No. 11-166

In The
Supreme Court of the United States

RADLAX GATEWAY HOTEL, LLC AND
RADLAX GATEWAY DECK, LLC, PETITIONERS

v.

AMALGAMATED BANK

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

BRIEF FOR RESPONDENT

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QUESTION PRESENTED

Whether a Chapter 11 plan that proposes to sell property free of liens, and leave the secured creditor with nothing more than the proceeds of the sale, must permit the secured creditor to credit bid, as required by 11 U.S.C. § 1129(b)(2)(A)(ii).

CORPORATE DISCLOSURE STATEMENT

Respondent Amalgamated Bank has no parent or publicly held company owning 10% or more of its stock.

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STATUTORY PROVISIONS INVOLVED

The relevant portions of the Bankruptcy Code, 11 U.S.C. §§ 363, 506, 1111, and 1129, are set forth in an appendix to this brief. App., *infra*, 1a-22a.

INTRODUCTION

Section 1129(b) of the Bankruptcy Code allows a debtor to cram down a plan over the objection of a class of creditors only if the plan is "fair and equitable" to that class. To be fair and equitable with respect to a class of secured creditors, a cramdown plan must, at a minimum, meet one of three distinct clauses in subparagraph (A) of Section 1129(b)(2). The first two clauses are detailed and specific and govern depending on how the plan proposes to treat the secured creditor's collateral. But each essentially guarantees that the secured creditor either will be paid the full value of its collateral or will take possession of the collateral.

The first clause, clause (i), provides that the secured creditor retains its lien on the property and is paid deferred cash payments up to the allowed amount of the claim its collateral secures. Retention of the lien ensures that if the prescribed payments are not forthcoming, the secured creditor can take its collateral.

The second clause, clause (ii), allows the debtor to sell the collateral free and clear of the secured creditor's liens, with the liens to transfer to the proceeds of the sale—but only if the secured creditor is

provided the right to "credit bid." A credit bid allows the secured creditor to bid for its collateral using the debt it is owed to offset the purchase price. Credit bidding ensures that, if the bidding at the sale is less than the amount of the claim the collateral secures, the secured creditor can, if it chooses, bid up the price to as high as the amount of its claim. That protects the secured creditor against being stripped of its collateral at below its real value. By using its credit to outbid a sale to a third party at a lower price, the secured creditor can choose to take possession of its collateral rather than be left undercompensated by the proceeds from a sale to another.

Here, petitioners propose to do precisely what is contemplated by clause (ii)—to sell respondent's collateral free and clear of its liens and provide respondent nothing more than the proceeds of that sale—but *without* giving respondent the right to protect itself by credit bidding. Petitioners argue that this may satisfy the third clause of Section 1129(b)(2)(A), clause (iii), which requires that the secured creditor be provided the "indubitable equivalent" of its secured claim.

Petitioners' primary defense of this approach is that the "or" before clause (iii) demonstrates that it is one of three permissible alternatives. But the question is not whether "or" means "or." The question is "or *what*?" Whatever clause (iii) may encompass, it cannot be what petitioners propose: an end-run around the more specific, and more stringent, protections of clause (ii).

Congress expressly decided what was required for a cramdown plan to be "fair and equitable" to an objecting class of secured creditors whose collateral was going to be sold free and clear of its liens. Those explicit requirements, including the only limited exception to them, are set forth in clause (ii). As the court of appeals correctly concluded, when Congress provides such a carefully reticulated scheme, the specific provision cannot be evaded through a general provision like clause (iii).

Moreover, no good reason justifies reading clause (iii) to permit the sale of a secured creditor's collateral free and clear of its liens without allowing it to bid its debt in the sale. Credit bidding protects the secured creditor against the well-recognized risk of undervaluation of collateral at sale in bankruptcy. Credit bidding thus preserves the benefit of a secured creditor's pre-bankruptcy bargain: the right to be repaid under certain terms or else to foreclose and take possession of the collateral. The Bankruptcy Code should not be read to upset these expectations.

At the same time, credit bidding does no harm to other creditors, because every penny of a cash bid would have to go into the secured creditor's pocket until that secured creditor has been paid in full. For the very same reason, the only parties who might benefit from preventing credit bidding are not those the bankruptcy laws are designed to protect, and often will include, as here, the preferred bidder of the debtor's insiders. No bankruptcy policy supports benefitting insiders or strangers at the expense of

secured creditors, and there is no reason to read the statute to allow that result.

STATEMENT OF THE CASE

A. Statutory Framework

1. Chapter 11 of the Bankruptcy Code permits a debtor to restructure its obligations and operations in order to preserve value and jobs by enabling it to continue in business itself or to pass its continuing operations to a third-party buyer. This benefits the debtor, its employees, and its creditors.

Several provisions of the Bankruptcy Code permit a Chapter 11 debtor to deal with property that is encumbered by liens in ways that may improve the result of the case. Each of these provisions, however, contains important protections for the lienholder that protect the secured creditor from undervaluation of its collateral. These protections are necessary because of the manner in which Section 506(a) of the Bankruptcy Code treats an undersecured creditor—i.e., a secured creditor for which the value of the collateral securing that creditor's claims is less than the amount owed the creditor.

Section 506(a) bifurcates an undersecured creditor's claim into a secured portion and an unsecured portion. Section 506(a) provides:

> An allowed claim of a creditor secured by a lien on property in which the estate has an interest * * * is a secured claim to the extent of the value of such creditor's interest in the

> estate's interest in such property * * * and is an unsecured claim to the extent that the value of such creditor's interest * * * is less than the amount of such allowed claim.

11 U.S.C. § 506(a)(1). Given this bifurcation, an accurate valuation of the current value of the collateral that secures a claim is essential to protect the legitimate expectations of a secured creditor. Otherwise, undervaluation can lead to the diversion of value from the secured creditor to third parties, including insiders and holders of junior interests, in a manner not justified by any bankruptcy policy.

2. One protection against such undervaluation is found in Section 363. Section 363(b) governs the sale of property of the estate "other than in the ordinary course of business." *Id.* § 363(b)(1). When property that is encumbered by a lien is to be sold under Section 363(b), the lienholder has the right under Section 363(k) to place what is commonly referred to as a "credit bid" for the property. A credit bid allows the secured creditor to bid for the property using the debt it is owed to offset the purchase price. Section 363(k) provides:

> At a sale under subsection (b) of this section of property that is subject to a lien that secures an allowed claim, unless the court for cause orders otherwise the holder of such claim may bid at such sale, and, if the holder of such claim purchases such

> property, such holder may offset such claim against the purchase price of such property.

Id. § 363(k). As Section 363(k)'s language makes clear, a secured creditor may credit bid up to the full face amount of its claim—i.e., its "allowed claim"—even if the claim amount exceeds the value of the collateral (that is, even if the secured creditor is undersecured). *Cohen v. KB Mezzanine Fund II, LP* (*In re SubMicron Sys. Corp.*), 432 F.3d 448, 459-460 (3d Cir. 2006).

The right to credit bid under Section 363(k) is well-recognized as an important check against the undervaluation of collateral at sale in bankruptcy. *See, e.g.*, 7 Collier on Bankruptcy, ¶ 1129.04[2][b][ii] (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2010). If the secured creditor believes that it could generate a greater return on the collateral than that represented by the bidder's offer, then the secured creditor may bid up to the full amount of its claim toward the purchase price. Once it has done so, any higher bid by the secured creditor or any other competing bidder ultimately will result in some cash for other creditors (and perhaps even the debtor).

3. Section 1111(b) also provides a check against undervaluation of a secured creditor's collateral. Section 1111(b)(1)(A) provides that a secured creditor's nonrecourse claims are to be treated as recourse claims. A nonrecourse claim is one where the creditor may look only to the collateral for payment of the claim in case of default; the creditor has no claim for

the deficiency between the value of the collateral and the total amount of the claim. Section 1111(b)(1)(A) provides that a secured claim shall be treated "as if the holder of such claim had recourse against the debtor on account of such claim, whether or not such holder has such recourse." 11 U.S.C. § 1111(b)(1)(A).

Under Section 1111(b)(1)(A)(i) and Section 1111(b)(2), a secured creditor (whether initially recourse or nonrecourse) may elect to forgo its recourse entitlement and instead have its claim treated as fully secured. If a secured creditor makes this election, then "notwithstanding [the bifurcation provision of] section 506(a) of this title, such claim is a secured claim to the extent that such claim is allowed." 11 U.S.C. § 1111(b)(2). The right to make a Section 1111(b) election serves as another important check against the risk of undervaluation of collateral. If a secured creditor believes that its collateral is undervalued, the creditor may opt to have its total debt treated as secured, rather than have the secured portion of its claim limited to the valuation amount of the collateral. *Ibid.*

4. Section 1129 governs the confirmation of Chapter 11 plans. There are two types of confirmation under Section 1129. Subsection (a) addresses consensual plan confirmation, which requires that all classes of creditors either approve the plan or not be impaired by the plan. 11 U.S.C. § 1129(a). Section 1129(a) sets forth 16 separate requirements that must be satisfied for a plan to be confirmed.

Subsection (b) governs non-consensual plan confirmation under Chapter 11—often referred to as cramdown plans. Section 1129(b) incorporates all the requirements of Section 1129(a), other than subsection (a)(8)'s mandate that all classes either accept the plan or be unimpaired. In addition, Section 1129(b) requires, inter alia, that the plan "not discriminate unfairly, and [be] fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan." 11 U.S.C. § 1129(b)(1). Each secured claim normally is placed in a class by itself. *Brady v. Andrew* (*In re Commercial W. Fin. Corp.*), 761 F.2d 1329, 1338 (9th Cir. 1985).

For a plan to be "fair and equitable" with respect to a class of secured claims, the plan, at a minimum, must satisfy Section 1129(b)(2)(A). That provision includes three distinct methods—each set forth in a separate clause—by which a plan can satisfy the "fair and equitable" requirement with respect to secured creditors. Section 1129(b)(2)(A) states:

> With respect to a class of secured claims, the plan provides—
>
> > (i)(I) that the holders of such claims retain the liens securing such claims, whether the property subject to such liens is retained by the debtor or transferred to another entity, to the extent of the allowed amount of such claims; and

> (II) that each holder of a claim of such class receive on account of such claim deferred cash payments totaling at least the allowed amount of such claim, of a value, as of the effective date of the plan, of at least the value of such holder's interest in the estate's interest in such property;
>
> (ii) for the sale, subject to section 363(k) of this title, of any property that is subject to the liens securing such claims, free and clear of such liens, with such liens to attach to the proceeds of such sale, and the treatment of such liens on proceeds under clause (i) or (iii) of this subparagraph; or
>
> (iii) for the realization by such holders of the indubitable equivalent of such claims.

11 U.S.C. § 1129(b)(2)(A).

B. Factual Background

Petitioners RadLAX Gateway Hotel, LLC and RadLAX Gateway Deck, LLC own and operate a Radisson Hotel and an adjacent, incomplete parking structure near the Los Angeles International Airport. Petitioners obtained a $142 million loan in 2007 to purchase the property, renovate the hotel, and build the parking structure. Pet. App. 3a-4a.

Respondent Amalgamated Bank is the trustee of lender Longview Ultra Construction Loan Investment Fund, in its capacity as administrative agent for itself

and co-lender U.S. Bank National Association. Pet. App. 4a, 41a n.2. U.S. Bank National Association is successor-in-interest to the Federal Deposit Insurance Corporation, as receiver for San Diego National Bank. Pet. App. 41a nn.2-3.

