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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

PETITIONERS' REPLY BRIEF

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CORPORATE DISCLOSURE

The corporate disclosure statement included in the petition for writ of certiorari remains accurate.

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PETITIONERS' REPLY BRIEF

Lender and its *amici* avoid any meaningful analysis of the language and structure of 11 U.S.C. § 1129(b)(2)(A), instead invoking alternative canons of interpretation and countervailing policy concerns to support their argument that chapter 11 plans involving the sale of property free of liens may be confirmed only if the secured creditor is allowed to credit bid under subsection (ii). They argue that secured creditors must have the presumptive right to credit bid to protect against judicial undervaluation of their collateral and debtor malfeasance. Neither of those concerns is present in this case, however, and, in any event, they cannot override the plain meaning of § 1129(b)(2)(A).

Lender accuses the Debtors of proposing the sale without credit bidding to benefit an insider, Peter Dumon, by directing the sale of their assets to a favored stalking horse bidder. That is false and contrary to the record: the Debtors' insiders have no ownership interest in the stalking horse, and Dumon does not own the hotel management company. The Debtors are not pursuing the sale for their own benefit, but rather to fulfill their fiduciary duty to maximize the value of their estate and confirm a chapter 11 plan for the benefit of *all* creditors. The proposed bid procedures at issue here are designed to achieve the fair market value of the Debtors' assets at an open and fully advertised auction, thereby avoiding concerns about judicial undervaluation.

Lender's goal in this case is clear: to take back its collateral for its exclusive benefit and prevent any possibility of confirming a chapter 11 plan for the

benefit of all creditors. To that end, Lender insists on the presumptive right to credit bid in any plan sale free of liens. But that interpretation is contrary to a natural reading of § 1129(b)(2)(A) and would give secured creditors an unconditional veto over any proposed sale of their collateral in bankruptcy. Such an approach would foreclose the possibility of bankruptcy relief for a broad category of deeply distressed enterprises where the secured creditor's claim far exceeds the value of the collateral—a result antithetical to the rehabilitative purpose of the Bankruptcy Code. The Court should reject that outcome because it is inconsistent with the text of § 1129(b)(2)(A) and serves no legitimate bankruptcy purpose.

A. Congress Did Not Limit the Application of Subsection (iii)

Lender asserts that § 1129(b)(2)(A)(ii) is the exclusive method by which a debtor may confirm a chapter 11 plan that involves the sale of property free of liens. Several, but not all, of its *amici* agree.[1] Although a plan that permits credit bidding under subsection (ii) would meet the statutory requirement for fair and equitable treatment of secured creditors, nothing in the text or legislative history of § 1129(b)(2)(A) suggests that subsection (ii) is the

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[1] It is not surprising that Lender has *amicus* support and the Debtors do not. Numerous well-financed trade organizations promote the interests of secured lenders, but there are no industry groups to advance the interests of chapter 11 debtors. Notably, however, Lender's *amici* do not agree on the proper statutory analysis. Indeed, the Bankruptcy Scholars acknowledge (at 9–12) that "Petitioners are right about the meaning of subsection (b)(2)(A)."

only way to satisfy that standard. To the contrary, the statute provides three alternative ways by which a debtor can provide fair and equitable treatment. If any one is satisfied, the plan meets the statutory requirement for confirmation notwithstanding the dissent of a secured creditor.

1. The Statutory Text Supports the Debtors' Reading of § 1129(b)(2)(A)

The Debtors' opening brief identified numerous features of § 1129(b)(2)(A) that support the conclusion that they may confirm their plan under subsection (iii). Lender's attempts to counter them are unavailing.

First, the three alternatives in § 1129(b)(2)(A) are connected by the disjunctive "or." Section 102(5) of the Bankruptcy Code defines "or" as "not exclusive." 11 U.S.C. § 102(5). It follows that the Debtors need to satisfy only one of the three alternatives. Lender argues (at 22) that "'or' just means that the debtor need not satisfy all three clauses." But it also means that subsection (ii) is not the exclusive way the Debtors may confirm their plan over Lender's objection. Instead, the Debtors may choose any one of the three alternatives. Lender's preferred interpretation of the statute impermissibly transforms "or" into "and" by requiring the Debtors to provide the indubitable equivalent of Lender's claim under subsection (iii) *and* credit bidding under subsection (ii). *See Scotia Pacific Co. v. Official Unsecured Creditors' Comm. (In re Pacific Lumber Co.)*, 584 F.3d 229, 245 (5th Cir. 2009).

