No. 11-166

IN THE

Supreme Court of the United States

RADLAX GATEWAY HOTEL, LLC
AND RADLAX GATEWAY DECK, LLC,
Petitioners,

v.

AMALGAMATED BANK,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE LOAN SYNDICATIONS AND TRADING ASSOCIATION, THE AMERICAN BANKERS ASSOCIATION, THE CLEARING HOUSE ASSOCIATION, THE COMMERCIAL FINANCE ASSOCIATION, THE COMMERCIAL REAL ESTATE FINANCE COUNCIL, THE EQUIPMENT LEASING AND FINANCE ASSOCIATION, THE FINANCIAL SERVICES ROUNDTABLE, THE MANAGED FUNDS ASSOCIATION, THE MORTGAGE BANKERS ASSOCIATION, AND THE SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION AS AMICI CURIAE IN SUPPORT OF RESPONDENT

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INTEREST OF AMICI CURIAE[1]

Amici curiae are among the leading financial-industry trade associations in the United States. Together, they represent the entire spectrum of lenders and debt investors. Amici's members provide corporate and commercial loans, mortgage-backed financing, asset-backed financing, and commercial real-estate loans; they include the largest national and international financial institutions as well as regional and local lenders and private investment funds; and they serve borrowers in all corners of the country. Amici's members collectively hold trillions of dollars of debt.

The **Loan Syndications and Trading Association** represents a broad range of financial institutions, including commercial banks, investment banks, and private investment funds; its mission is to promote a fair, orderly, efficient, and growing corporate loan market and to provide leadership in advancing and balancing the interests of all market participants. The **American Bankers Association** is the principal national trade association of the banking industry, and its members hold a substantial majority of domestic banking assets. **The Clearing House Association** is the nation's oldest banking association and is owned by the world's largest commercial banks. The **Commercial Finance Association** is the principal U.S. trade association for financial institutions providing asset-based financing and factor-

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[1] The parties have consented to the filing of this brief. Pursuant to Rule 37.3(a), letters of consent are on file with the Clerk of the Court. No counsel for a party authored this brief in whole or in part, and no person, other than amici curiae, their members, and their counsel, made a monetary contribution to the preparation or submission of this brief.

ing services to commercial borrowers; its members comprise substantially all of the major money-center banks and many regional and local banks and other lenders and factors in the United States. The **Commercial Real Estate Finance Council** represents all commercial real-estate finance industry constituents and is dedicated to promoting the strength and liquidity of that market. The **Equipment Leasing and Finance Association** represents companies in the equipment-finance sector, including leasing and finance companies, banks, financial-services companies, brokers/packagers, investment banks, manufacturers, and service providers. The **Financial Services Roundtable** represents 100 of the largest integrated financial-services companies providing banking, insurance, and investment products to American consumers. The **Managed Funds Association** represents the global alternative-investment industry, including hedge funds, funds of funds, managed futures funds, and their service providers. The **Mortgage Bankers Association** represents all facets of the real-estate finance industry, including mortgage companies, life insurance companies, commercial banks, and Wall Street conduits. The **Securities Industry and Financial Markets Association** brings together the shared interests of hundreds of securities firms, banks, and asset managers, and supports a strong financial industry, investor opportunity, capital formation, job creation, and economic growth.

Although amici specialize in different aspects of financial services and frequently represent different asset classes in bankruptcy proceedings, they share a common interest in this case. Resolution of the question presented here—whether secured lenders are entitled to "credit-bid" their claims in a sale of their collat-

eral under a chapter 11 plan of reorganization—will have a substantial effect on the cost and availability of secured credit in the United States.

Outside bankruptcy, secured lenders are entitled to be paid in full or to foreclose on their collateral. In bankruptcy, where debtors' assets are often auctioned, the right to credit-bid protects secured creditors' basic bargain by ensuring that they can either retain their right to full payment and their liens or, if the collateral is sold, acquire it themselves. Because legal restrictions and transaction costs can make cash bidding difficult or even impossible, if a secured lender is denied the right to credit-bid, its collateral may be sold for less than the lender would have bid for it. In that circumstance, the lender will realize less than the true value of its security interest.

Secured lenders—including amici's members—have long relied on the right to credit-bid to protect themselves against potential undervaluation of their collateral in bankruptcy. A new rule allowing debtors to bar credit-bidding would increase the risk of undervaluation, and to compensate for that risk, lenders would be forced to increase the cost of capital. Such a rule would have a significant negative impact on the market for secured financing at a moment when the ready availability of affordable credit remains essential to the national economic recovery. Amici therefore urge this Court to affirm the judgment below.

STATEMENT

This case focuses on one of the Bankruptcy Code's most significant protections for secured creditors—a creditor's right to "credit-bid" the amount of its claim when its collateral is sold in bankruptcy. A trustee or

debtor-in-possession may, under certain circumstances, sell property encumbered by a lien. 11 U.S.C. §363; *id.* §1129(b)(2)(A)(ii). Outside the chapter 11 plan process, a secured creditor "may bid at such sale" and "offset [its] claim against the purchase price of [the] property" if it is the winning bidder, "unless the court for cause orders otherwise." *Id.* §363(k). That is, a secured lender may "credit-bid" by using the outstanding balance on its loan to pay the purchase price.

For example, if a debtor sells a warehouse with a $100,000 mortgage, the lender may bid up to $100,000 for the warehouse without committing any cash. If the lender's bid is not the highest bid, its lien attaches to the proceeds from the sale (and, typically, the lender will ultimately receive the proceeds). If the lender's bid prevails, it gets the warehouse and its claim is reduced by the purchase price. Through credit-bidding, the secured creditor can bid what it believes the collateral is worth without incurring the significant transaction costs associated with a cash bid.

The question presented here is whether secured creditors have the same right to credit-bid when their collateral is sold under a chapter 11 plan. Where, as here, a class of secured creditors has not consented to its treatment under a proposed plan, that plan may nonetheless be confirmed—or "crammed down," in bankruptcy parlance—only if it is "fair and equitable." To be fair and equitable "[w]ith respect to a class of secured claims," a plan must provide for one of three forms of treatment, laid out in the three clauses of §1129(b)(2)(A):

> (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 [which requires that secured creditors be permitted to credit-bid], 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...; or
>
> (iii) for the realization by such holders of the indubitable equivalent of such claims.

