Radlax — 'An Easy Case'

Law360, New York (July 10, 2012, 12:36 PM ET) -- “This is an easy case,” Justice Antonin Scalia wrote in his brief, 12-page, May 29, 2012, opinion that settles the issue of whether the Bankruptcy Code grants the secured creditor a right to credit bid in an auction sale under a plan. See Radlax Gateway Hotel LLC v. Amalgamated Bank, 132 S. Ct. 2065 (May 29, 2012).

However, interestingly, the opinion barely mentions the infamous Philadelphia News[1] decision from the Third Circuit which was effectively overruled by the Supreme Court, putting to rest a split in the circuits regarding a secured creditor’s right to credit bid under a bankruptcy plan.

By way of background, the debtors purchased the Radisson Hotel at Los Angeles International Airport, planning to renovate the hotel and build a parking structure. The debtors, however, ran out of funds, owing the secured creditor over $120 million in principal. The debtors had no real hope of obtaining additional funding and filed for Chapter 11 bankruptcy in the U.S. Bankruptcy Court for the Northern District of Illinois.

The debtors filed a Chapter 11 plan proposing to auction all of their assets and contemporaneously filed a bid procedures motion. The debtors’ proposed auction procedures prohibited the lender from credit bidding[2] or bidding for the property, offsetting the debt owed to the lender with the purchase price.

In effect rejecting the analysis of the Third Circuit in Philadelphia News, the bankruptcy court denied the debtors’ bidding procedures, holding that the plan did not comply with section 1129(b)(2)(A) of the Bankruptcy Code, which requires a plan that intends to cram down debt to be fair and equitable. The bankruptcy court then certified a direct appeal to the Seventh Circuit Court of Appeals, which affirmed the bankruptcy court’s decision.

The U.S. Supreme Court, affirming the Seventh Circuit, analyzing the strict text of Bankruptcy Code section 1129(b)(2)(A), determined that for a cramdown plan to be fair and equitable with respect to a secured creditor, the plan must provide: (i) the secured creditor’s retention of liens and deferred cash payments, (ii) a sale, subject to Bankruptcy Code section 363(k), of the secured creditor’s collateral free and clear of liens, allowing liens to attach to sale proceeds, or (iii) the indubitable equivalent of the creditor’s claim.

The court determined that the debtors did not satisfy clause (ii) above because, by prohibiting secured creditors from credit bidding, the debtors violated section 363(k), which requires that, “unless the court for cause[3] orders otherwise the holder of such claim may bid at such sale, and, if the holder of such claim purchases such property, such holder may offset such claim against the purchase price of such property.”

The debtors argued that their cramdown plan was fair and equitable because it provided the indubitable equivalent of the creditor’s claim under clause (iii). Justice Scalia relied on the cannon of statutory construction that the specific governs the general — the specific provision of clause (ii) above is an exception to the general condition of clause (iii) above. Id. at *10-12.

The court noted that the general/specific canon is not a rule, per se, but rather a “strong indication of statutory meaning that can be overcome by textual indications that point in the other direction.” Id. at 13-14. The debtors provided no textual indications that section 1129(b)(ii)(A) of the Bankruptcy Code should be interpreted differently. Id.

Instead, the debtors argued that the text of the Bankruptcy Code, section 1129(b)(ii)(A) “‘unambiguously provides three distinct options for confirming a chapter 11 plan over the objection of a secured creditor.’” Id. at *15. (internal citations omitted). The court agreed and stated that, although clause (iii) applies to all cramdown plans, clause (ii), which requires credit bidding, applies to cramdown plans contemplating the sale of property free and clear of liens. Since clearly the debtors’ plan contemplated a sale free and clear of liens, the court concluded that “the debtors may not sell their property free of liens under §1129(b)(2)(A) without allowing lien holders to credit-bid, as required by clause (ii).” Id. at *15.

Despite the split in the circuits and shock waves set off in the wake of the Philadelphia News decision in 2010, the Supreme Court considered this an “easy” decision to make, determining that the parties’ debate over the purpose of the Bankruptcy Code, the merits of credit bidding, and pre-Code practices were not relevant because the text of section 1129(b)(2)(A) of the Bankruptcy Code is not ambiguous. Id. at *17-18. The court indicated that this is a straightforward issue, simply interpreting the plain and unambiguous meaning of section 1129(b)(2)(A) of the Bankruptcy Code.

Interestingly, and as noted above, the opinion barely mentions the infamous and controversial Philadelphia News decision from the Third Circuit in 2010 and ignores the Pacific Lumber[4] decision from the Fifth Circuit, both cases where the courts approved plans proposing to sell collateral free and clear without permitting credit bidding by the secured creditor. Further, the court mentions Philadelphia News only to say the opinion wrongly debated the intent of Bankruptcy Code section 1129(b)(2)(A) because the statue was clear on its face and does not need interpretation. Id. at *18.

Despite a reluctance to discuss the two key decisions to the contrary, the court unequivocally held that a secured creditor has a right to credit bid when a debtor sells its collateral free and clear of liens under a plan, thus settling the issue and overruling the contrary decisions of Philadelphia News and Pacific Lumber from the Third and Fifth Circuits. Secured creditors can now rest assured that their right to credit bid their debt at a section 363 sale is protected even when the sale is proposed in a plan.

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