Second, § 1129(b)(2)(A)'s introductory phrase "the plan provides" confirms that the plan proponent may choose which of the three alternatives to pursue. Lender concedes this point (at 32), but nonetheless insists that a plan proposing to sell property may be confirmed only through subsection (ii). There is no support for such a limitation in the statutory text.

Third, Congress' use of the term "includes" in the opening clause of § 1129(b)(2) means that there are no limitations on the three alternatives. *See* 11 U.S.C. § 102(3) (defining the term "includes" in the Code as "not limiting"). Yet Lender argues (at 30–32) for the opposite interpretation: that subsection (iii) *is* limited to plans that do not fit within subsections (i) or (ii). Had Congress intended that result, it would have included such a limitation in the statute—as it did in the only other section of the Code that uses the indubitable equivalent standard (11 U.S.C. § 361(3)) and in other sections of the Code where Congress limited the application of certain subsections (*see* Pet. Br. 20 (listing numerous examples in the Bankruptcy Code where Congress expressly limited the application of a subsection)).

Lender acknowledges (at 48) that § 361(3) imposes express limits on the "indubitable equivalent" option and § 1129(b)(2)(A) does not, but hypothesizes that the Debtors would advance the same argument even if similar limiting language were also used in § 1129(b)(2)(A). But the fact remains that Congress did *not* provide any such limiting language in § 1129(b)(2)(A). Furthermore, Lender ignores that Congress could easily have included the limiting phrase "except as provided in subsections (i) and (ii)" in § 1129(b)(2)(A)(iii), but chose not to do so even

though Congress included that precise language in numerous other sections of the Code. *See* Pet. Br. 20 (citing examples).

Lender's discussion of 11 U.S.C. § 1123(a)(5)(D) (at 46–47) is similarly flawed. That provision expressly permits a debtor to sell assets free of liens as a way to implement its plan, yet it does not impose a credit bidding requirement.[2] Lender also ignores that Congress did not extend the right to credit bid under 11 U.S.C. § 363(k) to all chapter 11 plans, even though the very next subsection, § 363(*l*), applies by its terms to all chapter 11 plans.

2. Lender's Favored Canons of Construction Do Not Apply

Because subsection (iii) contains no limitations, Lender resorts (at 27–28) to the canon of statutory construction that a specific statutory provision governs a general provision that addresses the same issue. That canon, however, applies only where the general provision is an exclusive subset of the specific provision. *See Bloate v. United States*, 130 S. Ct. 1345, 1354 (2010); *Nat'l Cable & Telecomms. Ass'n v. Gulf Power Co.*, 534 U.S. 327, 335–36 (2002) ("The specific controls but only within its self-described scope."). Here each subsection of § 1129(b)(2)(A) provides a different way to establish fair and equitable treatment for secured creditors. In particular, subsection (ii) provides the procedural

[2] Lender's suggestion (at 46) that 11 U.S.C. § 1123(a)(5)(D) "creates no substantive right to sell property free and clear of liens" is incorrect. Section 1123(a)(5) specifically lists ways in which a debtor may "provide adequate means for the plan's implementation," including the sale of property free of liens.

protection of credit bidding without regard to the substantive outcome of the sale. Subsection (iii), in contrast, provides the substantive protection of indubitable equivalence without mandating any particular procedure. Because each subsection covers situations not covered by the other subsection, the canon on which Lender relies does not apply. *See In re Philadelphia Newspapers, LLC*, 599 F.3d 298, 307–08 (3d Cir. 2010).