11 U.S.C. §1129(b)(2)(A).

Put more simply: "Under (i), the reorganized debtor keeps the property and may be allowed to stretch out the repayment of the debt beyond the period allowed by the loan agreement, but the lien remains on the property until the debt is repaid. Under (ii), the debtor auctions the property free and clear of the mortgage but the creditor is allowed to 'credit bid.' … Under (iii), the lien is exchanged for an 'indubitable equivalent,'" such as the collateral itself or a lien on property of unquestionably equal or greater value. *In re River East Plaza, LLC*, No. 11-3263, 2012 WL 169760, at *2 (7th Cir. Jan. 19, 2012) (Posner, J.).

Debtors here, RadLAX Gateway Hotel, LLC and RadLAX Gateway Deck, LLC, are single-asset real-

estate affiliates created to quarantine the financial risk of specific development projects. Those projects went "underwater"—that is, their value fell below the outstanding balance on the debtors' secured loans. A "stalking-horse" bidder, in which one of the debtors' owners has an equity stake, offered to buy the projects for a fraction of the existing debt and to retain existing management if its bid won.

Debtors wanted the stalking-horse bid to prevail. Accordingly, they proposed to sell their assets free and clear of their secured lender's lien, as clause (ii) permits, but *without* allowing their secured lender to credit-bid as clause (ii) requires. Debtors claimed that the plan could nonetheless be confirmed because the proceeds of the sale would provide the secured lender with the "indubitable equivalent" of its claim under clause (iii). The courts below correctly held that §1129(b)(2)(A) does not permit such a plan.

SUMMARY OF ARGUMENT

Debtors here want to sell their assets, which secure their substantial debt, to a stalking-horse bidder with ties to debtors' existing owners for a fraction of what debtors owe their secured lender. And they want to preclude their lender from credit-bidding on the assets because they are afraid the lender might outbid the stalking horse. They would prefer to erase the lender's lien and cash it out by giving it the proceeds of the restricted sale. But that is precisely the ploy that credit-bidding is designed to prevent.

Debtors' plan provides for a sale of their secured lender's collateral free and clear of the lender's lien—exactly the type of plan contemplated by clause (ii) of §1129(b)(2)(A). Debtors contend, however, that they

need not permit the secured lender to credit-bid, as clause (ii) requires, and may instead pay the lender the proceeds of the auction as the putative "indubitable equivalent" of its claim under clause (iii). Debtors argue that, by specifying three means of cramming down a class of secured creditors and separating them with the word "or," the statute unambiguously permits this scheme.

The text, structure, and purposes of the Code refute this interpretation of §1129(b)(2)(A). *First,* the most natural reading of §1129(b)(2)(A)'s three clauses is that each clause "govern[s], conclusively unless the [clause] itself indicates otherwise …, the category of proceedings it addresses." *Bloate* v. *United States*, 130 S. Ct. 1345, 1355 (2010). Accordingly, asset sales free and clear of a creditor's lien are governed by the requirements for such sales set out in clause (ii). Debtors' reading would allow the more specific provisions of clauses (i) and (ii) to be trumped by the catch-all provision of clause (iii) and would effectively render clauses (i) and (ii) surplusage.

Second, debtors' interpretation of §1129(b)(2)(A) is wholly inconsistent with the structure of the Bankruptcy Code's protections for secured creditors. The Code is meticulously designed to prevent an "involuntary reduction of the amount of a creditor's lien for any reason other than payment on the debt." *Dewsnup* v. *Timm*, 502 U.S. 410, 418-419 (1992). Several interlocking provisions of the Code, including §1129(b)(2)(A), work together to protect that basic right. As Judge Hand put it, a secured creditor "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 … unless by a substitute of the most indubitable equivalence." *In re Murel Holding Corp.*, 75 F.2d 941,

942 (2d Cir. 1935) (L. Hand, J.). Credit-bidding ensures that, if collateral is sold, the secured creditor can "get ... the property" securing its claim if the creditor values it more highly than other bidders do. As a logical matter, the proceeds of a sale at which the secured creditor is not permitted to credit-bid cannot be the "indubitable equivalent" of the right the secured creditor otherwise possesses to "get … the property" itself.

Finally, a plan like debtors' serves no legitimate bankruptcy or commercial purpose, and sanctioning it will seriously unsettle the market for secured credit—a market in which amici's members are essential participants. Credit-bidding can only benefit the bankruptcy estate. Creditors can bid more for their collateral if they are not required to incur the significant costs associated with a cash bid. Moreover, some secured creditors will not be able to bid at all without credit-bidding. And, as this case illustrates, allowing debtors to deny the right to credit-bid without cause serves no purpose other than to enable debtors to steer their assets to lower bidders favored by debtors' owners or management, enriching insiders at creditors' expense. Debtors' reading of the Code thus provides an invitation to mischief with no offsetting benefits for the estate. Ultimately, credit markets will respond to such inefficiencies by increasing the cost of borrowing, harming debtors as well as creditors and the economy as a whole.

ARGUMENT

I. THE BANKRUPTCY CODE'S TEXT ENTITLES SECURED CREDITORS TO CREDIT-BID AT ANY FREE-AND-CLEAR SALE UNDER A PLAN

Chapter 11's cram-down provisions state that a plan is "fair and equitable" to a non-consenting class of

secured creditors only if it provides (i) that the creditor will keep its lien and receive deferred cash payments in the full amount of its secured claim, with a present value equal to the present value of its security interest; (ii) that the collateral will be sold, subject to credit-bidding, free and clear of the creditor's lien, which will attach to the proceeds of the sale; or (iii) that the creditor will realize "the indubitable equivalent" of its secured claim. 11 U.S.C. §1129(b)(2)(A).

Debtors maintain that, because the statute's three clauses are joined by the word "or," the statute unambiguously permits sales free and clear of a creditor's lien without credit-bidding under clause (iii). As discussed below, debtors' reading would open a gaping hole in the Bankruptcy Code's carefully woven protections for secured creditors and subject the plan-confirmation process to the risk of abuse by insiders. But it is not a plausible construction of §1129(b)(2)(A) even when the provision's text is examined in isolation.