To secure the 2007 loan to petitioners, the lenders obtained a blanket lien on all of petitioners' assets. Bankr. Ct. Dkt. 235 at 6.

During construction of the parking facility, petitioners incurred substantial construction overruns. In 2009, petitioners exhausted their committed funding from the secured lenders and were unable to obtain additional funding or restructuring of the loan. Pet. App. 4a.

Petitioners filed for relief under Chapter 11 in August 2009. As of the filing of the bankruptcy petition, petitioners owed more than $120 million on the loans, with over $1 million in interest accruing each month. Pet. App. 4a-5a.

C. Proceedings Below

1. Petitioners' proposed plan

Petitioners submitted for confirmation a reorganization plan in which they proposed to sell at auction substantially all of their assets free and clear of the liens. Pet. App. 5a. Since substantially all of petitioners' assets were encumbered by the secured creditors' liens, petitioners' plan would have removed the secured creditors' security interest in petitioners' assets. Anticipating the objection of the secured

creditors, petitioners sought to obtain confirmation of their plan using the cramdown provisions of Section 1129(b)(2)(A).

Petitioners' plan treats respondent's claim as undersecured and bifurcates it into a secured portion, defined as the "Prepetition Senior Secured Claim," and an unsecured portion, defined as the "Prepetition Senior Deficiency Claim." J.A. 37.[1] Petitioners seek to invoke clause (iii) of Section 1129(b)(2)(A) to cram down a plan over the objection of respondent, an impaired secured creditor that petitioner has placed in a separate class—Class 3. J.A. 48.

Petitioners' proposed plan provides for the sale of encumbered property free and clear of liens and would leave respondent with nothing more (and indeed less) than the proceeds from that sale. J.A. 37-38 ("Prepetition Senior Secured Claim" and "Lender"), 52-53 ("Class 3"), 65-66 (Section 7.01), 69 (Section 7.06); *see* Pet. Br. 4. For the secured portion of respondent's claim, the plan provides that respondent "shall receive, in full satisfaction," of its claim, "the Sale Proceeds in Cash," minus the administrative claim of petitioners' "financial advisor and investment banker," which was retained to act as petitioners'

[1] Petitioners later submitted two amended plans, the most recent of which is included in the Joint Appendix at 174. Except where otherwise noted, this brief cites petitioners' original plan, because that is the plan that was submitted in conjunction with petitioners' proposed bid procedures. Petitioners' revised plans are substantially the same as their original plan in all respects relevant here.

broker. J.A. 29, 52. Respondent also would receive the balance of the cash on hand, if any, after payment of tax claims, mechanics' liens, and other priority claims. J.A. 52-53.[2] For the unsecured portion of respondent's claim, the plan provides that respondent will receive 5% of the profits over three years, J.A. 54, to be calculated after deducting a 12% return on the purchaser's investment, J.A. 26-27, 39-40.[3]

Petitioners also submitted proposed bid procedures to govern the sale of their assets at the plan auction. Petitioners proposed to sell their assets to a Stalking Horse bidder subject to a higher bid at auction. Pet. App. 5a-6a. A stalking horse bid is an initial bid on a debtor's assets from an interested buyer chosen by the debtor. *Contrarian Funds LLC v. Aretex LLC* (*In re WestPoint Stevens, Inc.*), 600 F.3d 231, 239 n.3 (2d Cir. 2010).

Harp Group, Inc., an entity owned and controlled by petitioners' principal, Peter G. Dumon, had the right to purchase a minority interest in the Stalking Horse bidder. J.A. 105. If the Stalking Horse bidder were to prevail at the auction, the existing management company would continue managing the hotel.

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[2] Petitioners' second amended plan provides that certain mechanics' liens also will be deducted from the proceeds of the sale before payment to respondent, rather than deducted from any cash left on hand. J.A. 210.

[3] Petitioners' second amended plan provides that respondent will receive $250,000 over three years "in full satisfaction" of respondent's unsecured claim. J.A. 213-214.

J.A. 105. That management company also is owned and controlled by Dumon. J.A. 105.

The Stalking Horse bid was only $47.5 million, which represented approximately 37% of the value of the secured creditors' prepetition claims against petitioners. Pet. App. 6a. Petitioners' proposal would have precluded the lenders from protecting their interests by credit bidding at the auction. This prohibition on credit bidding was a condition imposed by the Stalking Horse. J.A. 131.

Specifically, petitioners' proposed plan provides that "[t]he Confirmation Order shall grant the relief requested in the Sale and Bid Procedures Motion and authorize a sale of certain or substantially all of the Debtors' assets under sections 365, 1123(b)(4), 1129(b)(2)(A)(iii), 1145 and 1146(a) of the Bankruptcy Code under the terms and conditions of the Asset Purchase Agreement." J.A. 65-66. Petitioners' proposed bid procedures, in turn, provide that the plan sale "is being conducted under sections 1123(a) and (b) and 1129(b)(2)(A)(iii) of the Bankruptcy Code, and not section 363 of the Bankruptcy Code. As such, no holder of a lien on any assets of the Debtors shall be permitted to credit bid pursuant to section 363(k) of the Bankruptcy Code." J.A. 118, 149.

Respondent Amalgamated Bank, as the lenders' administrative agent, objected to petitioners' proposal. Pet. App. 6a.

2. The bankruptcy court's decision

The bankruptcy court rejected petitioners' bid procedures because they did not allow for credit bidding by the secured lenders. The court held that petitioners "may not use [the indubitable equivalence standard of] section 1129(b)(2)(A)(iii) to sell their assets free and clear of liens." Pet. App. 42a. Rather, to auction their assets free and clear, petitioners "must comply with the specific requirements of section 1129(b)(2)(A)(ii)," which provides for credit bidding under Section 363(k). *Ibid.*

After a trial, the court also concluded that there was no "cause" to deny credit bidding under Section 363(k), rejecting, among other theories, petitioners' claims that respondent and the other lender committed some kind of wrongdoing in the administration of the loan. *Id.* at 43a.

Petitioners appealed. The bankruptcy court certified the appeal directly to the Seventh Circuit under 28 U.S.C. § 158(d)(2)(B)(i) and Rule 8001(f)(2)(A)(i) of the Bankruptcy Rules. Pet. App. 30a. The Seventh Circuit authorized the appeal. J.A. 164.

Petitioners later acknowledged that the Stalking Horse bid was worth many millions of dollars *less* than the value of the property, and that petitioners therefore would not attempt to confirm the proposed plan. J.A. 166-167.

3. The Seventh Circuit's decision

The court of appeals unanimously affirmed the bankruptcy court.

The court of appeals first held that the parties continue to have a live dispute. The court based that conclusion on petitioners' filing of an amended asset purchase agreement that "largely resembled" the agreement that was submitted with the original reorganization plans. Pet. App. 8a.[4]

On the merits, the court of appeals rejected petitioners' argument that Section 1129(b)(2)(A)(iii) permits a cramdown plan to auction a secured creditor's collateral free and clear of its liens without credit bidding. Pet. App. 16a-17a. The court concluded that Section 1129(b)(2)(A)(ii) governs all sales of property free and clear of liens and that subsection (iii) "can only be used to confirm plans that propose disposing of assets in ways that can be distinguished from those covered by Subsections (i) and (ii)." Pet. App. 17a.

As the court of appeals explained, under petitioners' proposed interpretation, "plans could qualify for [confirmation] under Subsection (iii) even if they

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[4] In its brief in opposition, respondent suggested that this Court review "[w]hether the court of appeals correctly held, as a predicate question, that it had jurisdiction over this interlocutory appeal despite petitioners' abandonment of the plan ruled on by the bankruptcy court." Br. in Opp. i. The Court did not grant certiorari on that proposed additional question, and respondent therefore no longer presses it.

seek to dispose of encumbered assets in the ways discussed in Subsections (i) and (ii), but fail to meet these Subsections' requirements." Pet. App. 22a. But that "understanding of Section 1129(b)(2)(A)(iii) is unacceptable because it would render the other subsections of the statute superfluous." Pet. App. 23a. It would "place[ ] the two clauses in conflict" and "allow the general to subsume the specific." Pet. App. 23a n.7 (internal quotations omitted).

The court noted that there would be no reason for Congress to "state that a plan must meet certain requirements if it provides for the sale of assets in particular ways and then immediately abandon these requirements in a subsequent subsection." Pet. App. 23a. Thus, the "infinitely more plausible interpretation" is that each clause "stat[es] the requirements for a particular type of sale" and "'conclusively govern[s] the category of proceedings it addresses.'" Pet. App. 23a-24a (brackets omitted) (quoting *Bloate v. United States*, 130 S. Ct. 1345, 1355 (2010)).

The court of appeals further reasoned that petitioners' interpretation "treats secured creditors' interests in a way that sharply conflicts with the way that these interests are treated in other parts of the Code." Pet. App. 24a. "Sections 363(k) and 1129(b)(2)(A)(ii) provide a secured creditor with the right to credit bid whenever a debtor attempts to sell the asset that secures its debt free and clear of its lien." Pet. App. 24a-25a. "By granting secured parties this ability [to credit bid], the Code provides lenders with means to protect themselves from the risk that the winning

auction bid will not capture the asset's actual value." Pet. App. 19a. "If a secured lender feels that the bids that have been submitted in an auction do not accurately reflect the true value of the asset and that a sale at the highest bid price would leave them undercompensated, then they may use their credit to trump the existing bids and take possession of the asset." *Ibid.* Thus, "the Code promises lenders that their liens will not be extinguished for less than face value without their consent." Pet. App. 19a-20a. Accordingly, the court concluded that petitioners' interpretation "would not provide secured creditors with the types of protections that they are generally accorded elsewhere in the Code." Pet. App. 25a.

SUMMARY OF ARGUMENT

Section 1129(b) governs how a Chapter 11 reorganization plan may be confirmed over the objection of impaired creditors. 11 U.S.C. § 1129(b). For a cramdown plan to be confirmed, the plan must "not discriminate unfairly" and must be "fair and equitable" to dissenting classes of creditors. *Id.* § 1129(b)(1). A plan is "fair and equitable" to a secured creditor class only if, at a minimum, it satisfies one of three distinct paths designed to protect secured creditors, as set forth in clauses (i), (ii), or (iii).

A. Petitioners contend that, because the three clauses in Section 1129(b)(2)(A) are alternatives, they can use clause (iii) to cram down a plan that proposes precisely what is specifically covered by clause (ii)—but without providing the protection for secured

creditors required by clause (ii). That approach cannot be squared with the plain language of Section 1129(b)(2)(A), viewed as a whole.

Section 1129(b)(2)(A) establishes a carefully reticulated scheme, where clauses (i) and (ii) set forth specific requirements for cramdown plans, depending on how the plan proposes to treat the secured creditor's collateral. Clause (i) governs where the plan proposes that the liens will remain on the collateral. Clause (ii) governs where the plan proposes to sell the collateral free and clear of the liens. Clause (iii) governs where the plan proposes to treat the collateral in a way distinct from those in clauses (i) and (ii).

In clause (ii), Congress explicitly required that, for a secured creditor's collateral to be sold free and clear of its liens, the plan must provide the secured creditor the right to credit bid. 11 U.S.C. § 1129(b)(2)(A)(ii). Clause (ii) also delimits the sole, limited exception to the right to credit bid—"for cause."

