GIMME THE "INDUBITABLE EQUIVALENT": WHAT DOESN'T SUFFICE AS AN INDUBITABLE EQUIVALENT UNDER THE BANKRUPTCY CODE

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I. Issue

The issue recently decided by the United States Supreme Court in *RadLAX Gateway Hotel*[3] was whether a Chapter 11 bankruptcy plan could be confirmed over the objection of a secured creditor under 11 U.S.C. § 1129(b)(2)[4] if the plan provided for the sale of the secured creditor's collateral free and clear of the creditor's lien without providing the secured creditor the opportunity to credit-bid[5] at the sale.[6]

II. Facts

The case came before the bankruptcy court as a result of a failed commercial real estate investment. The Debtors, RadLAX Gateway Hotel, LLC and RadLAX Gateway Deck, LLC purchased the Radisson Hotel and adjoining lot at Los Angeles International Airport in 2007.[7] The purchase was financed by a $142 million loan the Debtors obtained from Longview Ultra Construction Loan Investment Fund, for which Amalgamated Bank served as the trustee.[8] The loan was secured by a lien on all of the Debtors' assets.[9] The Debtors wished to renovate the hotel as well as construct a parking structure on the adjacent

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[3] *RadLAX Gateway Hotel, LLC v. Amalgamated Bank*, 132 S.Ct. 2065, 2065 (2012).
[4] All section references are to the United States Bankruptcy Code of 1978, as amended, 11 U.S.C. §§ 101-1532 ("the Code").
[5] Credit-bidding is a process by which a creditor places a bid for its collateral using the debt owed to it to offset the purchase price. *See RadLAX Gateway Hotel*, 132 S.Ct. at 2069; *see also River Road Hotel Partners, LLC v. Amalgamated Bank*, 651 F.3d 642, 645 (7th Cir. 2011).
[6] *RadLAX Gateway Hotel*, 132 S.Ct. at 2068.
[7] *Id.*
[8] *Id.*
[9] *Id.*

lot.[10] The Debtors incurred several million dollars in unexpected costs while construction of the parking structure was in progress.[11] Construction was halted around March 2009 because the Debtors had run out of money,[12] and by August 2009, the Debtors owed more than $120 million on the loan, with interest accruing at a rate of $1 million per month.[13] When negotiations to obtain additional funding failed, the Debtors filed for Chapter 11[14] bankruptcy protection on August 17, 2009.[15]

a. Chapter 11 Plan

The Debtors filed their Chapter 11 Plan[16] ("the Plan") on June 4, 2010.[17] The Plan provided for the sale of substantially all of the Debtors' assets, with the proceeds being distributed to creditors according to the Code.[18] The Debtors filed a motion requesting the bankruptcy Court's approval of the asset sale.[19] The sale procedures sought to auction the Debtors' assets to the highest bidder, with the initial bid being provided by a stalking-horse[20] bidder which had been found after the Debtors had filed for bankruptcy, but before

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[10] *River Road Hotel Partners*, 651 F.3d at 644.
[11] *Id.*
[12] *Id.*
[13] *RadLAX Gateway Hotel*, 132 S.Ct. at 2070.
[14] Chapter 11 of the Code promotes the reorganization of a business as a going concern so that the business can continue to create value. *See* Hon. Charles G. Case, II, and James A. Newton, Three Current Issues under US Chapter 11 Law: Plan Sales, Gift Plans and Third Party Releases, 4 INT'L INSOLVENCY L.R. 511, 513 (2011) [hereinafter Case, *Issues under US Chapter 11 Law*]; *see, e.g.*, *In re Allied Mechanical Servs., Inc.*, 885 F.2d 837, 839 (11th Cir. 1989); *In re Timbers of Inwood Forest Assocs., Ltd.*, 793 F.2d 1380, 1408 (5th Cir. 1986).
[15] *River Road Hotel Partners*, 651 F.3d at 644.
[16] A Chapter 11 plan is the vehicle by which the debtor reorganizes and accomplishes the rehabilitation of its business. W. Homer Drake, Jr. and Christopher S. Strickland, *Chapter 11 Reorganizations*, § 12:1 (2d ed. 2011). Through a Chapter 11 plan, the debtor attempts to restructure its debts, pay its creditors, and return to active operation as a viable enterprise. *See id.* Upon court approval, a Chapter 11 plan is treated like a private contract, with its terms binding the debtor and its creditors. *See id.* In order for a court to confirm a Chapter 11 plan, it must determine that the Chapter 11 plan conforms to certain procedural and substantive requirements as set out by the Code. *See id.*
[17] *River Road Hotel Partners*, 651 F.3d at 645.
[18] *Id.*
[19] *Id.*
[20] Stalking horse bidders are solicited by Debtors so that their initial research, due diligence, and subsequent bid may encourage later bidders. *See* Case, *Issues under US Chapter 11 Law*, *supra* note 12, at 529 n. 141; *see also In re 310 Associates*, 346 E.3d 31, 34 (2d Cir. 2003).