It is a basic rule of construction that "[g]eneral language of a statutory provision, although broad enough to include it, will not be held to apply to a matter specifically dealt with in another part of the same enactment." *D. Ginsberg & Sons, Inc.* v. *Popkin*, 285 U.S. 204, 208 (1932). Here, clause (ii) "specifically deal[s]" with sales of a secured creditor's collateral free and clear of its lien. By incorporating §363(k), clause (ii) expressly requires that credit-bidding be permitted (absent cause to deny it) at any such sale. Reading the "indubitable equivalent" provision of clause (iii) nonetheless to permit free-and-clear sales *without* credit-bidding replaces the specific protections Congress set out with a vague generality. To give effect to all of the words Congress wrote, clauses (i) and (ii) must be read to govern matters within their scope, and clause (iii) to

account for the possibility that there may be plan provisions *outside* the scope of clauses (i) and (ii) that are confirmable because they give the creditor the indubitable equivalent of its claim.

This Court decided a closely analogous question of statutory interpretation in *Bloate*, 130 S. Ct. at 1354-1355. There, the Court considered the provision of the Speedy Trial Act that automatically excludes from calculation of the speedy-trial deadline "[a]ny period of delay resulting from other proceedings concerning the defendant, including but not limited to" eight specific types of delay. *Id.* at 1352 n.7 (quoting 18 U.S.C. §3161(h)(1)). One of those eight specific examples is "delay resulting from any pretrial motion, from the filing of the motion through the conclusion of the hearing on, or other prompt disposition of, such motion." *Id.* (quoting 18 U.S.C. §3161(h)(1)(D)). The question was whether other types of delay resulting from pretrial motions, such as delay before the motion was filed, were automatically excludable. This Court held that they were not, reasoning that the specific provisions of subparagraph (D) precluded construing the more general language of paragraph (1) to encompass any "delay resulting from any pretrial motion" not specifically identified in subparagraph (D). The Court explained that although "the list of categories [in paragraph (1)] is illustrative rather than exhaustive," that "in no way undermines our conclusion that a delay that falls within the category of delay addressed by subparagraph (D) is governed by the limits in that subparagraph." *Id.* at 1354.

The same is true here. Section 1129(b)(2)(A)(ii) does not describe the only type of plan that may be confirmed over a secured creditor's objection. But the existence of the more general "indubitable equivalent"

clause in no way undermines the conclusion that a cram-down plan falling within the category addressed by clause (ii)—that is, plans providing for a free-and-clear sale of collateral—must comply with the requirements of that clause, including the requirement of credit-bidding.

That reading is also required to prevent a glaring instance of statutory surplusage. It is a familiar rule that "'a statute ought, upon the whole, to be so construed that, if it can be prevented, no clause, sentence, or word shall be superfluous, void, or insignificant.'" *Duncan* v. *Walker*, 533 U.S. 167, 174 (2001). If a debtor may sell collateral free and clear of liens without credit-bidding and call the proceeds the "indubitable equivalent" of the creditor's claim under clause (iii), then clause (ii), which allows such sales only *with* credit-bidding, would do no statutory work. It makes little sense that Congress would carefully enumerate specific requirements governing the treatment of a secured creditor's claim in a cram-down plan in clauses (i) and (ii), only to make it all irrelevant in clause (iii).[2]

As in *Bloate*, this Court should "avoid[] these problems by treating [clauses (i) and (ii)] as illustrative, but construing each of the [clauses] to govern, conclusively

[2] Debtors argue (Br. 32) that their reading creates no surplusage because not all chapter 11 plans can satisfy the "indubitable equivalent" standard. But debtors' theory is that the proceeds from a free-and-clear sale of a secured creditor's collateral without credit-bidding can be the "indubitable equivalent" of the creditor's secured claim because the creditor is entitled only to the present value of its collateral—which, by debtors' hypothesis, is no more than the proceeds of the sale itself. *See* Br. 26, 36. On that reasoning, it is difficult to imagine any circumstance in which clause (ii) would apply.

unless the [clause] itself indicates otherwise …, the category of proceedings it addresses." 130 S. Ct. at 1355. That reading gives effect to each of the provisions Congress crafted, gives compass to specific provisions as well as general ones, and makes sense of §1129(b)(2)(A) as a whole.

Debtors' contrary arguments are unpersuasive. *First* and foremost, they contend (Br. 18) that because §1129(b)(2)(A)'s three clauses are joined by the word "or," the statute "unambiguously afford[s] a debtor flexibility in meeting the 'fair and equitable' standard through any of the three enumerated alternatives." That is true as far as it goes, but it doesn't go very far. There is no question that the debtor may satisfy the fair-and-equitable standard through any of §1129(b)(2)(A)'s three clauses. The question is whether clause (iii)'s "indubitable equivalent" provision permits the debtors to conduct a free-and-clear sale of collateral without allowing credit-bidding, given the specific requirements imposed by clause (ii). For the reasons given above, the answer to that question is no.

Second, debtors argue (Br. 18-19) that "Congress knew how to limit the scope of the 'indubitable equivalent' standard when it wanted to do so." They point to §361, which specifies three ways of providing "adequate protection" against a decrease in the value of a creditor's security interest during bankruptcy: (1) cash payments in the amount of the decrease in value; (2) a replacement lien in the amount of the decrease in value; or (3) "such other relief, other than entitling such entity to compensation allowable … as an administrative expense, as will result in the realization … of the indubitable equivalent" of the security interest. 11 U.S.C. §361. By specifying that administrative-expense treatment (which gives claims for expenses incurred in ad-

ministering the bankruptcy estate priority over other unsecured claims, *see id.* §507(a)(2)) cannot provide the "indubitable equivalent" of a creditor's security interest, debtors argue, §361 demonstrates that there are no such limitations on the "indubitable equivalent" standard in §1129(b)(2)(A)(iii).