Petitioners cannot evade this detailed and specific scheme by resorting to the general provision of clause (iii). However inclusive clause (iii)'s "indubitable equivalent" language may be, it cannot encompass what petitioners seek to do here: a sale free and clear of liens where the secured creditor is left with nothing more than the proceeds of the sale, but is not allowed to credit bid. To hold otherwise would render the more specific, and more stringent, requirements of clause (ii) essentially meaningless.

For sales free and clear of liens, Congress eschewed the case-by-case valuation approach sought by petitioners. Given the well-recognized risk of undervaluation of collateral, Congress provided secured creditors the right, in all sales free and clear of liens, to protect their security by credit bidding.

B. This conclusion is confirmed by other provisions of the Code. Section 363(k) and Section 1111(b) work in tandem with Section 1129(b)(2)(A) to protect secured creditors against the undervaluation of their collateral.

Section 363(k) provides the right to credit bid whenever, outside the ordinary course of business, property of the bankruptcy estate is sold free and clear of liens. The credit-bidding right protects secured creditors against attempts to sell their collateral for less than it is worth.

Section 1111(b) also protects against undervaluation of collateral. That provision allows a secured creditor to choose to have its entire allowed claim treated as secured, even if the secured creditor is undersecured. If a secured creditor thinks that the collateral is worth more than the actual or expected judicial evaluation, it can elect to have its entire allowed claim treated as secured.

In a cramdown plan, these protections interact with Section 1129(b)(2)(A) to ensure that, in most circumstances, a secured creditor will receive either its full payment or its collateral. Thus, under clause (i),

a secured creditor who makes a Section 1111(b) election will retain its liens to the full value of its allowed claim and be paid deferred cash payments totaling at least the present value of its allowed claim. Likewise, under clause (ii), the right to credit bid up to the full amount of the secured creditor's allowed claim ensures that the creditor either will be paid its full value or take its collateral.

Petitioners' approach should be rejected because it would disrupt these interlocking protections. And none of the provisions cited by petitioners supports allowing them to circumvent the credit-bidding requirement.

C. Allowing debtors to preclude credit bidding when selling property free and clear of liens would serve no bankruptcy purpose. It also would upset the settled expectations of secured creditors. Secured creditors extend loans with the expectation that the collateral will secure their interest: they either will be repaid or will be able to take their collateral. The Code should not be read as upsetting this background principle.

Credit bidding also maximizes value for the bankruptcy estate. Credit bidding increases competition in the sale, making it more likely that the auction will result in a higher bid. The right to cash bid is no substitute: not all secured creditors will be able to make a cash bid, and even those who can will incur transaction costs just to bid on their own collateral. There is no basis to assume Congress would have

intended such a needless cycling of money from the secured creditor, to the estate, and back again to the secured creditor.

Finally, no legitimate bankruptcy interest supports petitioners' approach. Petitioners seek to deny credit bidding so that their chosen Stalking Horse can obtain the property at a lower-than-market price. Allowing them to do so would simply invite manipulation, malfeasance, and favoritism. Petitioners are wrong to assert that their proposal somehow will generate cash to fund other creditors. Even under petitioners' theory, any cash generated by the sale would belong to respondent until its allowed claim is paid in full.

D. The legislative history supports requiring credit bidding when collateral is sold free and clear of liens. Congress viewed the protections of credit bidding under Section 363(k) and making an election under Section 1111(b) as interlocking, with both serving to protect against undervaluation of collateral. Moreover, the examples Congress gave of what would constitute the "indubitable equivalent" in clause (iii) are distinct from situations expressly governed by clauses (i) and (ii).

ARGUMENT

At issue in this case is whether a debtor can, under clause (iii) of Section 1129(b)(2)(A), do precisely what clause (ii) contemplates but *without* providing the secured creditor with the credit-bidding protection that clause (ii) requires. As both the court of

appeals and the bankruptcy court correctly concluded, the answer is no.

A. Section 1129(b) Precludes Confirmation Of A Plan That Proposes To Sell Collateral Free And Clear Of Liens Without Permitting Credit Bidding

When a Chapter 11 cramdown plan proposes to sell a secured creditor's collateral free and clear of its liens, the plain language of Section 1129(b)(2)(A) requires that the plan provide the secured creditor the right to credit bid.

1. The plain language of Section 1129(b)(2)(A) requires credit bidding when property is sold free and clear of liens

Petitioners' primary argument in support of their reading of Section 1129(b)(2)(A) is that clauses (i), (ii), and (iii) are connected by the disjunctive word "or." Pet. Br. 17. But "or" just means that the debtor need not satisfy all three clauses. 11 U.S.C. § 102(5). It does not define the scope of each clause. It also does not mean that clause (iii) may be used to cram down a plan that sells a secured creditor's collateral free and clear of its liens without allowing it to credit bid.

When Section 1129(b)(2)(A) is construed as a whole, as it must be, the plain language makes clear that the three paths govern distinct situations. *FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 132 (2000) ("a reviewing court should not confine itself to examining a particular statutory provision in isolation"). Which path governs depends on the

proposed treatment of secured creditors' claims under the plan. When, as here, the plan contemplates the sale of property free and clear of a secured creditor's liens, clause (ii) governs and the creditor must be given the right to credit bid.

a. *Clause (i)*. By its terms, clause (i) governs where the plan contemplates that the secured creditor will "retain the liens securing such claims." 11 U.S.C. § 1129(b)(2)(A)(i)(I). Under clause (i), Congress essentially permits the debtor to rewrite its loan for property already secured by liens. 7 Collier, *supra*, ¶ 1129.04[2][a].[5] The secured creditor is protected in clause (i) because, regardless of whether its collateral "is retained by the debtor or transferred to another entity," its liens remain on the property. 11 U.S.C. § 1129(b)(2)(A)(i)(I).

Clause (i) also guarantees the secured creditor the payment of the present value of its secured claim—i.e., "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." 11 U.S.C. § 1129(b)(2)(A)(i)(II).

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[5] The debtor may or may not be the plan proponent. Chapter 11 provides the debtor a 120-day period of exclusivity to file a reorganization plan. 11 U.S.C. § 1121(c)(2). In this case, petitioners are the plan proponents.

As discussed below (*see* pp. 39-41 *infra*), a secured creditor can make an election under Section 1111(b) so that its "claim is a secured claim to the extent that such claim is allowed." 11 U.S.C. § 1111(b)(2). If the secured creditor makes such an election, the total deferred payments it receives under Section 1129(b)(2)(A)(i) must equal (or exceed) the creditor's full claim against the debtor—i.e., "the allowed amount of such claim[ ]." 11 U.S.C. §§ 1111(b)(2), 1129(b)(2)(A)(i)(I).

Clause (ii). In contrast, clause (ii), by its terms, governs when the plan contemplates the sale of "property that is subject to the liens securing such claims, free and clear of such liens." 11 U.S.C. § 1129(b)(2)(A)(ii). In exchange for its secured claim, the secured creditor's liens "attach to the proceeds of such sale." *Ibid.* The resulting lien on the proceeds must then be treated "under clause (i) or (iii) of this subparagraph." *Ibid.*

Although the secured creditor thus may lose its interest in the property originally securing its claim, it still has the opportunity to rely on its collateral to protect itself. Clause (ii) expressly requires that any such sale be "subject to section 363(k)." *Ibid.* Section 363(k) requires credit bidding—"unless the court for cause orders otherwise the holder of such claim may bid at such sale and, if the holder of such claim purchases such property, such holder may offset such claim against the purchase price of such property." 11 U.S.C. § 363(k).

The statutory requirement that the sale be "subject to section 363(k)" provides an important protection against the undervaluation of collateral at sale in bankruptcy. *See, e.g.*, 7 Collier, *supra*, ¶ 1129.04[2][b][ii]. A number of factors may cause a price obtained at the auction of collateral to be undervalued. Pet. App. 20a n.6. For example, quick timing and insufficient notice or marketing may result in potentially interested purchasers being unaware of the sale. Additionally, there is reason to suspect that, by its very nature, *any* bankruptcy sale of property will not produce true market value. Pet. App. 18a-20a.

Finally, the debtor's existing management or ownership may stand to benefit if the assets are sold at a discount to an insider (or a buyer that includes an insider) who will preserve the existing business. This can lead to insider manipulation of the marketing and sale process, often quite subtle and difficult to detect, to achieve that goal. *Gandal v. Telemundo Grp., Inc.*, 997 F.2d 1561, 1562 (D.C. Cir. 1993); *Dynamic Corp. of Am. v. CTS Corp.*, 805 F.2d 705, 711 (7th Cir. 1986); Pet. App. 20a n.6.

Thus, as the court of appeals recognized, the right to credit bid provides secured "lenders with the means to protect themselves from the risk that the winning auction's bid will not capture the asset's actual value." Pet. App. 19a; 7 Collier, *supra*, ¶ 1129.04[2][b][ii]. Because the secured creditor will lose its lien and be entitled only to the "proceeds of such sale," the right to credit bid ensures that if a secured creditor is not going to be repaid in full, it

"may use [its] credit to trump the existing bids and take possession of the asset." Pet. App. 19a.

Clause (iii). Lastly, by its terms, clause (iii) provides a third, catchall path for plans. That clause provides that a cramdown plan may be fair and equitable if it provides "for the realization by such holders of the indubitable equivalent of such claims." 11 U.S.C. § 1129(b)(2)(A)(iii). While the language of clause (iii) is general, its scope is narrow. For something to meet the "indubitable equivalent" standard, it must be beyond any doubt that the creditor will receive the full value of the secured claim. *See* 7 Collier, *supra*, ¶ 1129.04[2][c].

The classic example under clause (iii) is the surrender of some or all of the property to the creditor (often called a "dirt-for-debt" plan). If the secured creditor receives all the collateral itself, there is no question that the creditor receives the true value of the collateral. *Arnold & Baker Farms v. United States* (*In re Arnold & Baker Farms*), 85 F.3d 1415, 1423 (9th Cir. 1996). The standard also may be satisfied by providing suitable substitute collateral (also known as a replacement lien) if "the creditor receives 'substitute of the most indubitable equivalence' providing for present value and safety of principal." *Ibid*. 7 Collier, *supra*, ¶ 1129.04[2][c].[6]

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[6] Plans providing for substitute collateral are disfavored and viewed with skepticism. Rightly so: "The debtor's only motive for substitution of collateral" is that "the substitute

(Continued on following page)

Nothing in the text of clause (iii) permits the debtor to provide *less* protection to a secured creditor than is required by clauses (i) or (ii).

b. Yet here, petitioners attempt to rely on the general language of clause (iii) to do precisely what is specifically governed by clause (ii): namely, to sell the secured creditors' collateral free and clear of their liens and pay them nothing more (and indeed less) than the proceeds from that sale. J.A. 52-53, 65-66, 68; *see* Pet. Br. 4. But petitioners propose to do so without affording the essential protection against undervaluation required by clause (ii): the right to credit bid at the sale. J.A. 118, 149. Petitioners also failed to prove "cause," Pet. App. 43a-44a, the only exception to the right to credit bid.

As the Seventh Circuit correctly held, clause (iii) does not permit such an end-run around the "detailed and carefully tailored language" of clause (ii). Pet. App. 12a, 23a. Rather, viewing Section 1129(b)(2)(A) as a whole, clause (iii) governs cramdown plans that "propose[ ] disposing of assets in ways that are not described in Subsections (i) and (ii)." Pet. App. 24a.