The fact that subsection (ii) refers to treatment of a lien on the proceeds from the sale through subsections (i) or (iii) does not change the result. It simply means that a sale is fair and equitable when it allows credit bidding *and* distributes any sale proceeds under subsections (i) or (iii). In that situation, the debtor does not need to demonstrate that the sale generated fair market value or that the proceeds are the indubitable equivalent of the secured creditor's claim, as it would under subsection (iii).

Lender does not dispute that subsection (ii) is procedural and subsection (iii) is substantive, but rejoins (at 33) that "the credit-bidding requirement of clause (ii) [cannot] be evaded by resort to clause (iii)." Lender mischaracterizes how the three statutory alternatives in § 1129(b)(2)(A) work. Each subsection is a way to provide fair and equitable treatment; if any one is satisfied, a debtor may confirm its plan over the dissent of the secured creditor. The Debtors are not "evading" the credit bidding requirement by pursing their plan under subsection (iii) any more than they would be "evading" the indubitable equivalent requirement by pursuing their plan under subsection (ii). The Debtors are simply pursuing one

option—subsection (iii)—specifically provided by Congress for confirming their chapter 11 plan over the objection of Lender. The text and structure of § 1129(b)(2)(A) plainly permit this possibility.

Lender is also wrong to suggest that the Debtors' reading of § 1129(b)(2)(A) renders subsection (ii) superfluous. Indeed, its example (at 51–52) of a $50,000 stalking horse bid on an asset encumbered by a $70,000 claim proves this point. In that case, the debtor may prefer to proceed under subsection (ii) and permit credit bidding because it might generate a surplus for the estate and would relieve the debtor of proving indubitable equivalence. Similarly, a debtor with multiple assets, not all of which are necessary for reorganization, may prefer to sell the unneeded property under subsection (ii) rather than have to prove indubitable equivalence. But where certain property *is* crucial to a successful exit from bankruptcy, such as in *Pacific Lumber*, the debtor needs the flexibility to transfer property without credit bidding. Subsection (iii) allows this possibility, but only if the debtor can prove that the secured creditor will receive the indubitable equivalent of its secured claim.

3. Subsection (iii) Is Not Restricted to Plans that Could Not Be Confirmed Under Subsections (i) or (ii)

Lender's argument (at 18) that subsection (iii) applies only to plans that cannot fit within the scope of subsections (i) and (ii) is also misguided. As demonstrated above, nothing in the statutory text imposes such a restriction. Furthermore, Lender concedes (at 26) that subsection (iii) can be satisfied

by providing substitute collateral. In doing so, the debtor could propose a repayment plan that provides a lien on different collateral under subsection (iii) instead of retaining the secured creditor's lien on the same collateral as required under subsection (i).[3]

The Debtors' plan here provides more certainty for Lender than substitute collateral. It pays Lender cash equal to the fair market value of its collateral determined at an open auction. If substitute collateral is a permissible use of subsection (iii), then full payment in cash equal to the present value of the collateral must be as well.

Lender claims (at 26) that surrendering collateral to the secured creditor is a "classic example" of indubitable equivalence under subsection (iii). Perhaps so, but Congress did not limit subsection (iii) to surrendering collateral, as it did in chapters 12 and 13 of the Code. *Cf.* 11 U.S.C. §§ 1225(a)(5), 1325(a)(5).

B. Subsection (iii) Provides an Alternative But Equal Protection to Secured Creditors

Lender further argues (at 34) against a plain reading of § 1129(b)(2)(A) by claiming that the indubitable equivalent requirement under subsection (iii) provides "a more generous" alternative to the credit bidding requirement under subsection (ii). That is not so. The Bankruptcy Code protects the secured creditor's interest in the present value of its

[3] The structure of § 1129(b)(2)(A) also allows a debtor to use subsection (i) *with* subsection (iii) by providing a stream of payments under subsection (i) and surrendering other collateral back to the secured creditor under subsection (iii).

collateral. *See* Pet. Br. 24–27. To that end, each of the three subsections of § 1129(b)(2)(A) guarantees that the secured creditor will realize at least this amount if a plan is confirmed over its objection. Subsection (i) requires a stream of deferred payments with a present value at least equal to the current value of the collateral. Subsection (ii) allows the secured creditor to take back its collateral (thus realizing its present value) through a credit bid. And subsection (iii) requires a debtor to provide the secured creditor with money or property that is the indubitable equivalent of the present value of the collateral. One alternative is not "more generous" than the other. Rather, each provides the same economic benefit to the secured creditor. *See* Pet. Br. 26 (providing a mathematical example).