If that argument proves anything at all, it proves too much. The existence of a specific limitation in §361(3) hardly suggests that there are *no other* limitations on what may constitute the "indubitable equivalent," either in §361(3) or §1129(b)(2)(A)(iii). Debtors would presumably concede that cash payments of *less than* the decrease in value would not provide the "indubitable equivalent" of the creditor's security interest under §361(3). But debtors' proposal for satisfying §1129(b)(2)(A)(iii)—taking one specified means of treating a secured creditor's claim, subtracting a specific protection, and calling it the "indubitable equivalent"—is precisely analogous.[3]

Third, debtors point (Br. 20-22) to §1123(a)(5)(D), which they say "authorizes the sale of estate property free of liens to implement a chapter 11 plan" while containing no credit-bidding requirement. They compare that provision to §363(k), which does contain an express

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[3] Section 361(3)'s specific prohibition on administrative-expense treatment merely reflects Congress's rejection of pre-Code judicial decisions suggesting that administrative priority could constitute adequate protection. *See In re Yale Express Sys., Inc.*, 384 F.2d 990 (2d Cir. 1967). Because estates are not always able to pay their administrative claims in full, such protection is not "adequate." *See, e.g., In re Beker Indus. Corp.*, 64 B.R. 890, 899 (Bankr. S.D.N.Y. 1986); 3 *Collier on Bankruptcy* ¶361.03[4][a].

credit-bidding requirement. But that comparison is deeply flawed.

As an initial matter, the premise of debtors' argument is wrong—§1123(a)(5)(D) does not "authorize" anything. Section 1123(a), which governs the contents of a plan of reorganization, lists eight requirements, including, in paragraph (5), that the plan "shall ... provide adequate means for its implementation." Paragraph (5) then lists ten non-exclusive examples of what might constitute adequate means, including "(D) sale of all or any part of the property of the estate, either subject to or free of any lien." That language plainly does not "authorize" a debtor to sell property free of liens under a plan in any way the debtor chooses. Rather, §1123(a)(5) merely *refers to* general categories of transactions that may be authorized, subject to specific requirements, by other applicable provisions of the Bankruptcy Code or non-bankruptcy law.

Moreover, §1123(a)(5) applies to all plans—not only cram-down plans under §1129(b), but also consensual plans under §1129(a), in which secured creditors have agreed to the terms of the debtor's plan. Contrary to debtors' contentions, therefore, §1123(a)(5)(D) is not "the most logical place to include" a provision ensuring the right to credit-bid. The most logical place to include such a provision is exactly where Congress put it: in §1129(b), which governs what may and may not be done *without* the creditors' consent.

This Court accordingly need not reach the question whether §1123(a)(5)'s subparagraphs affirmatively au-

thorize the transactions they describe.[4] Even if §1123(a)(5)(D) did "authorize" free-and-clear sales in some sense, debtors do not contend that it overrides the specific provisions of §1129(b)(2)(A) governing all cram-down plans. Debtors' comparison between §363(k) and §1123(a)(5)(D) is thus irrelevant: The proper comparison is between §363(k) and §1129(b)(2)(A)(ii), the cram-down provision dealing with free-and-clear sales. Both §363(k) and §1129(b)(2)(A)(ii) expressly require credit-bidding at a nonconsensual free-and-clear sale, and those specific provisions must be given effect.

II. THE STRUCTURE OF THE BANKRUPTCY CODE'S PROTECTIONS FOR SECURED CREDITORS REQUIRES THE RIGHT TO CREDIT-BID

Debtors' reading of §1129(b)(2)(A) also cannot be squared with the Bankruptcy Code's overall design for protecting secured creditors. Debtors argue (Br. 24-28) that the Code entitles secured creditors only to "the present value of the[ir] … collateral," and that secured lenders can therefore be involuntarily cashed out at that present value (as determined by a judge or by the winning bidder in a restricted auction). On the con-

[4] That question has significant implications for an important issue on which the courts of appeals have divided: whether and to what extent §1123(a)(5) preempts non-bankruptcy law governing the ten transactions it lists. *Compare Pacific Gas & Electric Co.* v. *California ex rel. Cal. Dep't of Toxic Substances Control*, 350 F.3d 932, 946-948 (9th Cir. 2003), *with In re FCX, Inc.*, 853 F.2d 1149 (4th Cir. 1988). Because the issue is both complex and highly significant, and resolving it is wholly unnecessary to the resolution of this case, the Court should avoid language that lower courts might construe as granting the premise of debtors' argument.

trary, the Code is designed specifically to *prevent* debtors from cashing out secured creditors in this manner.

For over a century, courts have adhered to the principle that bankruptcy law does not permit an "involuntary reduction of the amount of a creditor's lien for any reason other than payment on the debt." *Dewsnup* v. *Timm*, 502 U.S. 410, 419 (1992). The general rule is that absent consent, full payment, or surrender of the collateral, a secured creditor's lien must survive the bankruptcy. *Id.* at 417. Several interlocking provisions of the Bankruptcy Code ensure this protective treatment for secured claims, and the right to credit-bid is an integral part of the statutory scheme.

Section 506(a) of the Bankruptcy Code typically "bifurcates" an undersecured claim: If a lien is secured by property worth less than the amount owed, the creditor's claim is divided into a secured claim equal to the present value of the collateral, as determined by the bankruptcy court, and an unsecured claim for the balance. 11 U.S.C. §506(a)(1). But judicial valuation of collateral can be risky. Because the undersecured creditor will likely receive only cents on the dollar for its deficiency claim, if the court undervalues the collateral, the lender may recover less than it should. For example, if a loan for $100,000 is secured by property that the court believes is worth $40,000 but the lender believes is worth $80,000, §506(a) might force the lender to accept $40,000 in satisfaction of its secured claim when it would much prefer the collateral itself.

Accordingly, §1111(b)(2) of the Code provides the undersecured creditor with an alternative: It may elect to have its entire claim treated as secured and give up its unsecured claim for the deficiency. *See* 7 *Collier on Bankruptcy* ¶¶1111.03[2][a], 1111.03[3][c], 1111.03[5]

(16th ed. 2011). The creditor thereby protects itself from being forced to accept less than it believes its collateral is worth. If the debtor wants to keep the collateral, the secured creditor can keep its lien, up to the full amount of its claim.

