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Lenders Given Cause to ReLAX

Supreme Court Unanimously Upholds Credit-Bidding Rights for Chapter 11 Sales in RadLAX

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Editor's Note: *For other perspectives on this case, see the features on page 20 of the June 2012 issue and page 18 of the July 2012 issue.*

In recent years, restructuring professionals' certainty regarding the right of secured lenders to credit-bid at chapter 11 asset sales has waivered. First the Fifth Circuit in *Pacific Lumber Co., et al. v. Official Unsecured Creditors' Committee*,[1] then the Third Circuit in *In re Philadelphia Newspapers LLC, et al.*,[2] held that a debtor can confirm a plan pursuant to § 1129(b)(2)(iii) of the Bankruptcy Code without giving a secured creditor the right to credit-bid because (they held that) a secured creditor can always be offered the "indubitable equivalent" of its claim in lieu of a credit-bid. The Seventh Circuit in *RadLAX Gateway Hotel, LLC v. Amalgamated Bank* disagreed, adopting the reasoning of a dissenter from the Third Circuit to uphold a secured creditor's right to credit-bid in a plan sale.[3] The lender in *RadLAX* filed a petition for *certiorari* to the U.S. Supreme Court, which was granted in December 2011. Commentators mused widely (if not wildly) about the ramifications if the Court were to follow the reasoning of the Third and Fifth Circuits. That speculation came to an end five months after the Court granted *certiorari*. The Court heard arguments in April 2012 and rendered a short, blunt, unanimous 8-0[4] decision on May 29, 2012, upholding the Seventh Circuit's decision and solidifying secured lenders' rights to credit-bid in chapter 11 sales.[5]

The Statutory Provisions

The *RadLAX* decision centered on interpreting the language of § 1129(b)(2)(A). Commonly referred to as the "cramdown"[6] provisions of the Code, § 1129(b)(2)(A) permits debtors to confirm a reorganization plan over the objection of creditors as long as the plan treats secured creditors ("fair and equitable").[7] Section 1129(b)(2)(A) sets forth three alternative methods of providing fair and equitable treatment to secured creditors. These can be summarized as follows:[8]

1. Provide for the sale of the lender's collateral with the lien following the collateral;
2. Provide for the sale of the lender's collateral free and clear, with the lien attaching to the sale proceeds; or
3. Provide the lender with the indubitable equivalent of its secured claim.

Subsection (ii), by expressly referencing § 363(k) of the Code, preserves a secured creditor's right to credit-bid at a free-and-clear sale of its collateral.[9] Subsection (iii), on the other hand, does not reference § 363(k) and therefore does not incorporate credit-bidding rights for secured creditors.[10]

How Three Interpretations Divided the Judicial Landscape

The three cases that led up to the Supreme Court's *RadLAX* decision involved materially similar facts. The debtors filed for chapter 11 and in their reorganization plans sought to sell substantially all their assets free and clear of liens through a chapter 11 sale. In *RadLAX* and *Philadelphia Newspapers*, the debtors entered into agreements with stalking-horse bidders who agreed to provide the initial bid at each sale.[11] In *Pacific Lumber*, the debtors' plans called for a sale of the debtors' assets directly to a specific group of buyers.[12] In all three cases, the debtors sought approval of the sale process and confirmation under § 1129(b)(2)(A)(iii).[13] Since subsection (iii) does not expressly require that secured creditors have the right to credit-bid at a sale, the debtors proposed sale procedures that did not allow credit-bidding. Secured lenders in each case objected to the plans on the basis that they were unconfirmable under § 1129(b)(2)(A), arguing that subsection (ii) exclusively governs free-and-clear asset sales in chapter 11 cases and requires that lenders be allowed to credit-bid.[14]

The Third Circuit in *Philadelphia Newspapers* and the Fifth Circuit in *Pacific Lumber* held that a