In this way, § 1129(b)(2)(A) strikes a careful balance between protecting the secured creditor's interest in the value of its collateral and allowing the debtor flexibility to confirm a chapter 11 plan. The Fifth Circuit's decision in *Pacific Lumber*, which Lender and its *amici* ignore, illustrates how the alternatives in § 1129(b)(2)(A) permitted confirmation of a plan that benefited all stakeholders despite a secured creditor's objection. *See* Pet. Br. 49–51.

The protections provided by § 1129(b)(2)(A) also respect the constitutional limitations on modifying a secured creditor's rights in bankruptcy. In *Wright v. Union Central Life Insurance Co.*, 311 U.S. 273 (1940), the Court considered the constitutionality of the treatment of secured creditors under the Frazier-Lemke Amendments to the Bankruptcy Act. The Court recognized that "[s]afeguards were provided to protect the rights of secured creditors, throughout

the proceedings, to the extent of the value of the property," but that "[t]here is no constitutional claim of the creditor to more than that." *Id*. at 278–79. Section 1129(b)(2)(A) incorporates this principle in its three subsections, each of which preserves the secured creditor's right to realize the value of its collateral under a chapter 11 plan that it rejects.[4]

The Debtors' construction of § 1129(b)(2)(A) is consistent with Judge Learned Hand's use of the phrase "indubitable equivalence" in *Metropolitan Life Insurance Co. v. Murel Holding Corp. (In re Murel Holding Corp.)*, 75 F.2d 941 (2d Cir. 1935), on which Congress relied when enacting subsection (iii). In *Murel*, the court rejected a plan of reorganization under § 77B of the Bankruptcy Act that proposed to pay the secured creditor interest on its collateral for 10 years, with no payment of principal until the end of the term. Judge Hand explained that a creditor who fears the safety of its principal "wishes to get his money or at least the property" and that "[w]e see no reason to suppose that the statute was intended to deprive him of that in the interest of junior holders, unless by a substitute of the most indubitable equivalence." *Id*. at 942. In other words, a secured creditor is entitled to full payment, the collateral, or other property equal to the value of its collateral. Those three options are reflected in the three subsections of § 1129(b)(2)(A), all three of which permit a debtor to confirm a plan by providing its

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[4] There is thus no merit to the suggestion by one *amicus* (Professor Aaron et al.) that credit bidding must be required for all plan sales under § 1129(b)(2)(A) to avoid a constitutional question. Indeed, such an interpretation would cast doubt over the constitutionality of the "for cause" exception to credit bidding that Congress added to 11 U.S.C. § 363(k) in 1984.

secured creditor with the indubitable equivalent of the present value of the collateral.[5]

This result is also consistent with prior practice under Chapter XII of the Bankruptcy Act, which governed reorganization plans involving real property. Under that statute, a debtor could implement a plan of arrangement (reorganization) over the dissent of a secured creditor if it provided the objecting creditor with "adequate protection." Section 461(11) of the Act enumerated ways in which the debtor could provide adequate protection, including (1) retention or sale of the property subject to the debt, (2) sale of the property free of the debt, with the debt attaching to the proceeds, (3) payment of the appraised value of the property, or (4) some other method that would "equitably and fairly provide such protection." Chandler Act of 1938, ch. 575, § 461(11), 52 Stat. 840 (1976) (repealed in 1978). Just like the three alternatives for providing fair and equitable treatment under § 1129(b)(2)(A) of the Code, these options protected the secured creditor's interest in the present value of its collateral, but provided the debtor with flexibility to confirm a plan to benefit all creditors despite the dissent of its secured creditor. Lender and its *amici* repeatedly urge that Congress did not "write on a blank slate" when it adopted § 1129(b)(2)(A) in 1978, yet they ignore how Chapter XII of the Bankruptcy Act