they filed their plan.[21] The Debtors' stalking-horse bidder had offered a sum of $47.5 million[22] for the Debtors' assets.[23] Notably, the Debtors' sale procedures did not allow for Amalgamated Bank to credit-bid at the auction, but required Amalgamated Bank to provide their bid in cash. [24]

Amalgamated Bank filed an objection to the Debtors' proposed bid procedures, arguing that because the Plan impaired the Bank's interest and the Bank did not accept the Plan,[25] the Plan could not be confirmed unless it met one of the exception listed in section 1129(b)(2)(A).[26] Section 1129(b) of the Code, commonly known as the "cram-down"[27] provision, requires that a Chapter 11 plan not discriminate unfairly and be "fair and equitable"[28] with respect to each class of creditors that has not accepted the plan. Section 1129(b)(2)(A) of the Code requires specific treatment of a secured creditor's claim in order for a Chapter 11 plan to be crammed down over the objection of a secured creditor.[29] In essence, this section requires that a secured creditor 's claim may

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[21] *River Road Hotel Partners*, 651 F.3d at 645.
[22] The stalking-horse bid was later increased to $55 million. *See RadLAX Gateway Hotel*, 132 S.Ct. at 2069 n.1.
[23] *Id.*
[24] *RadLAX Gateway Hotel*, 132 S.Ct. at 2069.
[25] Generally, bankruptcy courts can only confirm a debtor's Chapter 11 plan if each class of creditors affected by the Chapter 11 plan consents. *See* 11 U.S.C. § 1129(a)(8); *see also RadLAX Gateway Hotel*, 132 S.Ct. at 2069.
[26] *River Road Hotel Partners*, 651 F.3d at 645.
[27] A cram-down occurs when a non-consensual chapter 11 plan is confirmed over the objection of a class of creditors. *See RadLAX Gateway Hotel*, 123 S.Ct. at 2069.
[28] The term "fair and equitable" requires that junior creditors may only receive or retain property under a Chapter 11 plan if all creditors ahead of them either consent or are paid in full. *See* Case, *Issues under US Chapter 11 Law*, *supra* note 12, at 514; *see also* 11 U.S.C. § 1129(b)(2).
[29] Section 1129(b)(2)(A) states that for a plan to be fair and equitable with respect to secured creditors, it must provide:

> (i)(I) that the holders of such claims retain the liens securing such claims, whether the property subject to such liens is retained by the debtor or transferred to another entity, to the extent of the allowed amount of such claims; and
> (II) that each holder of a claim of such class receive on account of such claim deferred cash payments totaling at least the allowed amount of such claim, of a value, as of the effective date of the plan, of at least the value of such holder's interest in the estate's interest in such property;
> (ii) for the sale, subject to section 363(k) of this title, of any property that is subject to the liens securing such claims, free and

be crammed down only if: (1) it retains its lien on the collateral and receives deferred cash payments at least equal to the value of its collateral;[30] it is able to credit-bid at the sale, pursuant to section 363(k),[31] if its collateral is being sold free and clear of all liens;[32] or (3) it is provided the "indubitable equivalent"[33] of its claim.[34]

Amalgamated Bank argued that the Debtors' Plan did not meet the requirements of section 1129(b)(2)(A)(i) because the proposed sale sought to sell Amalgamated Bank's collateral free and clear of all liens.[35] It also argued that the Debtors' Plan did not meet the requirements of section 1129(b)(2)(A)(ii) because the Plan specifically denied Amalgamated Bank the right to credit-bid at the sale.[36] The Debtors argued that while the Plan did not meet the requirements of section 1129(b)(2)(A)(i) or (ii), it provided Amalgamated Bank with the indubitable equivalent of its claim, thereby meeting

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> clear of such liens, with such liens to attach to the proceeds of such sale, and the treatment of such liens on proceeds under clause (i) or (iii) of this subparagraph; or
> (iii) for the realization by such holders of the indubitable equivalent of such claims.

11 U.S.C. § 1129(b)(2)(A)(i)-(iii).

[30] *See* 11 U.S.C. § 1129(b)(2)(A)(i); *see also RadLAX Gateway Hotel*, 123 S.Ct. at 2070.

