

Credit Bidding Dispute Comes Under Scrutiny by Supreme Court

by Joel R. Glucksman on May 1, 2012

Creditor's rights are a hot topic in the Supreme Court currently, and the ruling in a current case may give secured creditors more rights when it comes to recouping losses.

Arguments in the case of RadLAX Gateway Hotel center around whether debtors who have entered into Chapter 11 bankruptcy are permitted to sell off secured creditors' collateral without allowing them to submit a credit bid on the debt under bankruptcy law. The Supreme Court is considering a case that was heard last year and that caused a circuit split. The Seventh Circuit, ruling in the Chapter 11 reorganization of RadLAX Gateway Hotel's companion company River Road Hotel Partners, disagreed with the Third Circuit's 2010 decision involving Philadelphia Newspapers.

River Road, relying on the ruling in Philadelphia Newspapers, attempted to auction off the collateral of its secured creditors and barred them from submitting a credit bid.

The Bankruptcy Code allows three scenarios in which reorganizations under Chapter 11 are deemed "fair and equitable," but do not require the permission of secured lenders to be carried out. In dispute are two of the three clauses that relate to reorganization without the lenders' consent: ii) the sale of collateral free and clear of liens but subject to credit bidding, or iii) the realization by the creditor of the "indubitable equivalent" of its secured claim, as necessary scenarios.

The Third Circuit ruled in the case of Philadelphia Newspapers that the "plain language" in the use of "or" means that as long as the "indubitable equivalent" provision was met by the debtor, they were not required under bankruptcy law to allow lenders to bid. The Seventh Circuit disagreed with the Third Circuit's reasoning in the case of River Road.

The Supreme Court has focused more of its attention on the "indubitable equivalent" provision, rather than the "plain language" of the second clause, explaining that the former concept may be difficult to satisfy through auctions that do not afford lenders the opportunity to bid.