This Court repeatedly has held that "'[a] specific provision' * * * 'controls one[s] of more general application.'" *Bloate*, 130 S. Ct. at 1354 (quoting *Gozlon-Peretz v. United States*, 498 U.S. 395, 407 (1991))

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collateral is likely to be worth less than the existing collateral." *In re River E. Plaza, LLC*, ___ F.3d ___, 2012 WL 169760, at *5 (7th Cir. Jan. 19, 2012).

(brackets in original). In *Bloate*, the Court held that where Congress has provided a list of specific subparagraphs addressing particular circumstances, those options should "govern, conclusively unless the subparagraph itself indicates otherwise." *Id.* at 1355.

Thus, where Congress has turned its attention to a specific situation, and provided a carefully drawn provision to address it, a party cannot evade that better-fitted provision by resorting to a more general one, especially one with fewer restrictions. *See, e.g.*, *Hinck v. United States*, 550 U.S. 501, 506 (2007) (quoting *EC Term of Years Trust v. United States*, 550 U.S. 429, 433 (2007)). This is true "[h]owever inclusive may be the general language of a statute." *Fourco Glass Co. v. Transmirra Prods. Corp.*, 353 U.S. 222, 228 (1957). The general provision "'will not be held to apply to a matter specifically dealt with in another part of the same enactment.'" *Ibid.* (quoting *D. Ginsberg & Sons, Inc. v. Popkin*, 285 U.S. 204, 208 (1932)).

Here, clause (ii) explicitly addresses cramdown plans that contemplate a sale of the secured creditor's collateral free and clear of its liens that would leave the creditor with nothing more than the proceeds from that sale. 11 U.S.C. § 1129(b)(2)(A)(ii). Clause (ii) provides that such a plan can be "fair and equitable" only if it allows the secured creditor the right to credit bid. *Ibid.* Thus, "however inclusive" the general language of clause (iii)'s indubitable equivalent requirement may be, it cannot be read to permit a sale free and clear of the secured creditor's liens

without allowing credit bidding. *Fourco Glass Co.*, 353 U.S. at 228.

This conclusion is confirmed by the fact that clause (ii) expressly provides a role for clause (iii)'s indubitable equivalence requirement when a debtor sells property free and clear of liens. Specifically, clause (ii) provides that the secured creditor's liens will attach to the proceeds of the sale, with "the treatment of such liens on proceeds under clause (i) or (iii)." 11 U.S.C. § 1129(b)(2)(A)(ii). Thus, by the terms of clause (ii), clause (iii) comes into play in a sale free and clear of liens only *after* there has been a sale at which the secured creditor has had the right to credit bid.

Petitioners cannot skip this critical step and go straight to clause (iii)'s assessment of indubitable equivalence. Petitioners' interpretation would "allow[ ] the debtor to decide unilaterally to deny credit bidding, with only a belated court inquiry at confirmation to determine whether the denial of credit bidding was 'fair and equitable' to the secured lenders." *In re Philadelphia Newspapers, LLC*, 599 F.3d 298, 333 n.18 (3d Cir. 2010) (Ambro, J., dissenting). Congress rejected that approach. Instead, it required credit bidding as a "crucial check" against the "substantial risk that assets sold in bankruptcy auctions will be undervalued." Pet. App. 20a-21a.

Moreover, Congress expressly addressed the circumstance in which an objecting secured creditor's

collateral could be sold free and clear of liens without credit bidding. It determined that the right to credit bid should be afforded "unless the court for cause orders otherwise." 11 U.S.C. § 363(k). This is a narrow exception, as petitioners acknowledge, which they tried and failed to satisfy. Pet. Br. 35 (noting that the "cause exception in § 363(k) * * * is generally reserved for creditor malfeasance or priority disputes among lien holders"); Pet. App. 43a-44a. Given that Congress expressly delimited in clause (ii) when credit bidding can be denied, clause (iii) should not be read to create sub silentio a much broader exception.

Furthermore, as the Seventh Circuit concluded, petitioners' interpretation of clause (iii) "would render the other subsections of the statute superfluous." Pet. App. 23a. Reading clause (iii) to permit a sale of collateral free and clear of liens, without complying with clause (ii)'s express credit bidding requirement, would rob clause (ii) of its essential meaning. *Bloate*, 130 S. Ct. at 1354. It would have made little sense for Congress to have imposed such a specific requirement in one provision, only to have permitted evasion of that very same requirement in another. *Ibid.*

2. Petitioners' "plain language" arguments are unavailing

a. Petitioners' reliance on "includes" and "provides" (Pet. Br. 17-18) is as misplaced as their reliance on "or." *See* p. 22, *supra*.

The term "includes" is in the opening clause of Section 1129(b)(2) as a whole, not the opening clause

of subparagraph (A) dealing with secured creditors. *See* 11 U.S.C. § 1129(b)(2) ("the condition that a plan be fair and equitable with respect to a class *includes* the following requirements" (emphasis added)). This "includes" simply means that Section 1129(b)(2) sets forth the *minimum* "requirements" that a plan must meet in order to be considered "fair and equitable" to secured creditors (in paragraph (A)), unsecured creditors (in paragraph (B)), and interests (in paragraph (C)). *Federal Sav. & Loan Ins. Corp. v. D & F Constr. Inc.* (*In re D & F Constr. Inc.*), 865 F.2d 673, 675 (5th Cir. 1989); 7 Collier, *supra*, ¶ 1129.04[1]; 11 U.S.C. § 102(3) ("'includes' and 'including' are not limiting").

Even if "includes" were somehow read to make the three clauses in subparagraph (A) merely illustrative, that would not provide petitioners with "flexibility" (Pet. Br. 18) to evade the carefully drawn provisions of clause (ii). Sales of property free and clear of liens still would be governed by clause (ii)'s specific provisions. As this Court has explained, the fact that a list of provisions "is illustrative rather than exhaustive in no way undermines [the] conclusion" that a situation falling within one of the provisions "is governed by the limits in that [provision]." *Bloate*, 130 S. Ct. at 1354.

Moreover, the relevant opening clause is that of subparagraph (A). This opening clause states that for a plan to be "fair and equitable" "[w]ith respect to a class of secured claims," the plan must "*provide*[ ]" at least one of three alternatives to the class of secured

claims. 11 U.S.C. § 1129(b)(2)(A) (emphasis added). This language makes clauses (i), (ii), and (iii) not merely illustrative.

Contrary to petitioners' contention (Pet. Br. 17), nothing about the term "provides" in subparagraph (A)'s opening clause supports their interpretation. To be sure, when the plan proponent is the debtor, it can "select[ ] which of the three alternatives to pursue." Pet. Br. 17. But that says nothing about the scope of each alternative. It does not mean that a plan proponent can propose a sale free and clear of liens without satisfying the requirements of clause (ii).

b. Petitioners' attempts to avoid well-established canons of construction fare no better.

Petitioners contend that clauses (i) and (ii) provide procedural protections while clause (iii) imposes a different, more exacting substantive protection. Pet. Br. 29-31. According to petitioners, this means "neither subsection is more specific or more general than the other." Pet. Br. 30. They further assert that this means that their interpretation does not render clause (ii) superfluous. Pet. Br. 32.

As an initial matter, petitioners' substantive-versus-procedural argument ignores that the inquiry in each of the three clauses is aimed at determining what is "fair and equitable." 11 U.S.C. §§ 1129(b)(1), (2). *That*, not the "indubitable equivalent" requirement, is the substantive requirement that all cramdown plans must satisfy. *Ibid.* Each of the three clauses is designed to ensure, depending on the

proposed treatment of secured creditors' claims, that a secured creditor either receives full payment for its secured claims or can take the collateral that secures those claims. At bottom, what petitioners seek to do is substitute their preferred procedure—post hoc judicial valuation—for the credit-bidding procedure required by Congress.

In any event, petitioners fail to explain why their supposed substantive-versus-procedural distinction would mean that the credit-bidding requirement of clause (ii) could be evaded by resort to clause (iii). Regardless of whether credit bidding is characterized as procedural or substantive, Congress expressly determined that the right to credit bid is necessary, at a minimum, to render "fair and equitable" a plan that proposes to sell the secured creditor's collateral free and clear of its liens. Where, as here, two provisions (clauses (ii) and (iii)) could be capable of governing that type of sale, the more specific provision controls. *See, e.g.*, *Bloate*, 130 S. Ct. at 1354.

Petitioners attempt to distinguish *Bloate*, contending that, in that case, the "'specific governs the general' canon applied because the limiting subparagraph (D) was a subset of the more general § 3161(h)(1)." Pet. Br. 31. But the specific provision need not be a "subset" of the general for the specific provision to control. Indeed, the provisions do not even need to be in the same statute. *Fourco Glass*, 353 U.S. at 228-229 ("specific terms prevail over the general *in the same or another statute* which otherwise might be controlling" (emphasis added)); *see also*

Morales v. Trans World Airlines, Inc., 504 U.S. 374, 384-385 (1992); *HCSC-Laundry v. United States*, 450 U.S. 1, 6, 8 (1981). The important point is that, when Congress has enacted a provision with requirements carefully drawn to address a particular situation, that provision cannot be evaded by resort to a more general—particularly a more generous—provision. *See*, *e.g.*, *Hinck*, 550 U.S. at 506.

Petitioners' reading would render this carefully tailored scheme superfluous. On that point, their only response is that, even if clause (iii) allows sales free and clear of liens, a debtor still might "opt to pursue confirmation under subsection (ii) and simply permit the creditor to credit bid at the sale." Pet. Br. 32. That misses the point. Under their interpretation, "[t]he Bankruptcy Code would not need the 'intricate phraseology,' of the three clauses under § 1129(b)(2)(A)," because the debtor could simply proceed under clause (iii) with a sale that allows credit bidding. *Philadelphia Newspapers*, 599 F.3d at 330 (Ambro, J., dissenting) (quoting *United Sav. Ass'n of Texas v. Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365, 373 (1988)).

c. Nor is there merit in petitioners' suggestion that the court of appeals erroneously conflated the approval of bid procedures with plan confirmation.

Petitioners claim that "[a]pproval of auction bid procedures and confirmation of a plan are two separate and distinct parts of the chapter 11 process" and that "[t]he only question currently before the Court is

whether the Debtors may proceed with the auction using bid procedures that preclude credit bidding." Pet. Br. 40.

That is not so. The question that petitioners presented to this Court is "[w]hether a debtor may pursue a chapter 11 *plan* that proposes to sell assets free of liens without allowing the secured creditor to credit bid * * *." Pet. i (emphasis added).[7] Petitioners' proposed bid motion and plan are expressly interrelated. J.A. 65-66, 109, 223. They contemplate a cramdown plan that will provide for the sale of collateral free and clear of liens and leave the secured creditors with nothing more (and indeed less) than the proceeds of that sale. J.A. 52-53, 65-66, 68; *see* Pet. Br. 4. This is the precise situation specifically addressed by clause (ii), and it requires credit bidding.[8]

Regardless of whether an auction without credit bidding *could* result in an amount of proceeds that is

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[7] If petitioners are correct that the plan is not "before the Court" (Pet. Br. 40), the Court should dismiss the petition as improvidently granted.