[31] Section 363(k), which authorizes credit-bidding at the sale of a debtor's property that is subject to a lien, reads, in pertinent part:

> (k) At a sale . . . of property that is subject to a lien that secures an allowed claim, unless the court for cause 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.

11 U.S.C. § 363(k). Section 363 gives the bankruptcy court the discretion to determine what constitutes "cause" and fashion an appropriate remedy by conditioning credit bidding on a case-by-case basis. *See In re River Road Hotel Partners, LLC*, No. 09-B-30029, 2010 WL 6634603 at *1 (Bankr. N.D. Ill. Oct. 5, 2010); *see also In re 222 Liberty Assocs.*, 108 B.R. 971, 979 (Bankr. E.D. Pa. 1990).

[32] *See* 11 U.S.C. § 1129(b)(2)(A)(ii); *see also RadLAX Gateway Hotel*, 123 S.Ct. at 2070.

[33] The term "indubitable equivalent" was coined by Judge Learned Hand in *In re Murel Holding Corp.* where Judge Hand explained that a creditor fearing "the safety of his principal . . . wishes to get his money or at least the property. We see no reason to suppose that the statute was intended to deprive him of that in the interest of junior lienholders unless by a substitute of the most indubitable equivalence." *In re Murel Holding Corp.*, 75 F.2d 941, 942 (2d Cir. 1935). *See* Case, *Issues under US Chapter 11 Law*, *supra* note 12, at 515 n. 37.

[34] *See* 11 U.S.C. § 1129(b)(2)(A)(iii); *see also RadLAX Gateway Hotel*, 123 S.Ct. at 2070.

[35] *See RadLAX Gateway Hotel*, 123 S.Ct. at 2070.

[36] *See id.*

the requirement of section 1129(b)(2)(A)(iii) and therefore allowing the Plan to be crammed down against the wishes of Amalgamated Bank.[37] They also argued that a sale of Amalgamated Bank's collateral free and clear of its lien without providing Amalgamated Bank the opportunity to credit-bid could occur without contravening section 1129(b)(2)(A)(ii) because cause existed[38] to deny Amalgamated Bank the opportunity to credit-bid.[39]

b. Procedural History

The U.S. Bankruptcy Court in the Northern District of Illinois[40] denied the Debtors' motion seeking sale approval on October 5, 2010.[41] Specifically, the bankruptcy court rejected the Debtors' reliance on a case, *Philadelphia Newspapers*,[42] where the Third Circuit Court of Appeals allowed a debtor to deny a secured creditor the right to credit bit at a sale of its collateral because the debtor sought to cram down its Chapter 11 plan under section 1129(b)(2)(A)(iii) instead of section 1129(b)(2)(A)(ii).[43] It thus concluded that if the Debtors desired to conduct a sale of Amalgamated Bank's collateral free and clear of all liens, it would have to meet the requirements of section

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[37] *See River Road Hotel Partners*, 651 F.3d at 645.

[38] The Debtors argued that cause existed to deny Amalgamated Bank the opportunity to credit bid because: (1) Amalgamated Bank's actions caused the Debtors to fail; (2) allowing it to credit bid would chill the bidding process; and (3) there were millions of dollars in liens still being litigated at the state court level. *See In re River Road Hotel Partners, LLC*, No. 09-B-30029, 2010 WL 6634603 at *1 (Bankr. N.D. Ill. Oct. 5, 2010).

[39] *See id.*

[40] The states and territories of the United States of America are divided into ninety-five federal districts in which cases involving federal law are heard in the first instance. Those districts are grouped together into twelve circuits for appellate purposes. A thirteenth circuit, the Federal Circuit, hears appeals on a nationwide basis in cases arising in a few specific areas of law, bankruptcy not being one of them. *See* Case, *Issues under US Chapter 11 Law*, *supra* note 12, at 511 n.1.

[41] See *In re River Road Hotel Partners,* 2010 WL 6634603 at * 2.; *see also River Road Hotel Partners*, 651 F.3d at 645.

[42] *In re Philadelphia Newspapers, LLC*, 599 F.3d 298 (3rd Cir. 2010).

[43] In *Philadelphia Newspapers*, the Third Circuit held that that the credit bid provision (subsection 1129(b)(2)(A)(ii)) and the indubitable equivalent provision (subsection 1129(b)(2)(A)(iii)) of the Code are two alternative paths to meeting the fair and equitable test for a Chapter 11 plan's treatment of secured claims, and while only subsection 1129(b)(2)(A)(ii) specifically mentions the sale of a secured creditor's collateral, permitting such a sale under the broader subsection 1129(b)(2)(A)(iii) does not conflict with or render more subsection 1129(b)(2)(A)(ii) superfluous. *See Philadelphia Newspapers*, 599 F.3d at 304-311.

