RadLAX Gateway Hotel, LLC v. Amalgamated Bank: The Supreme Court Holds That Debtors Must Permit Credit-Bidding When Selling An Asset Free And Clear Of A Secured Creditor's Lien Under A Chapter 11 Plan

2012-06-01

On May 29, 2012, the Supreme Court issued its decision in *RadLAX Gateway Hotel, LLC v. Amalgamated Bank*,[1] resolving a controversial issue that had divided the courts of appeals: whether a chapter 11 debtor may bar a secured creditor from credit-bidding its claim when its collateral is sold under a plan of reorganization.[2] The Court held unanimously (8-0; Justice Kennedy did not participate) that the Bankruptcy Code does not permit a debtor to bar credit-bidding at such a sale.

RadLAX ensures that secured creditors will retain one of the central protections afforded them in a chapter 11 cram-down: the right, when their collateral is sold, to bid up to the full amount they are owed and obtain the collateral, if they value it more highly than other bidders, without being required to put up additional cash. That right to credit-bid helps preserve the benefit of the bargain the secured creditor made outside bankruptcy—either to be paid what it is owed, or to take its collateral.

RadLAX is thus important for its holding alone. As discussed below, however, the Supreme Court's reasoning and the general approach it took to the case are also instructive, particularly in light of the route the credit-bidding issue took to the Court.

The Credit-Bidding Issue In A Nutshell

Section 1129(b)(2)(A) of the Bankruptcy Code provides three alternative routes through which a debtor can confirm a chapter 11 plan that crams down the claims of secured creditors.[3] Under clause (i), the plan may provide that each secured creditor will keep its lien and receive a stream of payments with a face value of the full amount of the creditor's claim and a net present value equal to the present value of the creditor's security interest.[4] Under clause (ii), the plan may provide for the sale of collateral free and clear of a secured creditor's lien, with the lien attaching to the proceeds of the sale, subject to the requirement that the creditor is entitled to credit-bid its entire claim.[5]Or, under clause (iii), the plan may provide that the secured creditor will receive "the indubitable equivalent" of its claim.[6]

The question confronting the Supreme Court in *RadLAX* was whether a chapter 11 cram-down plan could be confirmed if it provided for the sale of collateral free and clear of a secured creditor's lien *without* permitting credit bidding, as clause (ii) would require, but also purported to provide that the secured creditor would receive the indubitable equivalent of its claim under clause (iii). The debtor contended that it was required to satisfy only one of the three alternatives, and that so long as its plan gave the secured creditor the indubitable equivalent of its claim, the debtor was not required to allow credit-bidding. The creditor countered that, under the debtor's interpretation of the statute, clause (ii)'s credit-bidding requirement would be rendered essentially meaningless, and that a free-and-clear sale of collateral that barred credit-bidding was inconsistent with the overall structure of protections the Bankruptcy Code provides for secured creditors.

The Split Among The Courts Of Appeals

The question presented in *RadLAX* had divided the courts of appeals. The Third and Fifth Circuits sided with debtors, holding that credit-bidding was not required in a free-and-clear sale of collateral under a plan if the plan provided the secured creditors with the indubitable equivalent of their claims.[7] In *RadLAX* itself, however, the Seventh Circuit came to the opposite conclusion.[8]

Philadelphia Newspapers illustrates the interpretation of the statute that is favorable to debtors. That case involved a debtor that wanted to sell its main assets, two daily Philadelphia newspapers, to a stalking-horse bidder it had selected, and thus wanted to bar its secured lenders from credit-bidding. A divided panel of the Third Circuit examined the language, context, and purpose of the cram-down provisions. The panel majority concluded that the statutory language was "unambiguous": "The use of the word 'or' in this provision operates to provide alternatives—a debtor may proceed under [clause] (i), (ii), *or* (iii), and need not satisfy more than one."[9] Judge Smith, concurring, added: "I simply cannot look past the statutory text .... Section 1129(b)(2)(A) uses the word 'or' to separate its [clauses] .... Thus, satisfaction of *any* of the three [clauses] is sufficient."[10] Accordingly, the majority reasoned, the statute plainly allowed a debtor to proceed under clause (iii)'s indubitable equivalent standard with a free-and-clear sale of collateral that bars credit-bidding.[11]