[5] Professor Aaron et al.'s argument that *Murel* requires the indubitable equivalent of the secured creditor's *right to credit bid* is incorrect. Credit bidding was not at issue in that case. Instead, Judge Hand held that the creditor must provide the indubitable equivalent of the *collateral* (i.e., something unquestionably equal in value to the collateral, *see Philadelphia Newspapers*, 599 F.3d at 310).

treated liens, which contradicts their claim that secured creditors have always had the right to receive payment in full or take back their collateral.

Lender nonetheless insists (at 22) that the Bankruptcy Code entitles it to credit bid and take back its collateral in all plan sales. But as shown above, subsection (iii) provides an alternative way to cram down a chapter 11 plan by providing the secured creditor with property at least equal to the present value of its collateral. This alternative provides the same protection to the secured creditor. For example, there is no economic disadvantage in receiving $70,000 in cash rather than repossessing collateral worth $70,000. As such, Lender cannot complain that it would be denied the benefit of its pre-bankruptcy bargain. Even if it could, that consideration is insufficient to override the statutory text. *United Sav. Ass'n of Tex. v. Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365, 379–80 (1988). Indeed, Lender acknowledges that an immediate cash distribution may be *preferable* to receiving the collateral itself. *See* Resp. Br. 53 ("Many secured creditors would rather take cash than have to deal with sustaining and then disposing of collateral."). Likewise, full payment of cash now may be preferable to a more speculative stream of deferred payments from a bankrupt borrower at a less favorable interest rate than the lender could obtain from a borrower outside of bankruptcy. *See Till v. SCS Credit Corp.*, 541 U.S. 465, 477 (2004) (precluding profit as a consideration in determining an appropriate interest rate in a bankruptcy plan).

Ultimately, Lender's arguments betray Lender's real objective in this case: to thwart the Debtors'

plan confirmation efforts by using a credit bid to obtain its collateral and prevent distributions to other creditors.[6] If credit bidding were required for all plan sales, Lender could prevent any sale over its objection because it could bid the entire amount of its claim (which far exceeds the estimated value of the property) to defeat any third-party cash bids. There would be no reason to proceed with an auction because the outcome would be preordained and would fail to generate any cash to fund a chapter 11 plan. The bankruptcy court would thus grant Lender relief from the automatic stay under 11 U.S.C. § 362(d) to foreclose on its collateral. Indeed, the same determination could be made at the outset of many bankruptcy cases where, as here, the secured creditor's claim greatly exceeds the value of its collateral. Such a result would defeat one of the primary purposes of the Bankruptcy Code, which is to foster consensual resolutions among various stakeholders, not to give secured lenders an unconditional veto over the chapter 11 process.

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[6] The evidence strongly suggests that Lender has no interest in any result other than foreclosure. It declined to file its own chapter 11 plan in this case even though the bankruptcy court terminated the Debtors' exclusive period to file a plan on August 30, 2010 at Lender's request. *See In re RadLAX Gateway Hotel, LLC*, Case No. 09-30047, Dkt No. 338 (Bankr. N.D. Ill.). Any such plan would be the functional equivalent of a credit bid, as it was in the companion *River Road* cases, where the lenders confirmed a chapter 11 plan and obtained title to their collateral in exchange for a reduction in debt while still providing some distributions to other creditors. *See In re River Road Hotel Partners, LLC*, Case No. 09-30029, Dkt. Nos. 840, 853 (Bankr. N.D. Ill).

C. There Is No Risk of Judicial Undervaluation

Although Lender and its *amici* insist that an absolute right to credit bid in all plan sales is necessary to protect against the potential undervaluation of collateral, that concern is misplaced. Judicial valuation plays a significant role in many bankruptcy cases. Bankruptcy judges routinely value property for many reasons—for example, to bifurcate claims under 11 U.S.C. § 506(a), to estimate claims under 11 U.S.C. § 502(c), and to determine adequate protection under 11 U.S.C. § 361. Indeed, the bankruptcy judge must value a stream of payments and the current value of collateral to determine the sufficiency of a repayment plan under subsection (i) of § 1129(b)(2)(A). But such valuations are not unique to bankruptcy. Many business decisions outside bankruptcy rely on similar opinions of value, including real property appraisals and business valuation models.