1129(b)(2)(A)(ii).[44] The bankruptcy court also rejected the Debtors' argument that cause existed for the denial of Amalgamated Bank's right to credit bid under section 1129(b)(2)(A)(ii).[45]

The Debtors appealed the bankruptcy court's ruling to the Seventh Circuit[46] in late 2010.[47] The Seventh Circuit affirmed the bankruptcy court's decision and held that section 1129(b)(2)(A) does not authorize the Debtors to use subsection 1129(b)(2)(A)(iii) to confirm their Plan to sell Amalgamated Bank's collateral free and clear of liens without providing Amalgamated Bank, a secured creditor, the right to credit-bid.[48] Specifically, the Seventh Circuit noted that nothing in the statutory text of section 1129(b)(2)(A) indicates whether subsection (iii) can be used to confirm any type of plan or can only be used to confirm plans that dispose of assets in a way fundamentally different from subsections (ii) and (i).[49] The court echoed Judge Ambro's[50] reasoning in his *Philadelphia Newspapers* dissent and noted that section 1129(b)(2)(A) has two plausible interpretations, one that interprets subsection (iii) as having global application, and one that interprets subsection (iii) as having a more limited application.[51]

Because the court concluded that section 1129(b)(2)(A) is subject to two interpretations, the court next relied on rules of statutory construction to

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[44] *In re River Road Hotel Partners*, 2010 WL 6634603 at * 1.
[45] *See id.*
[46] Appeals from the Northern District of Illinois are heard by the Seventh Circuit Court of Appeals. Normally, appeals from decisions of a bankruptcy court are heard first by the district court and thereafter by the Court of Appeals. 28 U.S.C. § 158(a). However, in this case, the bankruptcy court certified the issue directly to the Circuit Court. 28 U.S.C. § 158(d)(2).
[47] *See River Road Hotel Partners*, 651 F.3d at 645.
[48] *See id.* at 646-653.
[49] *Id.* at 650.
[50] Judge Thomas L. Ambro, along with Judges D. Brooks Smith and D. Michael Fischer comprised the three judge appellate panel that decided Philadelphia Newspapers; Judge Ambro was the lone dissenter. *See Philadelphia Newspapers*, 599 F.3d at 301. Judge Ambro formerly was a distinguished bankruptcy lawyer and is a Fellow of the American College of Bankruptcy. *See College Directory: Thomas L. Ambro*, THE AMERICAN COLLEGE OF BANKRUPTCY, http://www.amercol.org/dir/bio.cfm?id=282 (last visited Aug. 30, 2012).
[51] *Id.* at 650-651; *see also Philadelphia Newspapers*, 599 F.3d at 324-27 (Ambro, J., dissenting).

determine the meaning of the ambiguous statute.[52] The court then concluded that interpreting subsection (iii) as having global applicability, and thereby permitting an asset sale without allowing a secured creditor the right to credit-bid, violates the cardinal rule of statutory construction which requires that, if possible, a statute should be constructed so that "no clause, sentence, or word shall be superfluous, void, or insignificant."[53] Thus, the court held that subsection (iii) cannot be interpreted as disposing of a debtor's assets in a way already contemplated by subsections (i) and (ii).[54] It also affirmed the bankruptcy court's holding that the Code requires a cram down plan that seeks to sell encumbered assets free and clear of liens at auction to satisfy the requirements of subsection (ii).[55]

III. The Supreme Court's Analysis and Holding

The Debtors appealed the Seventh Circuit court's decision to the Supreme Court which granted certiorari in 2011.[56] Oral argument was held on April 23, 2012, and Justice Scalia delivered the opinion of the Supreme Court on May 29, 2012.[57] The Supreme Court noted that the Debtors, seemingly knowing that their Plan could not be confirmed under section 1129(b)(2)(A)(ii) because it failed to provide Amalgamated Bank the opportunity to credit bid at the auction of their collateral, therefore sought to seek confirmation under section 1129(b)(2)(A)(iii).[58] It concluded that the Debtors' reading of subsection (iii) as permitting exactly what subsection (ii) forbid was "hyperliteral and contrary to common sense."[59]

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[52] *See River Road Hotel Partners*, 651 F.3d at 651-52.
[53] *See id.*; *see also Duncan v. Walker*, 533 U.S. 167, 174 (2001).
[54] *See id.* at 652.
[55] *See id.* at 653.
[56] *See RadLAX Hotel Partners*, 132 S.Ct. at 2069. Certiorari is process by which the Supreme Court, in its discretion, decides to hear and decide a particular appeal. Although the number varies from year to year, the Supreme Court grants certiorari in approximately 1% of the cases for which review is sought. Therefore, as a practical matter, a decision by the appropriate court of appeals is normally the final word on contested issues. *See* Case, *Issues under US Chapter 11 Law*, *supra* note 12, at 511.
[57] *Id.* at 2065.
[58] *See id.* at 2070.
[59] *Id.*