[8] Moreover, if petitioners' proposed sale is somehow separate from the plan, and thus not a plan sale, the only other provision of the Bankruptcy Code that would allow such a sale would be Section 363(b). 11 U.S.C. § 363(b). That provision governs during the course of a bankruptcy proceeding outside the ordinary course of the debtor's business, including when the sales are free and clear of liens under 11 U.S.C. § 363(f). *Ibid.* By its terms, Section 363(k)'s credit-bidding requirement applies to "a sale under subsection (b) of this section." 11 U.S.C. § 363(k).

as much as would result if the secured creditors were allowed to credit bid (*see* Pet. Br. 40-41), that is not a basis to preclude credit bidding. If the auction produces bids sufficient to satisfy the secured creditor, it need not exercise its right to bid.

More importantly, Congress already specifically addressed this situation and eschewed petitioners' case-by-case approach. Recognizing the risk of undervaluation of the present value of the collateral in a sale free and clear of liens, Congress required credit bidding in all such sales to ensure that secured creditors' liens would "not be extinguished for less than face value without their consent." Pet. App. 19a-20a.[9]

B. Depriving A Secured Creditor Of Its Right To Credit Bid Cannot Be Reconciled With The Structure Of Chapter 11

The conclusion that Section 1129(b)(2)(A) requires the right to credit bid when collateral is sold free and clear of an impaired creditor's liens is confirmed by the structure of the Bankruptcy Code. As

[9] Although not at issue in this case, this protection would be just as necessary if a plan proposed to sell collateral free and clear of liens and provide the secured creditor the proceeds of that sale supplemented by some other form of compensation. *See* Pet. Br. 45. In that situation, the risk that the proceeds portion of the compensation would be undervalued would be no different than where, as here, the plan proposed to give nothing more than the proceeds. Moreover, allowing such a proceeds-plus-compensation plan under clause (iii) would invite evasion of clause (ii)'s carefully drawn requirements.

this Court repeatedly has held, particularly in the context of the Bankruptcy Code, "[s]tatutory construction * * * is a holistic endeavor." *United Sav. Ass'n*, 484 U.S. at 371. A provision is "often clarified by the remainder of the statutory scheme * * * because only one of the permissible meanings produces a substantive effect that is compatible with the rest of the law." *Ibid.* Here, the court of appeals correctly rejected petitioners' interpretation because it would "treat[ ] secured creditors' interests in a way that sharply conflicts with the way that these interests are treated in other parts of the Code." Pet. App. 24a. In particular, it "would make an anomalous distinction between those sales free of liens conducted prior to plan confirmation under § 363 and those sales free of liens conducted as part of a cramdown plan under § 1129(b)(2)(A)." *Philadelphia Newspapers*, 599 F.3d at 333 (Ambro, J., dissenting).

1. Other interlocking Code provisions confirm that credit bidding is required

Three provisions of the Bankruptcy Code work together to protect secured creditors against undervaluation of their collateral: Section 363(k), Section 1111(b), and Section 1129(b)(2)(A)(ii). Section 1129(b) was enacted in conjunction with Section 1111(b), and the two cannot be viewed in isolation. 124 Cong. Rec. 32,406 (1978) (statement of Rep. Don Edwards)

("Before discussing section 1129(b) an understanding of section 1111(b) is necessary.").[10]

a. Section 363(k) prevents the undervaluation of property secured by a creditor's liens by permitting credit bidding.

During the course of a bankruptcy proceeding, Section 363 allows for the sale, outside the ordinary course of the debtor's business, of property free and clear of liens under certain conditions. 11 U.S.C. § 363(b), (f). One such condition is that the secured creditor that holds the lien on the property has the right to credit bid up to the full amount of its claim toward the purchase of the property. 11 U.S.C. § 363(k). Section 363(k) provides:

> At a sale * * * of property that is subject to a lien that secures an allowed claim, unless the court for cause orders otherwise the holder of such claim may bid at such sale, and, if the holder of such claim purchases such property, such holder may offset such claim against the purchase price of such property.

11 U.S.C. § 363(k).

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[10] "Because of the absence of a conference and the key role[ ] played by Representative Edwards," this Court has treated his "floor statements on the Bankruptcy Reform Act of 1978 as persuasive evidence of congressional intent." *Begier v. IRS*, 496 U.S. 53, 64 n.5 (1990).

As the court of appeals recognized, the right to credit bid under Section 363(k) "provides lenders with means to protect themselves from the risk that the winning auction bid will not capture the asset's actual value." Pet. App. 19a. An accurate valuation of the current value is important to secured creditors because "any amount bid * * * up to the value of Lender's full claim becomes the secured portion of Lender's claim by definition." *Cohen*, 432 F.3d at 460. Section 363(k) thus "gives the secured creditor protections against attempts to sell the collateral too cheaply; if 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." 7 Collier, *supra*, ¶ 1129.04[2][b][ii].

Conversely, a lender need not use its credit to outbid other bidders unless the lender believes it could generate a greater return on the property than the return represented by the highest bidder's offer. *Ibid.* To the extent that a secured creditor credit bids the full value of its claim and loses at auction to a higher bid, that creditor was not undersecured because the value of the collateral was more than the total claim.

b. Section 1111(b) likewise protects secured creditors from undervaluation of their collateral.

This provision works in tandem with Section 506(a), which bifurcates an undersecured creditor's claim into a secured claim to the amount of the collateral and an unsecured claim for the deficiency.

11 U.S.C. § 506(a)(1).[11] In other words, if the creditor is owed $75 secured by a lien on property worth $50, that creditor has a secured claim for $50 and an unsecured claim for $25. Under Section 1111(b)(2), however, a class of secured creditors may elect instead to have their claims treated as fully secured, notwithstanding the fact that the collateral may be valued at less than the total claim. 11 U.S.C. § 1111(b)(2).

If a class of secured creditors makes this Section 1111(b)(2) election, then "such claim is a secured claim to the extent that such claim is allowed." *Id.* § 1111(b)(2). If a Section 1111(b)(2) election is made, the debtor may retain the collateral only by paying the creditor the full amount of its claim.

The right to make a Section 1111(b)(2) election serves as a check against undervaluation of collateral and preserves the secured creditor's benefit of its original bargain. If the creditor believes that the collateral is worth more than the bankruptcy court's actual or expected valuation, the creditor can keep its whole lien and forfeit its right to an unsecured claim for the difference between the total claim and the court's valuation of the collateral. Section 1111(b) thus "protects the legitimate expectation of secured lenders that the bankruptcy laws will be used only as

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[11] Under Section 1111(b)(1)(A), a secured creditor will be treated as a "recourse" lienholder, regardless of whether the creditor actually has recourse. *See* pp. 6-7, *supra*.

a shield to protect debtors and not as a sword to enrich debtors at the expense of secured creditors." 7 Collier, *supra*, ¶ 1111.03.

c. In a Section 1129(b)(2) cramdown plan, the interaction between Sections 363(k) and 1111(b) ensures that, in most circumstances, a secured creditor either will receive payment for its full claim or will be able to take possession of its collateral.

Clause (i). When a cramdown plan contemplates that the debtor's property will remain subject to liens, the secured creditor has the right to elect under Section 1111(b)(2) that its entire allowed claim be treated as a secured claim. *See* 11 U.S.C. §1129(b)(2)(A)(i). If the creditor so elects, it will retain liens on the entire allowed amount of its claim. In other words, if a secured creditor has a claim for $10 million secured by liens on property now worth $8.5 million, the creditor will retain liens with a face value of $10 million on the property. 11 U.S.C. § 1129(b)(2)(A)(i)(I) (creditor "retain[s] the liens securing such claims * * * to the extent of the allowed amount of such claims").

Moreover, the Code requires that the secured creditor receive "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." 11 U.S.C. § 1129(b)(2)(A)(i)(II). This means that the creditor must receive the present value of the collateral (i.e., "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"). And the "deferred cash payments" must total "at least the allowed amount of such claim"—which if there has been a Section 1111(b)(2) election is the face value of the total allowed claim.

Thus, in the example above, if the creditor has made a Section 1111(b)(2) election, a Section 1129(b)(2)(A)(i) cramdown plan under which the debtor retains the collateral must provide the following: "The amount of principal payments to the secured creditor must equal $10 million, as that is its 'allowed secured claim.' But the plan proponent need only give the creditor a note that has a present value of $8.5 million." 7 Collier, *supra*, ¶ 1111.03[6][B] (footnote omitted). Thus, the Section 1111(b)(2) election ensures that "the debtor is not taking advantage of inaccurate nonmarket valuation," *ibid.*, or seeking merely to rewrite a loan on more favorable terms.

Indeed, the very purpose of applying Section 1111(b) to this type of circumstance is to preclude debtors from misusing the Bankruptcy Code to rid themselves of liens and repay secured loans at a discount based on an inaccurate valuation of the collateral. It also serves to protect against "the harsh result of" *In re Pine Gate Assocs.*, 2 Bankr. Ct. Dec. 1478 (Bankr. N.D. Ga. 1976), under which "a debtor could file bankruptcy proceedings during a period when real property values were depressed, propose to repay secured [nonrecourse] lenders only to the extent of the then-appraised value of the property, and

'cram down' the secured lender class, preserving any future appreciation of the property for the debtor." *Tampa Bay Assocs. v. DRW Worthington, Ltd.* (*In re Tampa Bay Assocs.*), 864 F.2d 47, 49-50 (5th Cir. 1989).

Clause (ii). In contrast, if the debtor's property is to be sold free and clear of liens, the Section 1111(b) election is not an option. *See* 11 U.S.C. § 1111(b)(1)(B)(ii) (election may not be made if "such property is sold under section 363 of this title or is to be sold under the plan"). But in that circumstance, clause (ii) of Section 1129(b)(2)(A) protects the secured creditor against the risk of undervaluation. Similar to the Section 1111(b) election, clause (ii) provides the right to credit bid the full amount of the allowed claim (not merely the amount of the allowed secured claim).

As one of the principal drafters of the Bankruptcy Code has explained: secured creditors are "ineligible to make the [Section 1111(b)] election if the holders have recourse against the debtor and the collateral is sold. The recourse creditor will be able to bid in its claim when the collateral is sold and may have an unsecured claim for any deficiency." Kenneth N. Klee, *All You Ever Wanted to Know About Cram Down Under the New Bankruptcy Code*, 53 Am. Bankr. L.J. 133, 153 (1979); *see also* 7 Collier, *supra*, ¶ 1129.04[2][b][ii] ("If a sale is contemplated, that sale will preclude a secured creditor from making an election under section 1111(b) so long as the secured creditor's rights to credit bid the entire amount of its

debt is preserved."). The Section 1111(b)(2) election and the right to credit bid in Section 1129(b)(2)(A)(ii) are thus "opposite sides of the same coin," *Philadelphia Newspapers*, 599 F.3d at 334 (Ambro, J., dissenting)—by linking the secured creditor's rights to the full amount of its claim, they give the secured creditor the right to forgo all or part of the unsecured portion of its claim to ensure that the current value of its secured portion is not undervalued.

Petitioners' interpretation of Section 1129(b)(2)(A) therefore should be rejected because it would disrupt these careful protections created by Congress. There is no reason to believe that Congress created this elaborate scheme to protect secured lenders against the undervaluation of their collateral just to have it undone through clause (iii).

2. The other provisions in the Code on which petitioners rely do not support their reading of Section 1129(b)(2)(A)

a. In an attempt to respond to the elaborate, interlocking protections afforded by Sections 1111(b)(2) and 363(k), petitioners claim that there are "numerous situations where the Code provides *neither* protection." Pet. Br. 34. But nothing petitioners cite supports their attempt to circumvent the credit-bidding requirement in Section 1129(b)(2)(A)(ii).