Concerns about judicial valuation are not present where, as here, the collateral is to be sold at an open auction because the market will determine the property's value. *See Bank of Am. Nat'l Trust & Sav. Ass'n v. 203 N. LaSalle St. P'ship*, 526 U.S. 434, 457–58 (1999). As long as the auction is sufficiently advertised and conducted in a fair and reasonable manner, the results of the sale will, by definition, establish the fair market value of the collateral. Lender's fear of undervaluation is therefore unfounded.

Lender errs in suggesting (at 25) that the design of the proposed auction will cause its collateral to be undervalued. Unlike 11 U.S.C. § 363(b), which

permits *ad hoc* sales of property during the course of a bankruptcy case on 21 days' notice (or less for "cause," *see* Fed. R. Bankr. P. 2002(a)(2)), sales under a chapter 11 plan take much longer due to the time required to approve the disclosure statement and solicit votes for plan confirmation. That process takes at least 56 days and often much longer. *See* Fed. R. Bankr. P. 2002(b). This additional time allows for more robust notice and marketing efforts leading up to the sale. Lender's suggestion (at 54) that "the time between the announcement and performance of the auction can be as truncated as a matter of days" is thus incorrect. These differences, along with the many other protections provided to creditors in a plan context (s*ee* Pet. Br. 27–28), explain why Congress mandated credit bidding for all *ad hoc* sales of property under § 363(b), but *not* for all sales under a chapter 11 plan.

Furthermore, the Debtors included additional safeguards in their bid procedures that are designed to maximize the purchase price. For example, the Debtors' proposed bid procedures permit the financial advisors responsible for marketing the property and soliciting the stalking horse bidder to continue marketing the auction to other potential bidders through the sale date. J.A. 146. The bid procedures also incorporate ways in which Lender can provide additional input on how to increase the price achieved at the auction. J.A. 143–46, 151, 153–54. The Debtors' proposed auction is thus well designed to foster competitive bidding and realize the fair market value of the property.

Moreover, if Lender nonetheless thinks that the bids received at the auction undervalue its collateral,

Lender can submit its own cash bid. Most of that cash would be immediately returned to it through the plan (except for claims given a higher priority by the Bankruptcy Code).[7] Thus, there is no real risk that Lender will receive anything less than the fair market value of its collateral. Furthermore, the "absolute priority" rule is not implicated as the Debtors' equity holders would retain no interest under the plan and Lender may submit a cash bid at the sale or file its own plan. *See 203 N. LaSalle*, 526 U.S. at 458.

Finally, Lender can still object to plan confirmation on the ground that the Debtors have not satisfied the "indubitable equivalent" standard under subsection (iii) because the sale failed to realize the fair market value of the property. That determination, however, cannot be made until the results of the auction are known. Whether the sale proceeds provide indubitably equivalent value is not ripe at the bid procedures stage of the proceedings, but rather must be evaluated at plan confirmation, after the sale has occurred. Indeed, Lender does not dispute that the auction could generate sufficient proceeds to satisfy the indubitable equivalent standard at confirmation. *See* Resp. Br. 35–36. If the auction does not generate sufficient proceeds to satisfy that requirement, the Debtors would have to amend their plan to supplement the value distributed to Lender. That process is not problematic; it simply reflects the dynamic nature of

[7] The rationale for setoff in *Citizens Bank of Maryland v. Strumpf*, 516 U.S. 16 (1995), is not implicated in plan sales where, as here, there are senior liens (*e.g.*, real estate taxes and mechanics' liens) that must be paid before funds can be returned to the secured creditor.

a chapter 11 proceeding, which is designed to encourage negotiations among various stakeholders through the plan confirmation hearing, with the goal of reaching a consensual resolution. *See 203 N. LaSalle*, 526 U.S. at 457 n.28 (recognizing that "the Chapter 11 process relies on creditors and equity holders to engage in negotiations toward resolution of their interests" (citation omitted)).