These provisions interact with the cram-down provisions through clause (i) of §1129(b)(2)(A), which applies whenever the debtor chooses to keep the collateral subject to the secured creditor's keeping its lien. Clause (i) entitles the lien-holder to deferred cash payments that both "total[] at least the allowed amount of [the lien-holder's] claim" and have "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." 11 U.S.C. §1129(b)(2)(A)(i)(II). In plainer terms, under clause (i), a debtor may in effect obtain a refinancing. If the creditor has elected fully secured treatment of its claim under §1111(b), the creditor retains its lien and its right to full payment on its loan, but the debtor can pay off the loan over time, as long as the stream of payments has a present discounted value equal to the present value of the collateral. For example, if the court values collateral securing a $100,000 loan at $40,000, the creditor is entitled to cash payments equal to $100,000 over time that, discounted for the time value of money, are worth $40,000 today.

It might seem that the difference between keeping a lien together with a $100,000 stream of payments worth $40,000 today and actually receiving $40,000 today is trivial, but it is not. By electing secured treatment for its entire claim and keeping its $100,000 lien in place, the secured creditor who believes its collateral is really worth $80,000 prevents the debtor from exiting bankruptcy, selling the property the next day for more

than the $40,000 court valuation, and keeping the difference for itself.

Indeed, both the leading treatise and the legislative history make clear that a major purpose of the §1111(b) election is to prevent the debtor from cashing out a secured creditor at the judicial valuation of the collateral when the creditor thinks the collateral is (or will eventually be) worth more. *See* 7 *Collier on Bankruptcy* ¶1111.03[3][c] ("The election can be utilized to prevent an attempted cash out .... A secured creditor, by electing to be fully secured under section 1111(b)(2), can require payment of the full amount of the claim, regardless of the value of the collateral."); 124 Cong. Rec. 32,408 (1978) (Rep. Edwards) ("The advantage [of the election] is that … if the value of the collateral increases after the case is closed, the deferred payments will be secured claims.").[5]

Together, §1111(b) and §1129(b)(2)(A)(i) ensure that, if the debtor keeps the collateral, a secured creditor cannot be forced to accept anything less than its full claim. An involuntary "cash-out" at a judicial estimate (or debtor's estimate) of the collateral's present value is not permitted. *In re River East Plaza, LLC*, No. 11-3263, 2012 WL 169760 (7th Cir. Jan. 19, 2012) (Posner, J.), is instructive. In *River East*, the debtor attempted to use clause (iii) to bypass the protections of clause (i).

[5] The Code's protections against such an involuntary cash-out are particularly important in single-asset real-estate cases like this one, where the disposition of the real estate is the central focus. "Congress specifically legislated to prevent ... the debtor" in such cases from "retain[ing] the property subject to the mortgage by paying an appraised value, over the objection of the secured creditor." 7 *Collier on Bankruptcy* ¶1129.03[4][c][ii][B].

The secured creditor held a $38 million lien on an underwater building project, for which the debtor planned to substitute a lien on Treasury bonds worth $13.5 million—the debtor's estimate of the project's present value. The Seventh Circuit rejected that scheme:

> River East's aim may have been to cash out [its creditor's] lien in a period of economic depression and reap the future appreciation in the building's value when the economy rebounds. Such a cashout is not the indubitable equivalent of a lien on the real estate, and to require it would be inconsistent with section 1111(b) of the Code, which allows the secured creditor to defeat such a tactic by writing up his secured claim to the full amount of the debt, at the price of giving up his unsecured claim to the difference between the current value of the debt and of the security.

Id. at *6.

Credit-bidding provides the secured creditor with similar protection in a case where collateral is to be sold. In that scenario, the creditor loses the right to have its full claim treated as secured but gets a safeguard of comparable value: the right to credit-bid. A secured creditor is not entitled to make the §1111(b) election if its collateral is to be sold. 11 U.S.C. §1111(b)(1)(A)(ii), (B)(ii). But that is because the "creditor has the opportunity to protect its position. It may bid its debt at the sale of the collateral and recover the collateral. This ability gives it the benefit of its bargain[.]" 7 *Collier on Bankruptcy* ¶1111.03[3][b].

As the legislative history makes clear, "[s]ale of property … is excluded from treatment under section 1111(b) because of the secured party's right to bid in

the full amount of his allowed claim at any sale of collateral." 124 Cong. Rec. 32,407. The right to credit-bid is, in essence, the right to take title to the collateral unless someone else will pay more than the full value of the lien. *See* 7 *Collier on Bankruptcy* ¶1129.04[2][b][ii] ("[I]f the secured party thinks the collateral is worth more than the debtor is selling it for, it may effectively bid its debt and take title to the property."). A secured creditor thus need not accept what the debtor, or the court, or a stalking-horse bidder thinks its collateral is worth. If the collateral is to be sold, the creditor can bid what *it* thinks the collateral is worth and take possession of the collateral itself.

There is accordingly no merit to the debtors' suggestion (Br. 44) that the proceeds of a no-credit-bidding sale might provide the indubitable equivalent of the secured creditor's claim under clause (iii), making it appropriate to defer the question of equivalence until after the sale. When Congress permitted cram-down plans that provide a secured creditor the "indubitable equivalent" of its claim, it plainly had in mind the "equivalent" of what the rest of the Code painstakingly preserves for the secured creditor: full payment, secured by the creditor's lien, or the right to take the collateral. That is exactly what Judge Hand said when he coined the phrase "indubitable equivalent": "[A secured creditor] 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 … unless by a substitute of the most indubitable equivalence." *Murel Holding*, 75 F.2d at 942 (emphasis added). The legislative history confirms that principle: According to the Code's congressional sponsors, "[a]bandonment of the collateral to the creditor would clearly satisfy indubitable equivalence, as would a lien on similar collateral."

124 Cong. Rec. 32,407. In other words, the creditor can keep its entire lien (secured by collateral of unquestionably equal or greater value), or the creditor must get the property. Anything less is not the "indubitable equivalent" of the creditor's claim.