The *Philadelphia Newspapers* majority drew a spirited dissent from Judge Ambro, a former bankruptcy practitioner, who contended that the statute had more than one plausible interpretation,[12] but that the better reading favored the secured creditors. He argued that "Congress did not list the three alternatives as routes to cramdown confirmation that were universally applicable to any plan, but instead as distinct rules that apply specific requirements depending on how a given plan proposes to treat the claims of secured creditors."[13] That is, in Judge Ambro's view, clause (ii) governed *all* free-and-clear sales of collateral under a plan, and clause (iii) was simply inapplicable to such plans.[14] While either reading of the language was plausible when the statutory text was viewed in isolation, Judge Ambro contended that canons of statutory interpretation—in particular, the canon that specific provisions prevail over general ones—and the context provided by the Code as a whole supported his construction.[15] After examining in detail the interlocking provisions of the Code governing secured claims, Judge Ambro concluded that credit-bidding was an integral "part of a comprehensive arrangement enacted by Congress to avoid the pitfalls of undervaluation" of secured claims, "and thereby ensure that the rights of secured creditors are protected while maximizing the value of the collateral to the estate."[16]

Following on the heels of *Philadelphia Newspapers*, debtors in *RadLAX*—developers of a hotel at the Los Angeles airport who had borrowed heavily and then run out of funds—proposed a very similar plan. Debtors proposed to sell the hotel and related assets free and clear of its lenders' liens in an auction with a stalking-horse bidder and no credit-bidding, and to provide the lenders with the "indubitable equivalent" of their claims out of the sale proceeds.17 The Seventh Circuit concluded that, although the statutory language was not plain, the better reading of the statute barred such a plan for the reasons articulated in Judge Ambro's *Philadelphia Newspapers* dissent.[18]

The Supreme Court's Decision

The Supreme Court granted certiorari to resolve the circuit split. The parties and their *amici* presented arguments focusing not only on the text of the cram-down provisions, but also on the overall structure of the Bankruptcy Code's protections for secured creditors and the role credit-bidding plays in that structure. The Court, however, confined its analysis to the text of Section 1129(b)(2)(A). Like the Third Circuit majority, the Supreme Court concluded that the text of Section 1129(b)(2)(A) was unambiguous.[19] Unlike the Third Circuit, the Court concluded that the statutory text unambiguously *precluded* debtors from attempting to bar credit-bidding at a free-and-clear sale of creditors' collateral.

In an opinion written by Justice Scalia, the Court rejected the debtors' reading of the statute as "hyperliteral and contrary to common sense."[20] Relying on the "commonplace of statutory construction that the specific governs the general,"[21] the Court reasoned that "clause (ii) is a detailed provision that spells out the requirements for selling collateral free of liens, while clause (iii) is a broadly worded provision that says nothing about such a sale. ... [T]he '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)."[22]That is, of Section 1129(b)(2)(A)'s three clauses, "(i) is the rule for plans under which the creditor's lien remains on the property, (ii) is the rule for plans under which the property is sold free and clear of the creditor's lien, and (iii) is a residual provision covering dispositions under all other plans."[23] Accordingly, the Court concluded that "debtors may not sell their property free of liens under § 1129(b)(2)(A) without allowing lienholders to credit-bid, as required by clause (ii)."[24]

The Court briskly rejected the Third Circuit majority's reasoning, under which the word "or" was dispositive, explaining that "the question here is not whether debtors must comply with more than one clause, but rather which one of the three they must satisfy. Debtors seeking to sell their property free of liens under § 1129(b)(2)(A) must satisfy the requirements of clause (ii), not the requirements of *both* clauses (ii) and (iii)."[25]

The Court declined to consider "the purposes of the Bankruptcy Code, pre-Code practices, and the merits of credit-bidding," concluding that the statute contains "no textual ambiguity" and that the analysis thus did not need to proceed beyond the text.[26] It concluded by commenting: "The Bankruptcy Code standardizes an expansive (and sometimes unruly) area of law, and it is our obligation to interpret the Code clearly and predictably using well-established principles of statutory construction. Under that approach, this is an easy case."[27]

Conclusion

The Supreme Court rarely has the opportunity to resolve issues of importance to business bankruptcies, and credit-bidding is such an issue. For that reason alone, *RadLAX* is a significant—though in some respects narrow—decision.