D. Credit Bidding Does Not Always Maximize the Value of the Bankruptcy Estate

As further support for its position, Lender argues (at 51–54) that credit bidding is an unalloyed good that will always maximize the value of the bankruptcy estate. Lender is wrong for many reasons.

First, Lender provides no empirical evidence to support its position.[8] Allowing credit bidding where the debt far exceeds any reasonable estimate of the value of the property would almost surely decrease—not increase—the number of bidders at the auction. For example, if Lender is entitled to credit bid the full amount of its claim of more than $120 million at the auction of property worth less than half that amount, few third-party bidders would devote the time and resources required to conduct due diligence and raise sufficient funds to participate, either as a stalking horse or as a bidder at the auction. That is so because they would know that Lender has the ability and motivation to trump any cash bid with its credit bid. Indeed, throughout this case, Lender has

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[8] Lender's argument is derived from one law review article, which in turn lacks any empirical foundation. *See* Vincent S.J. Buccola & Ashley C. Keller, *Credit Bidding and the Design of Bankruptcy Auctions*, 18 GEO. MASON L. REV. 99 (2010).

expressed its desire to thwart any efforts to sell its collateral. Consequently, cash bidders that would otherwise participate in the auction would forgo the sale in light of Lender's outsized credit bid. Lender would be guaranteed to prevail at the auction, take back its collateral, and prevent confirmation of a chapter 11 plan for the benefit of all creditors.[9]

Second, the fact that a credit bid will reduce a secured creditor's claim even more than the highest cash bid is of little solace to other creditors if the debtor is unable to generate cash to confirm a chapter 11 plan.

Third, the ability to credit bid may confer an unfair advantage on the secured creditor. As Lender observes (at 53–54), credit bidding relieves that bidder—but only that bidder—of certain transaction costs associated with borrowing cash, such as loan closing costs and interest. The credit bidder thus pays less than a cash bidder to make the same bid. For example, if transaction costs are 5%, a $100 bid will cost the cash bidder $105 ($100 bid + $5 transaction costs), but will cost the credit bidder only $100. Cash bidders may be less willing to participate in an auction where they must pay more than a competing credit bidder to achieve the same result.

Fourth, credit bidding allows the credit bidder to bid with a currency (its credit) that is inherently less valuable than cash because it may only be used for one purpose: bidding on that creditor's collateral.

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[9] This is also true with a "loan-to-own" lender, where the secured creditor's goal is to obtain title to the asset instead of recovery on its claim. A credit bid in that circumstance would not reflect the fair market value of the collateral.

Cash, on the other hand, is fungible and may be used to bid at the sale of the secured creditor's collateral or deployed for some other purpose. Thus, cash bidders, but not credit bidders, will consider other opportunities, which will temper their willingness to bid at the auction. *See In re Homestead Partners, Ltd.*, 197 B.R. 706, 719 n.15 (Bankr. N.D. Ga. 1996) (recognizing that credit bidding at an auction can be unfair because it allows a competitor to bid with "a currency of no consequence"). The assertion that "credit bidding chills cash bidding no more than a deep-pocketed cash bidder would chill less-well-capitalized cash bidders" misses this crucial distinction. *See Philadelphia Newspapers*, 599 F.3d at 321 (Ambro, J., dissenting).

In sum, allowing credit bidding at every sale of collateral tilts the auction in favor of the secured creditor and against other potential cash bidders for no legitimate reason. As a result, fewer cash bidders may participate in the auction, thereby lowering the potential for the debtor to realize the fair market value of its assets. In contrast, requiring cash bidding for the auction creates no unfair advantage and still allows the Lender to protect any perceived undervaluation of its collateral by bidding cash. It also reflects how property is typically sold outside of bankruptcy, where bidders are required to use cash.

