

# One Minute Memo<sup>®</sup>



## U.S. Supreme Court Resolves Circuit Split In Favor Of Secured Lenders' Credit-Bid Rights In Chapter 11 Bankruptcy Cases

The U.S. Supreme Court issued a unanimous decision on May 29, 2012, finding that a chapter 11 bankruptcy plan of liquidation is not confirmable over a secured lender's objection if such plan prohibits the lender from credit bidding at a sale of its collateral.<sup>1</sup> See *RadLAX Gateway Hotel, LLC et al. v. Amalgamated Bank*, No. 11-166, 566 U.S. \_\_\_\_ (2012). The *RadLAX Gateway Hotel* decision affirmed a prior ruling by the Seventh Circuit Court of Appeals and rejected contrary rulings by the Third and Fifth Circuit Courts in *In re Philadelphia Newspapers, LLC*, and *In re The Pacific Lumber Co.*, which had confirmed chapter 11 plans that barred secured creditors from credit bidding.

Generally speaking, a bankruptcy court may only confirm a chapter 11 plan if each class of impaired creditors votes in favor of the plan. However, Bankruptcy Code section 1129(b)(2)(A) permits a bankruptcy court to confirm a plan without the consent of all classes of impaired creditors (i.e., "cram down") if the plan is "fair and equitable" to the dissenting creditors. A plan may be considered fair and equitable as to a dissenting secured creditor if the plan: (a) allows the secured creditor to retain its liens and receive deferred cash payments; (b) proposes a sale of the secured lender's collateral free and clear of all liens with such liens to attach to the proceeds of the sale, subject to the secured creditor's right to credit bid; or (c) provides the secured lender with the "indubitable equivalent" of its secured claim, which serves as a catch-all option.

The *RadLAX Gateway Hotel* decision concerned two related debtors who proposed liquidating chapter 11 plans whereby substantially all of their assets would be sold at auction. A defining feature of each plan was a prohibition on credit bidding. As such, the debtors relied on the *Philadelphia Newspapers* and *Pacific Lumber* decisions in seeking approval of bid procedures and accompanying plans under the indubitable equivalent option of the fair and equitable test. The debtors obtained initial auction bids totaling approximately \$47.5 million, nearly \$100 million below the value of the secured lenders' claims. The secured lenders objected to the proposed bid procedures and plans. The Bankruptcy Court for the Northern District of Illinois orally ruled that the prohibition on credit bidding rendered the plans unconfirmable and denied the bid procedures. The bankruptcy court also certified a direct appeal to the Seventh Circuit.

The Seventh Circuit affirmed the bankruptcy court's decision and found the entire three-part "fair and equitable" test to be ambiguous. See *River Road Hotel Partners, LLC, et al. v. Amalgamated Bank* decision, 651 F.3d 642 (7th Cir. 2011) (named after the companion case to *RadLAX Gateway Hotel*). The Seventh Circuit then held that the sale could not proceed under the indubitable equivalent option because such a result would violate various canons of statutory interpretation by: (a) rendering other Bankruptcy Code provisions that protect secured lenders' credit-bid rights superfluous; (b) conflicting with the objectives of the Bankruptcy Code; and (c) impermissibly allowing general Bankruptcy Code provisions to control over more specific provisions. The Seventh Circuit also held that a sale of collateral could not independently satisfy the indubitable equivalent option without credit bidding.

In what it referred to as an "easy case," the Supreme Court affirmed the Seventh Circuit's judgment based solely on the canon of statutory interpretation that a specific statutory provision governs a general provision. In other words, where general and specific authorizations exist side-by-side, the general/specific canon avoids rendering superfluous a specific provision that is swallowed by the general rule. While the Supreme Court acknowledged that the general/specific canon

## Seyfarth Shaw — One Minute Memo

is most frequently applied to statutes where a general permission or prohibition is contradicted by a specific prohibition or permission, the Court held that “the canon has full application . . . to statutes . . . in which a general authorization and a more limited, specific authorization exist side-by-side.”

The Supreme Court acknowledged that the specific/general canon is not absolute and can be overcome by contrary “textual indications.” However, the Supreme Court found that all indications in the Bankruptcy Code were in favor of upholding the credit-bid requirement. The Supreme Court also cited to several public policy considerations that supported its decision. These considerations included that credit-bid rights help to ensure collateral is not sold at depressed prices and that secured lenders, especially the Federal Government, should not be required to commit additional cash to a non-performing loan in order to protect its collateral.

The *RadLAX Gateway Hotel* decision is significant because it preserves long-recognized credit-bid rights and established risk profiles for pre-bankruptcy and debtor-in-possession financing. While this decision is a clear victory for secured lenders, it also demonstrates the importance of active involvement by secured lenders in chapter 11 bankruptcy cases. This is because a secured lender’s vote against a chapter 11 plan would almost certainly be insufficient to prevent cram down unless the secured lender also objected to confirmation of the plan. Therefore, secured lenders must be proactive participants in bankruptcy cases in order to protect their contractual rights.

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<sup>1</sup> Justice Kennedy took no part in the decision