First, petitioners point to the "cause" exception to credit bidding in Section 363(k). Pet. Br. 35. As discussed above, *see* pp. 29-30 *supra*, that express, limited exception counsels against reading the general

language of clause (iii) of Section 1129(b)(2)(A) to be an unstated, much broader exception. Moreover, that the Code strictly limits the circumstances where credit bidding can be denied (such as for malfeasance) confirms the importance of that right to secured creditors.

Second, petitioners point to 11 U.S.C. § 1111(b)(1)(B)(ii) to claim that, "if a debtor transfers collateral subject to a lien to a third party under § 1129(b)(2)(A)(i), the secured creditor is not entitled to make the § 1111(b) election because the collateral is sold." Pet. Br. 34. Laying aside that "transfers" under clause (i) of Section 1129(b)(2)(A) may not be "sales," it is far from clear that the plan petitioners hypothesize would be deemed "fair and equitable."

In any event, as a practical matter, any such sale under clause (i) is unlikely to occur when the secured creditor is undersecured. This is so because, under clause (i), the creditor would retain the lien, and the collateral would be sold subject to the liens. 11 U.S.C. § 1129(b)(2)(A)(i). For example, if a secured creditor were undersecured in a property currently worth $1 million, a buyer would be unlikely to pay anything at all (let alone anything close to $1 million) for a property that would remain subject to $1 million in liens, because the buyer would get no equity for his money. *See* 7 Collier, *supra*, ¶ 1129.04[b][iv] (a sale subject to liens "will reduce the price an intelligent buyer will pay for the collateral"). Even if such a sale were to occur, it would not present the same risk as petitioners' plan because the secured creditors would

retain their lien and hence would retain the benefit of their security.

Third, petitioners' final two examples likewise do not support their position. Pet. Br. 35. They note that a creditor cannot make an election under Section 1111(b) when its interest in the collateral is inconsequential or of no value. Petitioners further observe that the Code expressly allows a debtor to modify a lien to implement its plan. *Ibid.* (citing 11 U.S.C. § 1123(a)(5)(E)). Petitioners argue that these provisions support their reading of clause (iii) because they purportedly allow the debtor to take actions to inure to itself the "upside" potential of the collateral. Pet. Br. 35-36.

Even assuming that is so, that misses the point here. Petitioners are simply wrong in asserting that credit bidding is just about seeking "the upside potential of * * * collateral." Pet. Br. 28; *see* Pet. Br. 33. Credit bidding, as Congress recognized in Section 1129(b)(2)(A)(ii) and Section 363(k), is essential to an accurate determination of the *present* value of the collateral. It protects the secured creditor when "the bids that have been submitted in an auction do not accurately reflect the true value of the asset." Pet. App. 19a.

b. Petitioners also point to Section 1123(a)(5)(D), contending that it permits the sale of property "free of any lien," without mandating credit bidding. Pet. Br. 21. But that provision creates no substantive right to sell property free and clear of liens, let alone a

substantive right to do so without permitting credit bidding. Rather, Section 1123(a)—entitled "Contents of plan"—merely sets forth a *list* of the general kinds of provisions that a plan may include to meet the mandate that the plan provide "adequate means for its implementation." 11 U.S.C. § 1123(a).

Section 1123(a) thus does not purport to set forth substantive requirements for the various components that must be included in the plan. Other provisions, such as Section 1129, provide those substantive requirements. *See, e.g.*, 11 U.S.C. § 1129(a) ("The court shall confirm a plan only if all of the following requirements are met * * * ."). In the cramdown context, clause (i) of Section 1129(b)(2)(A) addresses plans that provide that lienholders "retain the liens securing such claims," and clause (ii) addresses plans that provide "for the sale * * * of any property * * * free and clear of such liens."

Petitioners' reliance on Section 363(*l*) is therefore misplaced. Petitioners point to that provision for the proposition that Congress knows how to require credit bidding under a Chapter 11 plan if it wants to. Pet. Br. 21. But that ignores that Congress *did* expressly require credit bidding in the very type of cramdown plan that petitioners propose: Section 1129(b)(2)(A)(ii) explicitly incorporates the credit-bidding requirements of Section 363(k).

c. Petitioners further assert that Section 1129(b)(2)(A)(iii)'s "indubitable equivalent" requirement is not limited by clause (ii)'s credit bidding

requirement because Congress expressly provided limitations in Section 361, a different indubitable equivalent requirement. Pet. Br. 19, 43.

Section 361 provides that "adequate protection" may be provided by "granting such other relief, other than entitling such entity to compensation allowable under section 503(b)(1) of this title as an administrative expense, as will result in the realization by such entity of the indubitable equivalent of such entity's interest in such property." 11 U.S.C. § 361(3). Pointing to that provision's "such other relief" and "other than" limitations, petitioners contend that the absence of a similar limitation in Section 1129(b)(2)(A)(iii) demonstrates that Congress intended for clause (iii) to encompass the precise circumstances addressed by clause (ii).

That is not so. Even if "other" appeared in Section 1129(b)(2)(A)(iii), petitioners likely would be advancing the same argument they make here, i.e., that they are doing something "other" than clause (ii). In any event, as explained above, interpretive canons of construction foreclose their resort to the more general provision of clause (iii) in the face of Congress's carefully drawn scheme for sales free and clear in clause (ii). *See* pp. 27-30 *supra.*

d. Petitioners suggest that Section 506(a), by bifurcating an undersecured creditor's allowed claim into a secured claim and an unsecured claim, eliminates the need for credit bidding. Pet. Br. 24-25, 27. Petitioners state that the Code establishes adequate procedures to ensure that the present value of a

secured creditor's collateral is protected during the pendency of bankruptcy (Pet Br. 24) and then is realized by the secured creditor at plan confirmation (Pet. Br. 25-27).

But as petitioners acknowledge, that ultimate realization by the secured creditor will depend upon accurately setting "the present value of its collateral when the plan is confirmed." Pet. Br. 25. As petitioners also acknowledge (Pet. Br. 26-27), that is the purpose of Section 1129(b)(2)(A). So this argument merely begs the question presented.

Likewise, petitioners' assertions (Pet. Br. 27-28) that, once bifurcated, a secured creditor's unsecured deficiency claim will be adequately protected says nothing about the correct interpretation of Section 1129(b)(2)(A). The important point for present purposes is to ensure that the secured portion of the secured creditor's claim is accurately valued at confirmation, so that the deficiency claim will be no larger than it should be. Otherwise, value will be wrongly diverted from the secured creditor to third parties, including junior interests.

C. No Purpose Would Be Served By Precluding Credit Bidding When Property Is Sold Free And Clear Of Liens

1. Credit bidding preserves the settled expectations of secured creditors when they bargain for a security interest

When Congress enacted the Bankruptcy Code, it did not "write 'on a clean slate.'" *Dewsnup v. Timm*,

502 U.S. 410, 419 (1992) (quoting *Emil v. Hanley (In re John M. Russell, Inc.)*, 318 U.S. 515, 521 (1943)). Rather, the Code preserves the bargains made under state law unless some federal interest requires a different result. *Butner v. United States*, 440 U.S. 48, 55 (1979). But petitioners would have this Court create a major change that would upset the expectations of creditors.

A secured creditor bargains for the right to be repaid under certain terms or else to take possession of the collateral—i.e., to get either its money or the property. Thus, in setting the pricing at which they are willing to lend, secured creditors have relied on their ability to foreclose and take possession of the collateral under state law if the loan is not repaid. *Philadelphia Newspapers*, 599 F.3d at 337 (Ambro, J., dissenting); 7 Collier, *supra*, ¶ 1129.04[2][a][v] ("loans have different rates depending" on creditor's collection rights). In addition, the right of the lender to credit bid at a foreclosure sale has a long history under state law. Alan N. Resnick, *Denying Secured Creditors the Right to Credit Bid in Chapter 11 Cases and the Risk of Undervaluation*, 63 Hastings L.J. 323, 331 (2012) ("Credit bidding was recognized under common law."); *see also Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555, 594-595 (1935) (holding that statute violated Takings Clause because, inter alia, it effectuated the taking of secured creditor's right to bid at sale of collateral).

In giving secured creditors the right to credit bid, Congress thus chose to protect the settled expectations

of the secured creditor when it made the loan. S. Rep. No. 95-989, at 53 (1978) ("Secured creditors should not be deprived of the benefit of their bargain."); H.R. Rep. No. 95-595, at 339 (1977) (same). As Judge Ambro correctly explained, under the "settled expectations of secured lending," a secured creditor is "assured of (1) retaining its lien on collateral and a payment stream, (2) a sale of collateral free of its liens with a corresponding right to credit bid, or (3) equivalent substitute collateral or the ability to take abandoned collateral." *Philadelphia Newspapers*, 599 F.3d at 337 (Ambro, J., dissenting). This Court should uphold that choice.

2. Credit bidding furthers the policy of maximizing the value of the bankruptcy estate

Credit bidding also furthers the "general Code policy of maximizing the value of the bankruptcy estate." *Toibb v. Radloff*, 501 U.S. 157, 163 (1991) (citing *Commodity Futures Trading Comm'n v. Weintraub*, 471 U.S. 343, 351-354 (1985)). Credit bidding, by definition, increases the number of available bidders at the auction. The estate benefits from increased competition between the bidders, because the auction price is more likely to be bid up. Vincent S. J. Buccola and Ashley C. Keller, *Credit Bidding and the Design of Bankruptcy Auctions*, 18 Geo. Mason L. Rev. 99, 117-120 (2010).

For example, if an asset is being auctioned and the stalking horse has an opening bid of $50,000 but the secured creditor has a $70,000 lien, if credit

bidding is permitted then there is a much greater chance that the stalking horse bidder will have to bid more than $50,000 to obtain the property. Without credit bidding, if the secured creditor is unable to come up with cash to bid, then the stalking horse is constrained only if there are other bidders that have enough cash in hand to outbid the stalking horse's opening bid. "Forbidding the credit bidder from credit bidding thus reduces the expected returns from the sale." *Id.* at 120.

By creating a better chance that the auction will result in a higher bid, credit bidding also helps other creditors. In the above example, credit bidding is more likely to result in a final sale at auction of $80,000, which is $10,000 more than the total secured claim. "In that case, the lender is paid in full, and the excess proceeds are returned to the debtor for distribution to other creditors." Jason S. Brookner, Pacific Lumber *and* Philadelphia Newspapers*: The Eradication of a Carefully Constructed Statutory Regime Through Misinterpretation of Section 1129(b)(2)(A) of the Bankruptcy Code*, 85 Am. Bankr. L.J. 127, 141 (2011). Therefore, the estate as a whole benefits from credit bidding.

Moreover, the secured creditor is a "key market participant" that likely has a better-informed view about the true value of the collateral and has "a vested interest in the outcome of the auction." *Id.* at 146; *see also* Buccola & Keller, *supra*, 18 Geo. Mason L. Rev. at 120. Precluding credit bidding may exclude the party that has the most interest and incentive to

value the property highly and thus may result in leaving "money on the table." Buccola & Keller, *supra*, 18 Geo. Mason L. Rev. at 120.