E. The Debtors' Plan Does Not Benefit Insiders or a Favored Third-Party Bidder

Lender and its *amici* repeatedly assert that the Debtors' proposed plan was engineered to sell assets below market value to a favored stalking horse bidder for the benefit of insiders. That claim

misstates the facts. Lender incorrectly relies on an outdated version of the proposed asset purchase agreement with a *different* stalking horse bidder. *See* Resp. Br. 12–13 (citing to J.A. 105). Under the current asset purchase agreement, no insider of the Debtors owns any part of the stalking horse bidder. J.A. 201. Furthermore, Peter Dumon, one of the Debtors' insiders, does not own the hotel management company, and there is no requirement that the winning bidder retain the current management company to manage the hotel. J.A. 146.[10]

Nor are the Debtors trying to sell their property at below market value to a favored stalking horse bidder. To the contrary, the Debtors' proposed bid procedures are designed to maximize the sale price and fund a chapter 11 plan for the benefit of all creditors. The selection of a stalking horse is customary in bankruptcy sales. The stalking horse bidder conducts due diligence and submits an initial bid, which assures the market that the property is worth buying. That bid sets the floor for the auction and is subject to higher and better bids designed to achieve fair market value. In return for making the initial bid, the stalking horse is customarily guaranteed a "break-up fee" if it is not the winning bidder, an amount calculated to reimburse it for its expenses in performing due diligence and negotiating the asset purchase agreement and related docu-

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[10] The only connection between Dumon and the management company is incidental, indirect and *de minimis*: Dumon's wife's trust has a partial ownership interest in an entity that has a minority interest in the hotel's current management company.

ments.[11] The stalking horse process serves to maximize the number of participants and bids at the auction, not minimize it.

Lender's assertion (at 14) that the Debtors would not seek to confirm their initial plan because the stalking horse bid was "many millions of dollars *less* than the value of the property" is also misleading. The initial stalking horse bid of $47.5 million for the hotel was made in June 2010. J.A. 106. This price reflected the stalking horse's view of the market value of the property and the challenging conditions of the credit markets at that time. In February 2011, the Debtors filed a new asset purchase agreement reflecting an increased stalking horse bid of $55 million. J.A. 286. The difference in the two bids reflected the appreciation in the value of the property and recovery of the credit markets over the intervening nine months, not a ploy to sell assets below market value. In any event, the stalking horse bid is not a final bid; it merely sets the floor and is subject to higher bids at an open and advertised auction.

Finally, Lender's contention (at 58–59) that "other creditors will not benefit (even from a cash bid by the secured creditor) until and unless cash is bid in the full amount of the secured claim plus one dollar" is incorrect. As Lender concedes (at 57), the Bankruptcy Code's distribution scheme allows certain priority and administrative claims to be paid ahead of the secured creditor. *See* 11 U.S.C. § 506(c). Additionally, senior liens such as real estate taxes

[11] The break-up fee in this case was a standard percentage (3%) of the stalking horse bid and subject to bankruptcy court approval.

and mechanics' liens can be paid from a secured creditor's collateral. Furthermore, the sale of property through a chapter 11 plan avoids transfer taxes, which can be significant in a case like this. 11 U.S.C. § 1146(a). Finally, the Debtors can require distributions to general unsecured creditors through a chapter 11 plan from the future operating profits of the hotel. By twice denying Lender's motions for relief from the automatic stay, the bankruptcy court has rejected Lender's argument that only Lender may reap the benefits of the sale.

In sum, the Court should allow the Debtors to discharge their responsibility as fiduciaries for all creditors of their estates, and should not require them to capitulate for the sole benefit of Lender. *See Wolf v. Weinstein*, 372 U.S. 633, 649 (1963) ("But so long as the Debtor remains in possession, it is clear that the corporation bears essentially the same fiduciary obligation to the creditors as does the trustee for the Debtor out of possession."). Indeed, the Debtors' role to act on behalf of all creditors is especially important in this case because no committee of unsecured creditors was appointed to represent their interests.

CONCLUSION

The judgment of the Seventh Circuit should be reversed and the case remanded to the bankruptcy court for consideration of the Debtors' bid procedures motion under the correct statutory interpretation.

Respectfully submitted,

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