As one prominent scholar has put it, the notion that a free-and-clear sale without credit-bidding could provide the indubitable equivalent of the secured creditor's claim is "mystifying," "[g]iven that credit-bidding allows the secured creditor to gain control over the asset and any other plan necessarily gives it something less." Baird, *Car Trouble* 16 (U. Chi. John M. Olin Law & Econ. Working Paper Series) (May 2011), *available at* ssrn.com/abstract=1833731. Exactly so. Debtors seek to take one of the three ways the Code protects the same property right, subtract a protection of significant value, and call the result the "indubitable equivalent" of that right. That cannot be correct as a matter of law or logic.

Indeed, debtors' proposal is the textbook violation of the indubitable-equivalence standard. The leading treatise and the Code's sponsors agree that "present cash payments less than the secured claim would not satisfy the standard." 124 Cong. Rec. 32,407; *see* 7 *Collier on Bankruptcy* ¶1129.04[2][c]. But that is exactly what debtors are proposing. They are attempting to value the property at the highest cash bid (which may well be artificially low due to the inefficiencies of a bankruptcy auction), and then cash out the secured creditor at that amount without giving the creditor the option to take its collateral by credit-bidding its claim.

That result is precisely what §1129(b)(2)(A) is designed to prevent. The Code provides that the debtor may keep the collateral—in which case the creditor

may elect to have its full claim treated as secured, retain its lien, and receive deferred cash payments totaling its full claim (clause (i)) or it may sell the collateral while permitting the secured creditor to credit-bid up to the full value of its claim (clause (ii)). The debtor may also preserve the creditor's lien but substitute collateral of indubitably equal or greater value or abandon the collateral to the creditor (clause (iii)). But, absent the creditor's agreement, the debtor cannot keep the collateral or transfer it to a third party by cashing out the secured creditor for less than the full value of its claim.

That reading is further supported by the strong presumption that the Bankruptcy Code does not abrogate state-law property rights without a "clear and manifest" contrary intention. *See BFP* v. *Resolution Trust Corp.*, 511 U.S. 531, 543-545 (1994). As Justice Brandeis recognized long ago, the "right of the mortgagee to insist upon full payment before giving up his security … [is] the essence of a mortgage." *Louisville Joint Stock Land Bank* v. *Radford*, 295 U.S. 555, 579-580 (1935). That is, outside bankruptcy, the secured creditor is entitled to be paid in full or to foreclose on its collateral. It has long been understood that a critical aspect of that entitlement is "[t]he [lien-holder's] right to protect its interest in the property by bidding at [a] sale whenever held, and thus to assure having the mortgaged property devoted primarily to the satisfaction of the debt, either through receipt of the proceeds of a fair competitive sale or by taking the property itself." *Wright* v. *Vinton Branch of Mountain Trust Bank*, 300 U.S. 440, 457-459 & n.3 (1937) (reading statute to permit creditor to bid without restriction to avoid constitutional concerns). This Court recognized the form that such a bid takes: When "[t]he buyer …

will be the mortgagee himself, [he] may offset the price against the debt." *W.B. Worthen Co.* v. *Kavanaugh*, 295 U.S. 56, 63 (1935); *see also Sage* v. *Central R.R. Co.*, 99 U.S. 334, 344-345 (1879); *Easton* v. *German-American Bank*, 127 U.S. 532, 538-539 (1888). Far from disclosing a "clear and manifest" intent to alter these basic rights of secured creditors, all evidence suggests that Congress carefully crafted the Code to preserve those rights.

Debtors argue that there are "numerous situations" in which the Code gives the secured creditor neither the right to credit-bid nor the right to keep its full lien by making the §1111(b) election. Again, debtors are wrong.

First, debtors contend (Br. 34) that collateral may be sold under §1129(b)(2)(A)(i), which contemplates possible "transfer[]" of the collateral to another entity. In that situation, debtors argue, a secured creditor may not make the §1111(b) election because the collateral will be sold, yet has no right to credit-bid, because clause (i) does not expressly mention credit-bidding.

But debtors simply assume the conclusion that clause (i)'s reference to "transfer" permits sales without credit-bidding. Although this Court need not reach the question, there is no reason to think that such a plan would be confirmable, and good reason to think it would not be. "Transfer" is a much broader term than "sale," *see* 11 U.S.C. §101(54), and a plan of reorganization can transfer property without selling it. In such a situation, the secured creditor remains entitled to exercise the §1111(b) election and retain its full lien. But where the plan provides for the *sale* of the debtors' collateral, and the creditor cannot retain its whole lien because that sale forecloses the §1111(b) election, it is

most consistent with the statutory structure and purpose to require that credit-bidding be permitted. *See In re California Hancock, Inc.*, 88 B.R. 226, 230-231 (B.A.P. 9th Cir. 1988) (rejecting a putative sale under clause (i) that did not permit credit-bidding and collecting authorities supporting the proposition that "the *sale exception* to section 1111(b)(1)(A) applies only where the lienholder is allowed to *credit bid*" (emphasis in original)).[6]

Second, debtors note (Br. 35) that courts may deny the right to credit bid "for cause." But that is merely the exception that proves the rule—or, rather, the exception the rule itself provides. And as debtors themselves concede, they "were unable to demonstrate cause in this case."

Third, debtors point out (Br. 35) that a creditor may not make the §1111(b) election if its interest in the collateral is of inconsequential value. That exception exists to prevent creditors with a minimal or merely theoretical interest in collateral—say, a junior lienholder with a lien on an underwater asset—from "holding up" a plan by insisting on fully secured treatment.

[6] This conclusion is reinforced by the overall goal of all three clauses: to ensure "fair and equitable" treatment for the non-consenting secured creditor. Whichever clause is nominally invoked, a plan involving the forced cash-out of a secured creditor through a sale without credit-bidding, thus permitting an insider to take from the collateral value that by right belongs to the secured creditor, is not "fair and equitable." *Cf., e.g., Bank of Am. Nat'l Trust & Sav. Ass'n* v. *203 N. LaSalle St. P'ship*, 526 U.S. 434, 444 (1999) (reason for "fair and equitable" requirement is "the danger inherent in any reorganization plan proposed by a debtor, then and now, that the plan will simply turn out to be too good a deal for the debtor's owners").