The secured creditor may choose not to credit bid its entire claim. Instead, it may credit bid to force the cash bids of others up to a point somewhere close to what it thinks the actual value of the collateral is, then take the proceeds. Thus, even if the lender does "not desire to own the property," it "may still increase its bid by using a credit bid to maximize its own return on its collateral." Brookner, *supra*, 85 Am. Bankr. L.J. at 141. Many secured creditors would rather take cash than have to deal with sustaining and then disposing of collateral.

Credit bidding also reduces transaction costs. If the "lender does not have sufficient liquidity to make a cash bid or needs to incur short-term borrowing costs," then "the need to make a cash bid instead of a credit bid could prove costly for the lender." Resnick, *supra*, 63 Hastings L.J. at 355. Generating cash to bring to the auction often means that the creditor must try to secure funding from banks—which is not free. "The Bank, after all, is not a charitable enterprise. If the creditor seeks a loan, even one with a short duration that is highly secured, he will have to pay the Bank for the use of its money." Buccola & Keller, *supra*, 18 Geo. Mason L. Rev. at 121. The "interest and fees" charged to the creditor "will reduce the amount the credit bidder is willing to bid for debtor's assets on a one-for-one basis," *ibid.*, which potentially reduces the final sale amount and the

cash flowing into the estate. By the same token, the secured creditor may be forced to "sacrifice short-term opportunity costs with regard to other potential uses" of the cash that it must commit to an auction of its collateral for at least some period of time. Resnick, *supra*, 63 Hastings L.J. at 355.

This also assumes, incorrectly, that the creditor always will be able to generate cash for a bid. Banks "do not hand out $740 million or $300 million casually. They require time to conduct due diligence to ensure that, for instance, the secured creditor actually has a perfected security interest in all of the collateral up for sale." Buccola & Keller, *supra*, 18 Geo. Mason L. Rev. at 123-124. Because "the time between the announcement and performance of the auction can be as truncated as a matter of days, secured creditors may lack the time to secure capital." *Id.* at 124 (footnote omitted). Indeed, "the recent financial crisis confirms that there are periods where capital is scarce even to the most credit-worthy borrowers." *Ibid.* In such times, lenders themselves may therefore be short of capital for cash bidding on a loan they made in better times. Some lenders may be contractually prohibited from incurring debt. Thus, "prohibiting credit bidding is often the same as preventing the secured creditors from submitting a bid" at all. *Id.* at 123.

3. Petitioners' approach serves no legitimate bankruptcy interest

Petitioners' approach, by contrast, serves no legitimate bankruptcy policy. The only reason to deny

credit bidding here would be to allow the Stalking Horse to obtain the property for a lower-than-market price. Denying credit bidding does nothing for the estate.

To the contrary, it "undermine[s] the Bankruptcy Code by skewing the incentives of the debtor to maximize benefits for insiders, not creditors." *Philadelphia Newspapers*, 599 F.3d at 337 (Ambro, J., dissenting). It opens up the process to manipulation, malfeasance, and favoritism. It enables the stalking horse to attempt to "acquire the debtor's assets on the cheap" by taking advantage of the secured creditor's potential inability to cash bid—i.e., "seizing upon coordination difficulties inherent in the administration of a large syndicated loan that might actually prevent the multiple secured lenders from writing a check to themselves." Ralph Brubaker, *Cramdown of an Undersecured Creditor Through Sale of the Creditor's Collateral: Herein of Indubitable Equivalence, the § 1111(b)(2) Election, Sub Rosa Sales, Credit Bidding, and Disposition of Sale Proceeds*, 29 Bankr. L. Letter No. 12, at 12 (Dec. 2009).

Indeed, this case illustrates the very risks against which Congress was legislating. When the bankruptcy petition was filed in this case, petitioners owed over $120 million on the secured claim at issue, with over $1 million in interest accruing each month. Pet. App. 4a-5a. Yet petitioners proposed to sell their assets to a Stalking Horse for only $47.5 million, subject to a higher bid at auction. Pet. App. 5a-6a. The Stalking Horse bid amount reflected that, by

some tens of millions of dollars, there is no equity in petitioners' assets in excess of the value of respondent's liens, without even taking into account any of the alleged mechanics liens that have been asserted against the properties.

For that reason, petitioners' plan could have benefitted only the Stalking Horse (or the prevailing bidders). The Stalking Horse demanded the "no credit bidding" requirement. J.A. 131. The only other possible beneficiaries were insiders. If the Stalking Horse is the winning bidder, the deal was structured to permit petitioners' insider to acquire a minority interest in the Stalking Horse. J.A. 105. If the Stalking Horse bidder were to prevail at the auction, the existing management company would continue managing the hotel. That management company is owned and controlled by the same insider. J.A. 105.

Petitioners assert that credit bidding makes it more difficult for a Chapter 11 plan to be confirmed (Pet. Br. 51-53), but that is not so. In general, it should be of no consequence to the debtor which of the bidders wins at the auction. If the secured creditor uses its credit at the auction and obtains the asset, that benefits the estate just as much as if another party wins and pays cash for the asset. Whether the winning bidder wins with credit or with cash, either way the estate's debt is reduced by the same amount. Nor is the provision of cash preferable to credit bidding, for until the secured creditor's claim

is satisfied in full, no cash can go to other creditors. Brookner, *supra*, 85 Am. Bankr. L.J. at 141-142.

Moreover, there is simply no reason to force the secured creditor to put money into the estate in the form of a cash bid simply to eventually put it back in its own pocket. Surely Congress did not contemplate the "senseless shuffling of funds from the Bank to the creditor to the debtor to the creditor back to the Bank," with the transaction costs to be borne by the secured creditor for no substantive reason. Buccola & Keller, *supra*, 18 Geo. Mason L. Rev. at 102; *see also* Brubaker, *supra*, 29 Bankr. L. Letter at 12 ("What legitimate reason is there to require the lender to essentially write a check to itself?"). Finally, by ensuring the inclusion of at least one more qualified bidder, and thereby potentially generating more value to the estate, credit bidding makes it *more* likely that a plan will be confirmable.

Petitioners are wrong to suggest that an auction without credit bidding generates "cash available to fund a chapter 11 plan for creditors." Pet. Br. 52. "In general, no other parties or creditors may receive any proceeds from the sale of the collateral unless and until the lender is paid in full or agrees otherwise." Brookner, *supra*, 85 Am. Bankr. L.J. at 141-142. Absent the secured creditor's consent, expenses cannot be charged against secured creditors unless they fall within the Section 506(c) exception. *In re Trim-X, Inc.*, 695 F.2d 296, 301 (7th Cir. 1982). Section 506(c) allows deduction only of "reasonable, necessary costs and expenses of preserving, or disposing of" property

securing a claim, and only "to the extent of any benefit to the holder of such claim." 11 U.S.C. § 506(c). Thus, even under petitioners' theory, in which debtors could proceed under clause (iii), the proceeds of any sale of the secured creditor's collateral would belong to the secured creditor. The debtor cannot use the secured creditor's cash proceeds to fund other creditors *and* to strip the secured creditor of its lien.[12]

What petitioners actually complain of is that credit bidding here—in a single-asset bankruptcy—makes it more difficult for the debtor to propose a confirmable plan in which it will shed the lien attached to all its assets and transfer the assets to a favored Stalking Horse or some other third party at below market value. But benefitting insiders, or even totally unrelated third-party purchasers, at the expense of secured creditors is not a legitimate bankruptcy policy. There is no preference in the Bankruptcy Code for the debtor to be able to choose who the winning bidder at an asset sale will be—even when the sale is essentially a sale of all the debtor's assets. This is even more so because, as noted above, 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

[12] Indeed, even if petitioners could proceed under clause (iii), petitioners' plan to use the cash derived from the sale of the collateral to pay other creditors or to pay expenses is fatal to confirmation. *See* 11 U.S.C. § 506(c); 7 Collier, *supra*, ¶ 1129.03[4][a][i] (discussing absolute priority rule).

dollar. Hence, there is no bankruptcy justification for petitioners' approach.

D. The Legislative History Confirms That Credit Bidding Is Required

The legislative history of the Bankruptcy Code demonstrates that Congress intended credit bidding to fulfill the same protection against undervaluation of collateral that is provided under Section 1111(b). The reason expressly stated for excluding the Section 1111(b) election where the asset is to be sold is that the secured creditor has the right to credit bid at the sale: "Sale of property under section 363 or under the plan 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 under section 363(k) * * * ." 124 Cong. Rec. 32,407 (1978) (statement of Rep. Edwards).

Moreover, there is no discussion of Section 1129(b)(2)(A)(ii) in the legislative history because "Clause (ii) is self explanatory." *Ibid.*

Finally, the discussion of clause (iii)'s "indubitable equivalent" standard in the legislative history suggests that clause (iii) governs situations other than those covered by clause (ii). The examples of what would be the indubitable equivalent are "[a]bandonment of the collateral to the creditor" and "a lien on similar collateral." *Ibid.*

CONCLUSION

For the foregoing reasons, the judgment of the court of appeals should be affirmed.

Respectfully submitted,

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APPENDIX

TITLE 11 – BANKRUPTCY

CHAPTER 3 – CASE ADMINISTRATION

SUBCHAPTER IV – ADMINISTRATIVE POWERS

§ 363. Use, sale, or lease of property

(a) In this section, "cash collateral" means cash, negotiable instruments, documents of title, securities, deposit accounts, or other cash equivalents whenever acquired in which the estate and an entity other than the estate have an interest and includes the proceeds, products, offspring, rents, or profits of property and the fees, charges, accounts or other payments for the use or occupancy of rooms and other public facilities in hotels, motels, or other lodging properties subject to a security interest as provided in section 552(b) of this title, whether existing before or after the commencement of a case under this title.

(b)(1) The trustee, after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate, except that if the debtor in connection with offering a product or a service discloses to an individual a policy prohibiting the transfer of personally identifiable information about individuals to persons that are not affiliated with the debtor and if such policy is in effect on the date of the commencement of the case, then the trustee may not sell or lease personally identifiable information to any person unless –

(A) such sale or such lease is consistent with such policy; or

(B) after appointment of a consumer privacy ombudsman in accordance with section 332, and after notice and a hearing, the court approves such sale or such lease –

(i) giving due consideration to the facts, circumstances, and conditions of such sale or such lease; and

(ii) finding that no showing was made that such sale or such lease would violate applicable nonbankruptcy law.

(2) If notification is required under subsection (a) of section 7A of the Clayton Act in the case of a transaction under this subsection, then –

(A) notwithstanding subsection (a) of such section, the notification required by such subsection to be given by the debtor shall be given by the trustee; and

(B) notwithstanding subsection (b) of such section, the required waiting period shall end on the 15th day after the date of the receipt, by the Federal Trade Commission and the Assistant Attorney General in charge of the Antitrust Division of the Department of Justice, of the notification required under such subsection (a), unless such waiting period is extended –

(i) pursuant to subsection (e)(2) of such section, in the same manner as such subsection (e)(2) applies to a cash tender offer;

(ii) pursuant to subsection (g)(2) of such section; or

(iii) by the court after notice and a hearing.

(c)(1) If the business of the debtor is authorized to be operated under section 721, 1108, 1203, 1204, or 1304 of this title and unless the court orders otherwise, the trustee may enter into transactions, including the sale or lease of property of the estate, in the ordinary course of business, without notice or a hearing, and may use property of the estate in the ordinary course of business without notice or a hearing.