From debtors' perspective, *RadLAX* may limit their flexibility in structuring asset sales under a plan: All free-and-clear sales of collateral under a plan must now comply with clause (ii), absent the secured creditors' consent.[28]

From secured creditors' perspective, *RadLAX* reaffirms a key bankruptcy protection. One of the critical concerns for an undersecured creditor in bankruptcy is the valuation of its security interest. The Bankruptcy Code bifurcates undersecured claims into secured and unsecured portions,[29] with very different treatment accorded to each. Certain undersecured creditors may choose to have their entire claim treated as secured and relinquish the unsecured deficiency claim.[30] By doing so, they protect themselves against undervaluation of their security interests.[31] But undersecured creditors whose collateral is to be sold lack that option.[32] Instead, they have the right to credit-bid at the sale of their collateral. Legal restrictions and transaction costs associated with cash bidding may sometimes preclude a secured creditor from bidding at all if it cannot credit-bid. The right to credit-bid thus ensures that creditors can get their collateral whenever they value it more highly than other bidders, rather than being cashed out for whatever the highest cash bidder thinks the collateral is worth.

RadLAX declined to look beyond the text of § 1129(b)(2)(A), and offered no broader statements about the structure or purpose of the Bankruptcy Code. But the Supreme Court's closing comments are suggestive of the approach the Court will take to similar questions in the future. The Bankruptcy Code is a statute, and questions that arise under it are questions of statutory interpretation. They cannot be resolved by the invocation of broad, general bankruptcy policy—whether the policy is protecting secured creditors or encouraging reorganization. Rather, they should be analyzed through the traditional tools of statutory construction, which should be applied in a way that produces clear and predictable rules. As long as it is informed by an understanding of the Bankruptcy Code's overall design—itself a traditional part of statutory construction—that approach may in fact help to tame "unruly" bankruptcy law.

---

[1] No. 11-166, 2012 WL 1912197 (U.S. May 29, 2012).

[2] WilmerHale represented the Loan Syndications and Trading Association, the American Bankers Association, The Clearing House Association, the Commercial Finance Association, the Commercial Real Estate Finance Council, the Equipment Leasing and Finance Association, the Financial Services Roundtable, the Managed Funds Association, the Mortgage Bankers Association, and the Securities Industry and Financial Markets Association, which filed a brief as amici curiae in the Supreme Court in support of the secured creditor, Amalgamated Bank.

[3]*See* 11 U.S.C. § 1129(b)(2)(A).

[4]*Id.* § 1129(b)(2)(A)(i).

[5]*See id.* § 1129(b)(2)(A)(ii) (incorporating requirements of § 363(k)); *id.* § 363(k) (setting forth credit-bidding requirement).

[6]*Id.* § 1129(b)(2)(A)(iii). Typical examples of treatment satisfying the "indubitable equivalent" clause include abandonment of the collateral to the creditor or a substitute lien on property of indubitably equal value. *See 7 Collier on Bankruptcy* ¶ 1129.04[2][c] (Resnick & Sommer, eds., 16th ed. 2009).

[7]*See In re Philadelphia Newspapers, LLC*, 599 F.3d 298 (3d Cir. 2010); *In re Pacific Lumber Co.*, 584 F.3d 229 (5th Cir. 2009).

[8]*See In re River Road Hotel Partners, LLC*, 651 F.3d 642 (7th Cir. 2011).

[9]*Philadelphia Newspapers*, 599 F.3d at 305.

[10]*Id.* at 319 (Smith, J., concurring).

[11]*Id.* at 313-14 (majority).

[12]*Id.* at 322 (Ambro, J., dissenting).

[13]*Id.* at 325.

[14]*Id.* at 327.

[15]*Id.* at 328-34.

[16]*Id.* at 334.

[17]*River Road*, 651 F.3d at 644-45.

[18]*Id.* at 651-53.

[19]*RadLAX*, 2012 WL 1912197 at *6.

[20]*Id.* at *4.

[21]*Id.* (quoting *Morales v. Trans World Airlines, Inc.*, 504 U.S. 374, 384 (1992)).

[22]*Id.* at *5 (quoting *D. Ginsberg & Sons, Inc. v. Popkin*, 285 U.S. 204, 208 (1932)).

[23]*Id.*

[24]*Id.*

[25]*Id.*

[26]*Id.* at *6.

[27]*Id.*

[28]The decision's logic may also limit debtors' flexibility with regard to "plans under which the creditor's lien remains on the property." *Id.* at *5. Under the Court's reading of Section 1129(b)(2)(A), all such plans, if non-consensual, must seemingly comply with the requirements of clause (i).

[29] 11 U.S.C. § 506(a).

[30]*Id.* § 1111(b).

[31]*See 7 Collier on Bankruptcy* ¶ 1111.03[3][c].

[32]11 U.S.C. § 1111(b).

Authors

Danielle Spinelli

RETIRED PARTNER

+1 202 663 6000