7 *Collier on Bankruptcy* ¶1111.03[3][a]. Such a creditor is treated differently from other secured creditors because its claim is essentially unsecured.

Finally, debtors argue (Br. 35-36) that even a creditor that has made the §1111(b) election is not "guaranteed to participate in the future appreciation of its collateral" because debtors can modify liens. Leaving aside the dubious merits of the debtor's hypothetical lien-modifying plan, this argument misses the point in a way that colors debtors' entire brief. The question presented in this case is not whether a secured creditor is "guaranteed ... the future appreciation of its collateral" or limited to the collateral's present value. Rather, the question is how the collateral's present value will be determined.

Debtors assume that the present value of the collateral is an easily determinable number that a judge can calculate independent of the processes by which the property will be sold. But "[i]n practice, no problem in bankruptcy is more vexing than the problem of valuation." *203 N. LaSalle*, 526 U.S. at 466 n.5 (Stevens, J., dissenting) (internal quotation marks and citation omitted). Accordingly, "one of the Code's innovations [was] to narrow the occasions for courts to make valuation judgments." *Id.* at 457 (majority). The Code's preference, instead, is for "decisions ... []tested by competitive choice" and reflecting the judgments of the creditors themselves. *Id.* at 457-458.

Credit-bidding is part of that competitive testing process: It gives the secured creditor the right to participate in the valuation of its own collateral, up to the full amount of its claim, by bidding in an open auction. Credit-bidding thus is not a device for appropriating more than the present value of the collateral, but a

mechanism for more accurately determining what that present value is. *See, e.g.*, Resnick, *Denying Secured Creditors the Right To Credit Bid in Chapter 11 Cases and the Risk of Undervaluation*, 63 Hastings L.J. 323, 340 (2012) ("[H]ow can [one] know that the bankruptcy court accurately valued the collateral if there was no market test by auction at which the noteholders had a right to credit bid?"). In short, the creditor's right to credit-bid is simply the right to obtain its collateral if the creditor values the collateral more highly than others do. If a creditor is precluded from exercising that right, the proceeds of an auction cannot represent the true "present value" of the collateral.

III. Denying Credit-Bidding Serves No Legitimate Purpose And Will Adversely Affect The Market For Secured Credit

The debtors' interpretation should also be rejected because there is no legitimate bankruptcy or commercial purpose for precluding credit-bidding at an asset sale, absent "cause" under §363(k). Credit-bidding only benefits the estate, and its absence invites mischief and manipulation by favored bidders, old equity, or existing management. Moreover, adopting debtors' rule will inevitably have an adverse effect on the availability and cost of secured credit, which will ultimately harm debtors and creditors alike.

A. Denying Credit-Bidding Serves No Legitimate Purpose

Debtors make no serious attempt to explain how denying secured lenders the right to credit-bid will serve the central aim of the bankruptcy process: "maximizing the value of the bankruptcy estate." *Toibb* v. *Radloff*, 501 U.S. 157, 163 (1991). Indeed, there is no

way in which constraining a secured lender's ability to bid, and thus limiting the number of potential bidders at an auction, can possibly maximize the value of the auctioned property. To the contrary, "credit bidding is an unalloyed good" for the bankruptcy estate, and "keeping a credit bidder from participating … is an unsupportable strategy, at least for a debtor intent on maximizing its sale proceeds." Buccola & Keller, *Credit Bidding and the Design of Bankruptcy Auctions*, 18 Geo. Mason L. Rev. 99, 119-120 (2010).

As this case shows, however, debtors are not always primarily concerned with maximizing the value of the estate: A cheap sale to a debtor's preferred bidder can benefit existing equity-holders or management at the expense of third-party creditors or other stakeholders. Denying credit-bidding thus facilitates the sale of collateral at a discount to a bidder favored by debtors' existing management or owners, elevating their self-interest over the paramount aim of maximizing the estate.

Credit-bidding benefits the bankruptcy estate for at least three reasons. *First*, credit-bidding increases the number of available bidders, and having more bidders tends to produce higher bids. Auction theory (and common sense) make clear that the winning bid reflects what the highest and next-highest bidders are willing to pay. Adding more bidders thus can only increase the winning bid, and excluding a bidder can only decrease it—especially at expedited bankruptcy sales where the stalking horse may be the only party prepared to come with cash in hand. An auction with N+1 bidders is always better than an auction with only N, but this is especially so where N is very small.

Second, the secured lender is not just any bidder. It is likely to have particularly good information about the asset to be sold. At expedited sales, lack of information may discourage some parties from participating at all, and may cause others to discount their bids in light of the risk that they have misvalued the asset. *See, e.g.*, Akerlof, *The Market For "Lemons": Quality Uncertainty And The Market Mechanism*, 84 Q.J. Econ. 488 (1970). The secured lender likely knows the value of the asset better than most, and so may bid more confidently at higher values. Excluding or discouraging its participation is thus particularly damaging. *See* Buccola & Keller at 120.

Moreover, the secured lender has a particularly strong incentive to deter abusive insider bidding or management self-dealing. Bankruptcy proceedings present a principal-agent problem, in which the incentives of the debtor's owners and existing management are unlikely to accord with those of the creditors whose interests the debtor-in-possession has a duty to protect. Present management may have an incentive to favor "white knight" bidders who will preserve the existing business (and management's own positions). *See Dynamics Corp. of Am.* v. *CTS Corp.*, 805 F.2d 705, 711 (7th Cir. 1986). The secured creditors directly bear the costs of low-ball bids on their collateral and so have an incentive to defeat them. "Credit bidding affords them a ready tool to effectively act on that incentive," and, conversely, excluding the secured lenders from bidding their credit "is the most effective means for management to steer the debtor's assets to a favored, low-value purchaser." Buccola & Keller at 120.

Finally, credit-bidding minimizes the substantial costs associated with preparing and financing a cash bid and thus maximizes what the secured creditor can af-

ford to pay (because the bidder who can avoid the additional costs of a cash bid can offer that much more for the asset). Forcing the secured lender to pay in cash simply imposes a tax on the lender and means that the estate realizes less on the sale. From the standpoint of estate maximization, this is manifestly ill-conceived. *See* Buccola & Keller at 121.

