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Supreme Court Hears Argument in Credit Bidding Case
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On April 23, 2012, the Supreme Court heard argument in the *RadLAX Gateway Hotel, LLC v. Amalgamated Bank case*. The Court has been asked to resolve the question of whether a debtor may confirm a plan of reorganization that prohibits a secured creditor from credit bidding the amount of its claim during an auction sale. A credit bid allows a secured lender to use the debt owed to it as "currency" to bid for the debtor's assets in which it has a security interest.

The debtor, RadLAX argued that the Supreme Court should reverse the decision of the Seventh Circuit Court of Appeals, which prohibited it from implementing a sale process that would have provided for the sale of substantially all of its assets, a Radisson Hotel at the Los Angeles International Airport and an adjacent parking structure, free and clear of liens without allowing the secured credit an opportunity to credit bid. The RadLAX chapter 11 plan proposed to conduct an auction of the assets and the distribution of the sale proceeds to its creditors. The plan specified that no secured creditor would be permitted to credit bid at auction, which is a significant departure from past bankruptcy practice. The secured creditor's administrative agent and trustee, Amalgamated Bank, objected to the proposed bid procedures on the grounds that the sale of its collateral, free of liens, required that the lender be permitted to credit bid the amount of its outstanding indebtedness. The bankruptcy court agreed with Amalgamated Bank and denied RadLax's proposal with regard to not permitting credit bids. On a direct appeal, the Seventh Circuit affirmed the bankruptcy court's decision. RadLAX subsequently appealed the decision to the U.S. Supreme Court.

The Seventh Circuit's decision created a split with two other Circuit Court rulings that a chapter 11 plan involving the sale of assets free of liens must allow secured lenders an opportunity to credit bid. The Third and Fifth Circuits previously ruled that these types of "cramdown" plans are not required to permit the secured creditor the ability to credit bid. *In re Philadelphia Newspapers*, 599 F.3d 298 (3d Cir. 2010); *Bank of N.Y. Trust Co. v. Official Unsecured Creditors' Comm. (In re Pac. Lumber Co.)*, 584 F.3d 229 (5th Cir. 2009).

At issue is the interpretation of section 1129(b)(2)(A) of the Bankruptcy Code, which provides three routes to confirmation of a reorganization plan:

- The retention of the liens with deferred cash payments made to the secured creditor;
- A free-and-clear assets sale subject to credit bidding; or
- The provision of the "indubitable equivalent" of the secured interests to the creditors.

Although the RadLAX debtor argued that the "indubitable equivalent" prong was intended by Congress as an alternative to credit bidding, the Seventh Circuit disagreed, and held that the requirement that a secured creditor must receive the "indubitable equivalent" of its claims means the secured creditor necessarily has the ability to credit bid the full amount of its outstanding claim.

In its Supreme Court brief, RadLAX argued that (i) the plain language of the alternative options available under section 1129(b)(2)(A) permits confirmation of a plan that denies a secured creditor the right to credit bid, (ii) the denial of a credit bidding right is consistent with the Bankruptcy Code's treatment of secured creditors, and (iii) the question of whether RadLAX's proposed plan satisfied the indubitable equivalent prong was decided prematurely during the bid procedures process and should not have been addressed until a subsequent confirmation hearing. One of the policy arguments RadLax raised was that requiring a plan proponent to allow credit bidding has the effect of providing a significantly undersecured creditor with a veto over the sale process and deprives debtors of the flexibility that they need to restructure in this modern distressed real estate environment.

Although the Supreme Court has not yet ruled, it appears from the questions raised by the Justices at the argument that the Court is likely to affirm the Seventh Circuit's holding and reject RadLax's arguments. Chief Justice Roberts and Justice Alito both commented that by denying the secured creditor an ability to credit bid, RadLax was not really providing the secured creditor with an "indubitable equivalent," because the secured creditor had bargained for the right to control the collateral when it negotiated for property to secure its loan. Justice Breyer seemingly disagreed with RadLax's position with respect to the textual reading of the statue, and observed that the statute could be read either way, and that the use of the word "or" did not necessarily mean that offering the "indubitable equivalent" would displace the secured creditor's right to credit bid. Justice Breyer suggested that adopting the position advanced by RadLax would facilitate insider manipulation of the sale process, since a stalking horse buyer and a debtor could work together to ensure that the buyer took control over the property for a low price, with the benefit of keeping the debtor's principals employed in the business. This viewpoint is consistent with the position articulated in other court decisions that favor the practice of having the market set pricing through competitive bidding as being superior to a judicial valuation process. Justice Scalia focused on the interests of the United States government as a creditor, adopting an argument advanced by the Solicitor General that not permitting credit bidding would prejudice the United States when it is a creditor because of its general inability to access cash to bid in a bankruptcy auction. Justice Sotomayor expressed her view that the rule proposed by RadLax would represent a significant shift from traditional bankruptcy practice, and that no justification exists for "upsetting the norm".

Amalgamated Bank's arguments were met with considerably less hostility and none of the criticisms that were leveled at RadLax by the Justices. The Justices asked a few practical questions about how bankruptcy sales work in practice. They gave Amalgamated Bank considerable leeway to make its primary argument that Congress recognized credit bidding as an effective method of ensuring that a secured creditor receives the actual current value of its collateral by requiring debtors to allow secured creditors to credit bid at a sale pursuant to section 363 of the Bankruptcy Code, and that a comparison of section 1129(b)(2)(A) with section 363 should not result in the conclusion that section 1129(b)(2)(A) creates an exception to the credit bidding requirement.

While these comments could lead an observer to believe that the Supreme Court is unlikely to overturn the decisions of the lower courts in this case, the anticipated decision and its rationale will be very important to the bankruptcy and lending communities.

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