

Supreme Court Clarifies Secured Creditors' Rights Under Chapter 11 "Cramdown" Plans

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Earlier this year, the Supreme Court resolved the question of whether a debtor may sell a secured creditor's collateral free and clear liens while prohibiting the creditor from credit-bidding at the sale. In an unanimous decision (Justice Kennedy did not participate), the Court in *RadLAX Gateway Hotel, LLC v. Amalgamated Bank*, 132 S. Ct. 2065 (2012) held that a debtor may not confirm a Chapter 11 "cramdown" plan that provides for a sale free and clear of liens, but prevents the secured lender from credit-bidding at the sale. The decision resolved a split among the Third, Fifth and Seventh Circuits.

What is a "Cramdown" Plan?

By way of background, "cramdown" plans are a tool for Chapter 11 debtors to use when a consensual plan cannot be reached with all of its classes of creditors. In that case, a plan may still be confirmed by the Bankruptcy Court over the objection of creditors whose rights are impaired by the plan, provided that the standards of 11 U.S.C. § 1129 are met. As to secured creditors, a plan may be confirmed despite a secured creditor's objection if it "does not discriminate unfairly, and is fair and equitable." 11 U.S.C. § 1129(b)(1). A plan is "fair and equitable" if one of the tests under subsection of 11 U.S.C. § 1129(b)(2)(A) are met:

(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 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.

Subsection (i) requires that the secured creditor retain its lien and receive deferred cash payments. Under subsection (ii), the secured creditor's collateral is sold free and clear of the lien, "subject to section 363(k)" and the creditor's lien attaches to the sale proceeds. The inclusion of the language "subject to section 363(k)" was important in the *RadLAX* case because under that statute the creditor is permitted to credit-bid at the sale unless the court orders otherwise for cause. Last, subsection (iii) requires that the creditor receive the "indubitable equivalent" of its claim, such as the property under certain facts.

Lesson in Statutory Construction

The debtor in *RadLax* proposed a liquidating plan that would auction its assets free and clear of its secured creditor's lien and use the sale proceeds primarily to repay the creditor who was prohibited from credit-bidding at the sale. The debtor argued that the plan was "fair and equitable" under subsection (iii) because the cash generated by the sale was the "indubitable equivalent" of the secured creditor's claim.

In an opinion written by Justice Scalia, the Supreme Court rejected this argument and affirmed the 7th Circuit. The Court concluded that "the debtor's reading of § 1129(b)(2)(A) – under which clause (iii) permits precisely what clause (ii) proscribes – to be hyperliteral and contrary to common sense." (Ouch.) The opinion sets forth a detailed analysis of one of the canons of statutory construction: the specific governs the general. Applying the same to section 1129(b)(2)(A), Justice Scalia wrote:

Here, clause (ii) is a detailed provision that spells out the requirements for selling collateral free of liens, while clause (iii) is a broadly worded provision that says nothing about such a sale. The general/specific canon explains that the "general language" of clause (iii), "although broad enough to include it, will not be held to apply to a matter specifically dealt with" in clause (ii)." (citation omitted) *Id.* at 2071-72.

(The opinion later states that under this principle of statutory construction, "this is an easy case." *Id.* at 2073).

Post-RadLAX Impact

The Supreme Court's *RadLAX* ruling resolved the split in authority among several circuit courts. The ruling eliminated a potential tool for debtors and, in turn, provided secured creditors leverage when negotiating with debtors. It is now clear that a secured creditor cannot be denied the right to credit-bid up to the full amount of its secured claim under a cramdown plan that is proposing to sell the collateral free and clear of liens.

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