The experience of amici and their members teaches that cash bidding cannot substitute for credit-bidding for several practical reasons. As an initial matter, few entities have the necessary cash on hand to purchase the kinds of properties typically at issue in commercial bankruptcies. Creditors will thus incur interest payments and fees to investment bankers, lawyers, and others who may be necessary to structure such large-scale transactions. Moreover, when a creditor wins its collateral with a cash bid, the cash is not immediately returned to the creditor. Instead, the cash flows into the estate, and the creditor obtains a lien on the cash. 11 U.S.C. §1129(b)(2)(A)(ii). The creditor's money will thus be unavailable for as long as it takes to consummate the plan and distribute the estate's assets. These costs—both out-of-pocket expenses and time-value losses—are a deadweight loss that harms both creditors and the estate. And that is assuming, contrary to recent evidence, that credit will necessarily be available to finance a cash bid. If credit markets are frozen, bidding will be impossible for all but the most cash-flush creditors.

Even more importantly, some secured creditors may not be able to bid at all if prevented from credit-bidding. The coordination costs of organizing a cash bid can be prohibitive. Bankruptcy sales are often highly expedited, and cash bidding may require time-consuming due-diligence work by potential financiers.

And many modern commercial financings involve syndicates of secured lenders or groups of secured bondholders, which complicates the tendering of cash bids on their collective behalf. Moreover, some of today's most common commercial creditors operate under legal restrictions that prevent them from making cash bids. More and more loans are held by mutual funds or collateralized loan obligations (CLOs) whose operations are governed by indentures restricting the uses that can be made of available cash. These indentures may not allow such creditors to use or borrow cash to purchase property, even if that cash will ultimately be returned to the creditor.[7]

In short, barring credit-bidding discourages or completely forecloses participation by a low-cost, high-information bidder. Such a choice cannot serve creditors' best interests.

There is no reason creditors should prefer cash bids to credit bids: Both equally reduce the debt on the estate's balance sheet. Nor is there substance to the idea that the deep-pocketed credit-bidder chills participa-

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[7] This problem is particularly acute for commercial real-estate loans held in commercial mortgage-backed securities (CMBS). The vast majority of these loans are held in "real estate mortgage investment conduits" (REMICs), trusts prohibited from raising cash after the initial issuance of the debt they hold for their beneficiaries. Loss of REMIC status has severe tax consequences that will essentially foreclose cash bidding for a significant proportion of commercial debt: One quarter of all commercial and multifamily mortgage debt is held in CMBS, and as of the fourth quarter of 2011, 8.6% of the loans in outstanding CMBS were 30 days or more delinquent or in foreclosure or real-estate owned. *See* Mortgage Bankers Association, *Commercial Real Estate/Multifamily Finance Quarterly DataBook, Q4 2011* (forthcoming March 2012).

tion by others. The same would be true of any deep-pocketed bidder, and an auction can ill afford to exclude the participants with the greatest resources on the grounds that they might outbid everyone else. And debtors' suggestion (Br. 52-53) that the secured creditor might bid its full claim, above the collateral's "current value," to take the collateral and "defeat[] the purpose of the auction" is telling. The purpose of an auction is to realize the maximum value for the estate, not to aid the debtor in steering property toward a preselected buyer with insider ties. From the estate's perspective, there could hardly be a better result than a secured creditor's agreement to write off the entire debt the estate owes it in exchange for property worth less than that. Denying credit-bidding can only assist schemes by debtors or their insiders to take value from the estate at creditors' expense.

B. Denying Credit-Bidding Will Adversely Affect The Market For Secured Credit

Ultimately, permitting debtors to preclude credit-bidding benefits no one—not even debtors. Making "bankruptcy provisions [more] 'friendly to debtors' [works] only in the short run; in the long run, the fewer rights that creditors have in the event of default, the higher interest rates will be to compensate creditors for the increased risk of loss." *River East Plaza*, 2012 WL 169760, at *7. Taking away secured creditors' right to credit-bid will have precisely that effect, and risks destabilizing the market for secured credit at a time when the national economy remains fragile.

Lending markets necessarily factor risk, including risks associated with bankruptcy, into lending decisions and pricing. And the essence of secured credit is that the creditor is able to look to the collateral as an alter-

nate source of repayment if the debtor fails to pay. The ability to take possession of the collateral is thus essential to the secured creditor's assessment of the risk it incurs in lending. If debtors could bar their secured lenders from credit-bidding, lenders would need to increase interest rates and impose more stringent terms on borrowers to account for the possibility that they could be denied the full value of their collateral in bankruptcy.

Put another way, lenders would be forced to decide how to price the risk that they could lose their fundamental right as secured creditors either to be paid in full or take their collateral. The entire market for secured credit is founded on that right, and on the basic principle, until recently well-established, that the right exists inside as well as outside bankruptcy. Debtors' construction of the cram-down provisions thus "uproots settled expectations of secured lending." *In re Philadelphia Newspapers, LLC*, 599 F.3d 298, 337 (3d Cir. 2010) (Ambro, J., dissenting).

"[S]ecured credit lowers the costs of lending transactions not only by increasing the strength of the lender's legal right to force the borrower to pay, but also ... by limiting the borrower's ability to engage in conduct that lessens the likelihood of repayment." Mann, *Explaining the Pattern of Secured Credit*, 110 Harv. L. Rev. 625, 683 (1997). Permitting debtors to lessen the likelihood of repayment by denying credit-bidding will inevitably increase the cost, and potentially restrict the availability, of secured credit. Moreover, it will introduce serious uncertainties into both the primary secured-lending market and the secondary debt market, as market participants attempt to quantify and protect against the increased risk. The upshot will be that less investment will be made through borrowing,

more non-bankrupt debtors will fail, and fewer chapter 11 debtors will successfully reorganize. U.S. credit markets are slowly recovering from the worst financial crisis since the Great Depression. This is no time to introduce new uncertainty and risk.

CONCLUSION

The judgment below should be affirmed.

Respectfully submitted.

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