1 584 F.3d 229 (5th Cir. 2009).
2 599 F.3d 298 (3d Cir. 2010).
3 651 F.3d 642 (7th Cir. 2011).
4 The 8-0 decision excluded Justice Kennedy, who took no part in the decision.
5 *RadLAX Gateway Hotel LLC, et al. v. Amalgamated Bank*, 132 S.Ct. 2065 (2012).
6 Section 1129(b) allows a debtor to confirm a plan without the consent of all its creditors, and when the requirements of § 1129(b) are met, confirmation can be "crammed down" the throat of dissenting creditors. *See* 7 *Collier on Bankruptcy* ¶ 1129.03 (16th ed. 2011).
7 11 U.S.C. § 1129(b)(2)(A) (2010).
8 *Id.* (using the disjunctive "or" between subsections (ii) and (iii)).
9 *Id.* at (b)(2)(A)(ii).
10 *Id.* at (b)(2)(A)(iii).
11 *See RadLAX*, 651 F.3d at 645; *Philadelphia Newspapers*, 599 F.3d at 301.
12 *Pacific Lumber Co.*, 584 F.3d at 237 (describing transfer of substantially all of debtors' assets to new entities).
13 *RadLAX*, 651 F.3d at 645; *Philadelphia Newspapers*, 599 F.3d at 302-3; *Pacific Lumber Co.*, 584 F.3d at 238.
14 *See* § 1129(b)(2)(A)(ii).

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chapter 11 plan premised on a free-and-clear sale without credit-bidding is confirmable under subsection (iii)'s indubitable-equivalent standard under a plain-language reading of § 1129(b)(2)(A).[15] The courts' interpretation of the Code relied primarily on "the cardinal canon of statutory interpretation"[16] that, where the plain language of a statute is unambiguous, those terms govern.[17] The Third and Fifth Circuits found no ambiguity in the language of § 1129(b)(2)(A), focusing on the disjunctive construction of the subsections. Both courts held that § 1129(b)(2)(A)'s plain meaning set up three alternative, nonexclusive methods of confirming a plan over the objection of creditors.[18] The courts concluded that a secured lender's right to credit-bid at a chapter 11 asset sale under subsection (ii) was not absolute and could be avoided where a debtor sought confirmation under subsection (iii) by providing secured creditors with the indubitable equivalent of their claims.[19]

In *RadLAX*, however, the Seventh Circuit split from the Fifth and Third Circuits, favoring the dissent lodged by Circuit Judge Thomas Ambro in *Philadelphia Newspapers*. Thus, the Seventh Circuit concluded that subsection (ii) applies exclusively to chapter 11 asset sales and that secured lenders must have the right to credit-bid at the sale.[20] To arrive at this conclusion, the panel found § 1129(b)(2)(A) to be ambiguous and therefore employed a broader use of canons of statutory interpretation to decipher the Code's meaning.

Examining § 1129(b)(2)(A) in the context of the entire Bankruptcy Code,[21] the Seventh Circuit found § 1129(b)(2)(A) susceptible to at least two plausible interpretations: one where subsection (iii) has global applicability and can apply to any type of plan and sale structure, and another where subsection (iii)'s scope is more limited.[22] Upon finding § 1129(b)(2)(A)'s language ambiguous, the court next examined its provisions in the context of the entire Code. The Seventh Circuit found § 1129(b)(2)(A)(ii)'s express reference to § 363(k), which grants secured creditors the right to credit-bid at public sales of a debtor's assets, to be compelling evidence that Congress intended § 1129(b)(2)(A)(ii)'s protections to apply whenever a chapter 11 plan calls for the sale of a debtor's assets free and clear of liens.[23] Judge Ambro's dissent in *Philadelphia Newspapers* took this analysis a step further, pointing to the contextual protections given to secured creditors under §§ 1123(a)(5)(D) and 1111(b) as proof that a chapter 11 asset sale must be governed exclusively by the provisions of subsection (ii).[24]

The Seventh Circuit's statutory analysis also employed the canon of anti-superfluousness in reading § 1129(b)(2)(A)(ii) and (iii). Under the canon of anti-superfluousness, courts strive to avoid favoring a statute's general provision over one that is more specific if favoring the general provision renders the more specific provision superfluous or redundant.[25] The Seventh Circuit reasoned that subsection (ii)'s detailed sale provisions, which contemplate exactly the types of sales at issue in these cases, are rendered meaningless if a debtor can bypass subsection (ii)'s sale requirements by seeking confirmation under subsection (iii).[26] Thus, to preserve the specific provisions of subsection (ii), the court held that subsection (ii) applies exclusively to chapter 11 asset sales and limits subsection (iii)'s applicability to situations that do not include a free-and-clear sale of assets.

The opinion chided the debtor's reading of the statute as "hyperliteral and contrary to common sense"—which apparently (in Court speak) means "correct, but not right."

The Opinion: Short, to the Point and "Easy?"

