *RadLAX Gateway Hotel LLC v. Amalgamated Bank*, 566 U.S. — (2012), held that a Chapter 11 plan may not be confirmed over the objection of a secured creditor if the plan provides for the sale of the creditor's collateral free and clear of its liens, but does not permit the creditor to credit-bid at the sale. Writing for a unanimous Court, Justice Antonin Scalia delivered the opinion affirming the decision of the U.S. Court of Appeals for the Seventh Circuit in *River Road Hotel Partners, LLC v. Amalgamated Bank*, 651 F.3d 642 (2011), effectively overruling the contrary decisions of the Third and Fifth Circuits in *In re Philadelphia Newspapers*, 599 F.3d 298 (3d Cir. 2010), and *Bank of New York Trust Co. N.A. v. Official Unsecured Creditors' Committee* (*In re Pacific Lumber Co.*), 584 F.3d 229 (5th Cir. 2009).

Background

The debtors in *RadLAX* financed the purchase, renovation, and construction of a hotel with a loan secured by all of their assets. Ultimately, the debtors ran out of funds with which to complete the project and filed voluntary Chapter 11 petitions with the Bankruptcy Court for the Northern District of Illinois. Thereafter, the debtors submitted a Chapter 11 plan pursuant to which they sought to auction their assets to the highest bidder, with the sale proceeds to be used principally to repay the secured creditor. Under the proposed auction procedure, however, the secured creditor was not permitted to credit-bid (i.e., bid for the property using the debt it was owed to offset the purchase price). The debtors proposed to confirm their plan under the cramdown provision of Bankruptcy Code § 1129(b)(2)(A)(iii) by asserting that they provided the secured creditor with the "indubitable equivalent" of its claim. The Bankruptcy Court denied confirmation as not in compliance with the requirements of Section 1129(b)(2)(A). The Bankruptcy Court certified an appeal directly to the Seventh Circuit, which affirmed, holding that the debtors could not sell the secured creditor's collateral free and clear of its lien without permitting the creditor to credit-bid.

Supreme Court Decision

In affirming the Seventh Circuit decision, Justice Scalia characterized the debtors' attempt to construe the statute so as to circumvent the credit-bid requirement as "hyperliteral and contrary to common sense." He explained that under Section 1129(b)(2)(A), for a plan to be confirmed over the objection of the secured creditor, it must meet one of three requirements to be deemed "fair and equitable." The subsections under Section 1129(b)(2)(A) detail those requirements: Section 1129(b)(2)(A)(i) is the requirement for plans under which the creditor retains its lien; subsection (ii), which incorporates Section 363(k) of the Bankruptcy Code, is the requirement for plans under which the collateral is to be sold free and clear of the creditor's lien and the creditor is provided with the right to credit-bid; and subsection (iii) is a residual provision for other plans, such as one in which the creditor receives the collateral itself. Thus, subsection (ii) is a specific provision covering sales of the collateral free and clear, while subsection (iii) is a general provision for the satisfaction of the secured creditor's claim with its "indubitable equivalent." The well-established canon of statutory interpretation requires that the specific govern the general.

Implications

The Supreme Court decision appears to have put to rest the dispute over whether a secured creditor's credit-bid

right could be eliminated by a sale of assets under a plan, preserving this protection against the risk that the creditor's collateral would be sold at a depressed price. However, the language of Section 363(k), and by extension Section 1129(b)(2)(A)(ii), may provide another potential basis for circumvention of the credit-bid right, as the language allows for an exception where "the court for cause orders otherwise." Justice Scalia noted that the Bankruptcy Court had found that no such cause existed in *RadLAX*. It remains to be seen whether—and under what circumstances—debtors will seek to utilize this exception in Section 363(k) to justify their elimination of a secured creditor's right to credit-bid.

Contacts

Morgan Lewis is well positioned to assist institutional lenders, investment funds, other secured creditors, landlords, and other creditors and interested parties in determining the implications of the Supreme Court's *RadLAX* decision for their businesses.

If you have any questions or would like more information on the issues discussed in this LawFlash, please contact any of the following Morgan Lewis attorneys:

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