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Will the Supreme Court Protect Lenders on Collateral Bidding?

The U.S. Supreme Court will soon rule on a case of far-reaching importance for any party affected by a Chapter 11 plan in a business bankruptcy case. At stake is the longstanding expectation of secured lenders that they'll either be repaid or permitted to take their collateral by means of a credit bid; in other words, paying for the collateral with their lien.

RadLAX Gateway Hotel, LLC and RadLAX Gateway Deck, LLC v. Amalgamated Bank, scheduled to be heard on April 23, 2012, is a pointed example of just how unfair it can be to deny secured lenders the right to credit bid. When the debtor in *RadLAX* filed for bankruptcy, it owed the secured lender $120 million. Yet, the debtor sought to bar the lender's credit bid and sell the debtor's assets to a stalking horse bidder for only $47.5 million. The Court of Appeals for the Seventh Circuit determined that the lender must have the right to credit bid. This determination was contrary to other rulings by the Third and Fifth Circuits.

Credit bidding is a time-honored tradition that enables secured lenders to protect the value of their collateral by bidding up to the full amount of their claims at the sale auction. If credit bidding were not permitted, secured lenders would still have the right to bid at the auction, pay in cash at the closing, and, ultimately, have that cash paid over to them once it passes through the debtor's estate. However, this round tripping of the cash is cumbersome and creates transaction costs.

The abrogation of the right to credit bid could invite parties in chapter 11 cases to test the outer limits of other rights afforded secured lenders under the Bankruptcy Code.

Those rights may now hinge on how nine justices interpret one two-letter word: the word "or" is the linchpin.

About the Author

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If the class of secured lenders does not vote in favor of a Chapter 11 plan, the law permits a "cramdown plan" if its treatment of the secured lender class is "fair and equitable." The Bankruptcy Code provides three means for satisfying this "fair and equitable" requirement: the secured lender retains its liens and receives deferred cash payments up to certain specified amounts; sale of the secured lender's collateral (subject to credit bidding), free and clear of the lender's liens, with the liens to attach to the sale proceeds; *or* [my emphasis]…the realization by the secured lender of the "indubitable equivalent" of its claims.

If read literally, it allows the amorphous concept of "indubitable equivalent" as a stand-alone alternative for satisfying the "fair and equitable" test, thus potentially depriving the secured lender of its right to credit bid.

One imagines a veritable free-for-all if debtors can seize an opportunity to use "indubitable equivalence" to undervalue the secured lender's collateral. Erosion of the protections afforded by the Bankruptcy Code could adversely affect the availability and cost of secured credit — ultimately impacting future borrowers as well as lenders.

Those who support the absolute right of secured lenders to credit bid can take heart from the plethora of amicus briefs filed on behalf of the lender — in stark contrast to the absence of any such support for the debtor. The court may well pay attention to opinions offered by many disinterested legal experts and academics. They have no agendas. Yet their commentary strongly suggests informed consensus on the spirit of the law as well as the good faith that is the very foundation of commerce.