In a 10-page decision, the Supreme Court unanimously affirmed the Seventh Circuit, concluding that debtors cannot sell property under a chapter 11 plan without allowing lienholders the right to credit-bid at the sale. The opinion by Justice Scalia succinctly and firmly held that the provisions of § 1129(b)(2)(A) operate very simply: "[Subsection] (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."[27]

The Court rested its holding on the "general/specific" canon of statutory interpretation: Where two statutory authorizations exist side-by-side, one specific and one general, the specific provision should be given effect to preserve the effect of the entire statute and avoid superfluity.[28] In this case, the Court found that the specific requirement of subsection (ii) always applies to a proposed plan sale of collateral. Subsection (iii) may give the debtor the right to come up with other methods for providing the secured lender with the indubitable equivalent of its claim, but it does not provide an alternative method of collateral disposition. In short, the Code does not give a debtor the option of selling collateral in a plan sale in a way that prohibits credit-bidding.

After *RadLAX*: What Now?

The Court called *RadLAX* an "easy case"[29] and spent far less time on analysis than the three decisions that led up to

15 *Philadelphia Newspapers*, 599 F.3d at 318; *Pacific Lumber Co.*, 584 F.3d at 248-49.
16 *Philadelphia Newspapers*, 599 F.3d at 304.
17 *Id.*
18 *Philadelphia Newspapers*, 599 F.3d at 309-10; *Pacific Lumber Co.*, 584 F.3d at 245-48.
19 *Philadelphia Newspapers*, 599 F.3d at 309-10; *Pacific Lumber Co.*, 584 F.3d at 245-48.
20 *RadLAX*, 651 F.3d at 653.
21 *RadLAX*, 651 F.3d at 648-49 (citing *Kasten v. Saint-Gobain Performance Plastics Corp.*, 131 S.Ct. 1325, 1330 (2011)).
22 *Id.* at 649-50; *see also Philadelphia Newspapers*, 599 F.3d at 322-27 (Ambro, J., dissenting).
23 *RadLAX*, 651 F.3d at 650-51.
24 *Philadelphia Newspapers*, 599 F.3d at 331-34 (Ambro, J., dissenting).
25 *RadLAX*, 651 F.3d at 651-52; *Philadelphia Newspapers*, 599 F.3d at 330 (Ambro, J., dissenting).
26 *RadLAX*, 651 F.3d at 651-52; *Philadelphia Newspapers*, 599 F.3d at 330 (Ambro, J., dissenting).
27 *RadLAX*, 132 S.Ct. at 2072.
28 *See RadLAX*, 132 S.Ct. 2068 (citing *D. Ginsberg & Sons Inc. v. Popkin*, 285 U.S. 204, 208 (1932)). While the nomenclature differs, the "general/specific" canon is interchangeable with the Seventh Circuit's "anti-superfluousness" canon of interpretation.
29 *Id.* at 2073.

it. The Court dismissed the import of pre-Code practice, legislative history or intent in reaching its decision and agreed with the Third and Fifth Circuits that there was no ambiguity in the statute, but disagreed with their conclusion. While upholding the Seventh Circuit, the Court disagreed with the Seventh Circuit panel's determination that the statute was ambiguous, stating that in applying the general/specific canon of statutory interpretation, only one conclusion could be reached. So where does this leave practitioners?

Debtor's counsel, particularly in smaller/single-asset cases, have had a significant procedural arrow removed from their quiver. Until the Court's ruling, debtor's counsel held out at least a sliver of hope that they could use the threat of "indubitable equivalent" treatment against a recalcitrant secured creditor. No more. Perhaps this will lead to additional creativity from debtors and their advisors in terms of using the "indubitable-equivalent" standard in plan negotiations. Perhaps both sides will consider additional reorganization options when dealing with the treatment of secured debt. In any event, this puts secured creditors more squarely in the driver's seat in pre-plan negotiations.

It is difficult to know how much a decision upholding the Third and Fifth Circuit decisions would have altered the landscape in complex chapter 11 cases, since the economics that drive plan negotiations and, in particular, confirmable plans would not be materially changed. Lenders are still breathing easier in the wake of the *RadLAX* decision.

One other lesson from *RadLAX*: The Court may be dominated by so-called strict constructionists, but a literal reading of a statutory provision may not prevail if it violates other principles of statutory construction. The opinion chided the debtor's reading of the statute as "hyperliteral and contrary to common sense"[30]—which apparently (in Court speak) means "correct, but not right." abi

30 *Id.* at 2068.