Like the Seventh Circuit court, the Supreme Court also relied on a canon of statutory construction. It, however, relied on a different canon: *lex specialis derogat legi generali* (the specific governs the general).[60] The Court noted that this canon is most frequently applied to statutes where a general permission or prohibition is contradicted by a specific permission or prohibition; thus, to eliminate the contradiction, the specific provision is construed as an exception to the general authorization.[61] The Court further reasoned that the same canon could be used when a general authorization co-exists alongside a more limited, specific authorization.[62] The Court concluded that in that context, the canon requires that the terms of the specific authorization must be complied with, thereby also following the canon that "effect shall be given to every clause of a statute."[63] With respect to section 1129(b)(2)(A), the Court reasoned that subsection (ii) is a detailed provision which governs the sale of collateral free and clear of liens, while subsection (iii) is a broad provision which says nothing about sales.[64] It therefore held that the general language of subsection (iii) could not apply to a matter that is specifically dealt with in subsection (ii).[65]

The Debtors argued that their reading of subsection (iii) does not render subsections (i) and (ii) superfluous because these subsections are a "safe-harbor" since they set forth procedures that will always establish an indubitable equivalent while subsection (iii) requires judicial evaluation to determine if an indubitable equivalent has been provided.[66] However, the Court rejected this argument, noting that the structure of section 1129(b)(2)(A) suggests that each subsection is applicable to specific situations: subsection (i) applies when a creditor's lien remains on the property; subsection (ii) applies when the

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[60] *See id.* at 2071; *see also Morton v. Mancari*, 417 U.S. 535, 550-51 (1974).
[61] *See RadLAX Gateway Hotel*, 132 S.Ct. at 2071.
[62] *See id.*
[63] *Id.*; *see also United States v. Chase*, 135 U.S. 255, 260 (1890).
[64] *See RadLAX Gateway Hotel*, 132 S.Ct. at 2071.
[65] *See id.* at 2071-72.
[66] *See id.* at 2072.

property is to be sold free and clear of liens; and subsection (iii) is a residual provision which applies to all other plans.[67]

The Debtors also argued that subsection (ii) is no more specific than subsection (iii) because subsection (ii) provides procedural protection to creditors, via credit-bidding, while subsection (iii) provides substantive protection to creditors by providing them with the indubitable equivalence of their claim.[68] Since they contend that subsection (ii) is no more specific than subsection (iii), the Debtors argued that subsection (ii) is not a limiting subset of subsection (iii) and therefore precludes the application of the canon *lex specialis derogat legi generali*.[69] The Court rejected this argument as well and specifically found subsection (ii) to be "entirely a subset"[70] of subsection (iii). The Court concluded that "[subsection] (iii) "applies to *all* cram-down plans, which include all of the plans within the more narrow category described in [subsection] (ii)."[71]

In conclusion, the Court noted that the Code standardizes an expansive and sometimes unruly area of law, and that it was the Court's obligation to interpret the Code clearly and predictably using established canons of statutory construction.[72] With this obligation in mind, the Court held that Chapter 11 debtors may not sell their property free and clear of liens under 1129(b)(2)(A) without allowing lienholders to credit-bid, as required by subsection (ii).[73]

IV. Conclusion

The Court's decision in *RadLAX Gateway Hotel* effectively ended a circuit split which resulted from the Third Circuit's *Philadelphia Newspapers* decision

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[67] *See id.*
[68] *See id.*
[69] *See RadLAX Gateway Hotel*, 132 S.Ct. at 2072-73.
[70] *Id.* at 2072.
[71] *Id.* at 2072-73.
[72] *See RadLAX Gateway Hotel*, 132 S.Ct. at 2073.
[73] *See id.*

and the Fifth Circuit's decision in *In re Pacific Lumber Co.*,[74] which were both pro-debtor and allowed the sale of collateral without providing the secured creditor the opportunity to credit-bid, and the Seventh Circuit's *River Road Hotel Partners* decision, which was pro-creditor and prevented such a sale.

[74] In *Pacific Lumber*, the debtor sold property to a private equity fund without allowing secured bondholders, which were owed approximately $700 million, the opportunity to credit bid. *See In re Pacific Lumber Co.*, 584 F.3d 229(5th Cir. 2009).