(2) The trustee may not use, sell, or lease cash collateral under paragraph (1) of this subsection unless –

(A) each entity that has an interest in such cash collateral consents; or

(B) the court, after notice and a hearing, authorizes such use, sale, or lease in accordance with the provisions of this section.

(3) Any hearing under paragraph (2)(B) of this subsection may be a preliminary hearing or may be consolidated with a hearing under subsection (e) of this section, but shall be scheduled in accordance with the needs of the debtor. If the hearing under paragraph (2)(B) of this subsection is a preliminary hearing, the court may authorize such use, sale, or lease only if there is a reasonable likelihood that the

trustee will prevail at the final hearing under subsection (e) of this section. The court shall act promptly on any request for authorization under paragraph (2)(B) of this subsection.

(4) Except as provided in paragraph (2) of this subsection, the trustee shall segregate and account for any cash collateral in the trustee's possession, custody, or control.

(d) The trustee may use, sell, or lease property under subsection (b) or (c) of this section only –

(1) in accordance with applicable nonbankruptcy law that governs the transfer of property by a corporation or trust that is not a moneyed, business, or commercial corporation or trust; and

(2) to the extent not inconsistent with any relief granted under subsection (c), (d), (e), or (f) of section 362.

(e) Notwithstanding any other provision of this section, at any time, on request of an entity that has an interest in property used, sold, or leased, or proposed to be used, sold, or leased, by the trustee, the court, with or without a hearing, shall prohibit or condition such use, sale, or lease as is necessary to provide adequate protection of such interest. This subsection also applies to property that is subject to any unexpired lease of personal property (to the exclusion of such property being subject to an order to grant relief from the stay under section 362).

(f) The trustee may sell property under subsection (b) or (c) of this section free and clear of any interest in such property of an entity other than the estate, only if –

(1) applicable nonbankruptcy law permits sale of such property free and clear of such interest;

(2) such entity consents;

(3) such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of all liens on such property;

(4) such interest is in bona fide dispute; or

(5) such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest.

(g) Notwithstanding subsection (f) of this section, the trustee may sell property under subsection (b) or (c) of this section free and clear of any vested or contingent right in the nature of dower or curtesy.

(h) Notwithstanding subsection (f) of this section, the trustee may sell both the estate's interest, under subsection (b) or (c) of this section, and the interest of any co-owner in property in which the debtor had, at the time of the commencement of the case, an undivided interest as a tenant in common, joint tenant, or tenant by the entirety, only if –

(1) partition in kind of such property among the estate and such co-owners is impracticable;

(2) sale of the estate's undivided interest in such property would realize significantly less for the estate than sale of such property free of the interests of such co-owners;

(3) the benefit to the estate of a sale of such property free of the interests of co-owners outweighs the detriment, if any, to such co-owners; and

(4) such property is not used in the production, transmission, or distribution, for sale, of electric energy or of natural or synthetic gas for heat, light, or power.

(i) Before the consummation of a sale of property to which subsection (g) or (h) of this section applies, or of property of the estate that was community property of the debtor and the debtor's spouse immediately before the commencement of the case, the debtor's spouse, or a co-owner of such property, as the case may be, may purchase such property at the price at which such sale is to be consummated.

(j) After a sale of property to which subsection (g) or (h) of this section applies, the trustee shall distribute to the debtor's spouse or the co-owners of such property, as the case may be, and to the estate, the proceeds of such sale, less the costs and expenses, not including any compensation of the trustee, of such sale, according to the interests of such spouse or co-owners, and of the estate.

(k) At a sale under subsection (b) of this section of property that is subject to a lien that secures an allowed claim, unless the court for cause orders otherwise the holder of such claim may bid at such sale, and, if the holder of such claim purchases such property, such holder may offset such claim against the purchase price of such property.

(*l*) Subject to the provisions of section 365, trustee may use, sell, or lease property under subsection (b) or (c) of this section, or a plan under chapter 11, 12, or 13 of this title may provide for the use, sale, or lease of property, notwithstanding any provision in a contract, a lease, or applicable law that is conditioned on the insolvency or financial condition of the debtor, on the commencement of a case under this title concerning the debtor, or on the appointment of or the taking possession by a trustee in a case under this title or a custodian, and that effects, or gives an option to effect, a forfeiture, modification, or termination of the debtor's interest in such property.

(m) The reversal or modification on appeal of an authorization under subsection (b) or (c) of this section of a sale or lease of property does not affect the validity of a sale or lease under such authorization to an entity that purchased or leased such property in good faith, whether or not such entity knew of the pendency of the appeal, unless such authorization and such sale or lease were stayed pending appeal.

(n) The trustee may avoid a sale under this section if the sale price was controlled by an agreement

among potential bidders at such sale, or may recover from a party to such agreement any amount by which the value of the property sold exceeds the price at which such sale was consummated, and may recover any costs, attorneys' fees, or expenses incurred in avoiding such sale or recovering such amount. In addition to any recovery under the preceding sentence, the court may grant judgment for punitive damages in favor of the estate and against any such party that entered into such an agreement in willful disregard of this subsection.

(*o*) Notwithstanding subsection (f), if a person purchases any interest in a consumer credit transaction that is subject to the Truth in Lending Act or any interest in a consumer credit contract (as defined in section 433.1 of title 16 of the Code of Federal Regulations (January 1, 2004), as amended from time to time), and if such interest is purchased through a sale under this section, then such person shall remain subject to all claims and defenses that are related to such consumer credit transaction or such consumer credit contract, to the same extent as such person would be subject to such claims and defenses of the consumer had such interest been purchased at a sale not under this section.

(p) In any hearing under this section –

(1) the trustee has the burden of proof on the issue of adequate protection; and

(2) the entity asserting an interest in property has the burden of proof on the issue of the validity, priority, or extent of such interest.

CHAPTER 5 – CREDITORS, THE DEBTOR, AND THE ESTATE

SUBCHAPTER I – CREDITORS AND CLAIMS

§ 506. Determination of secured status

(a)(1) An allowed claim of a creditor secured by a lien on property in which the estate has an interest, or that is subject to setoff under section 553 of this title, is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, or to the extent of the amount subject to setoff, as the case may be, and is an unsecured claim to the extent that the value of such creditor's interest or the amount so subject to setoff is less than the amount of such allowed claim. Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest.

(2) If the debtor is an individual in a case under chapter 7 or 13, such value with respect to personal property securing an allowed claim shall be determined based on the replacement value of such property as of the date of the filing of the petition without deduction for costs of sale or marketing. With respect to property acquired for personal, family, or household purposes, replacement value shall mean the price a retail merchant would charge for property of that kind considering the age and condition of the property at the time value is determined.

(b) To the extent that an allowed secured claim is secured by property the value of which, after any recovery under subsection (c) of this section, is greater than the amount of such claim, there shall be allowed to the holder of such claim, interest on such claim, and any reasonable fees, costs, or charges provided for under the agreement or State statute under which such claim arose.

(c) The trustee may recover from property securing an allowed secured claim the reasonable, necessary costs and expenses of preserving, or disposing of, such property to the extent of any benefit to the holder of such claim, including the payment of all ad valorem property taxes with respect to the property.

(d) To the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void, unless –

(1) such claim was disallowed only under section 502(b)(5) or 502(e) of this title; or

(2) such claim is not an allowed secured claim due only to the failure of any entity to file a proof of such claim under section 501 of this title.

CHAPTER 11 – REORGANIZATION

SUBCHAPTER I – OFFICERS AND ADMINISTRATION

§ 1111. Claims and interests

(a) A proof of claim or interest is deemed filed under section 501 of this title for any claim or interest that appears in the schedules filed under section 521(1) or 1106(a)(2) of this title, except a claim or interest that is scheduled as disputed, contingent, or unliquidated.

(b)(1)(A) A claim secured by a lien on property of the estate shall be allowed or disallowed under section 502 of this title the same as if the holder of such claim had recourse against the debtor on account of such claim, whether or not such holder has such recourse, unless –

(i) the class of which such claim is a part elects, by at least two-thirds in amount and more than half in number of allowed claims of such class, application of paragraph (2) of this subsection; or

(ii) such holder does not have such recourse and such property is sold under section 363 of this title or is to be sold under the plan.

(B) A class of claims may not elect application of paragraph (2) of this subsection if –

(i) the interest on account of such claims of the holders of such claims in such property is of inconsequential value; or

(ii) the holder of a claim of such class has recourse against the debtor on account of such claim and such property is sold under section 363 of this title or is to be sold under the plan.

(2) If such an election is made, then notwithstanding section 506(a) of this title, such claim is a secured claim to the extent that such claim is allowed.

§ 1129. Confirmation of plan

(a) The court shall confirm a plan only if all of the following requirements are met:

(1) The plan complies with the applicable provisions of this title.

(2) The proponent of the plan complies with the applicable provisions of this title.

(3) The plan has been proposed in good faith and not by any means forbidden by law.

(4) Any payment made or to be made by the proponent, by the debtor, or by a person issuing securities or acquiring property under the plan, for services or for costs and expenses in or in connection with the case, or in connection with the plan and incident to the case, has been approved by, or is subject to the approval of, the court as reasonable.

(5)(A)(i) The proponent of the plan has disclosed the identity and affiliations of any individual proposed to serve, after confirmation of the plan, as a director, officer, or voting trustee of the debtor, an affiliate of the debtor participating in a joint plan with the debtor, or a successor to the debtor under the plan; and

(ii) the appointment to, or continuance in, such office of such individual, is consistent with the interests of creditors and equity security holders and with public policy; and

(B) the proponent of the plan has disclosed the identity of any insider that will be employed

or retained by the reorganized debtor, and the nature of any compensation for such insider.

(6) Any governmental regulatory commission with jurisdiction, after confirmation of the plan, over the rates of the debtor has approved any rate change provided for in the plan, or such rate change is expressly conditioned on such approval.

(7) With respect to each impaired class of claims or interests –

(A) each holder of a claim or interest of such class –

(i) has accepted the plan; or

(ii) will receive or retain under the plan on account of such claim or interest property of a value, as of the effective date of the plan, that is not less than the amount that such holder would so receive or retain if the debtor were liquidated under chapter 7 of this title on such date; or

(B) if section 1111(b)(2) of this title applies to the claims of such class, each holder of a claim of such class will receive or retain under the plan on account of such claim property of a value, as of the effective date of the plan, that is not less than the value of such holder's interest in the estate's interest in the property that secures such claims.

(8) With respect to each class of claims or interests –

(A) such class has accepted the plan; or

(B) such class is not impaired under the plan.

(9) Except to the extent that the holder of a particular claim has agreed to a different treatment of such claim, the plan provides that –

(A) with respect to a claim of a kind specified in section 507(a)(2) or 507(a)(3) of this title, on the effective date of the plan, the holder of such claim will receive on account of such claim cash equal to the allowed amount of such claim;

(B) with respect to a class of claims of a kind specified in section 507(a)(1), 507(a)(4), 507(a)(5), 507(a)(6), or 507(a)(7) of this title, each holder of a claim of such class will receive –

(i) if such class has accepted the plan, deferred cash payments of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or

(ii) if such class has not accepted the plan, cash on the effective date of the plan equal to the allowed amount of such claim;

(C) with respect to a claim of a kind specified in section 507(a)(8) of this title, the holder of such claim will receive on account of such claim regular installment payments in cash –

(i) of a total value, as of the effective date of the plan, equal to the allowed amount of such claim;

(ii) over a period ending not later than 5 years after the date of the order for relief under section 301, 302, or 303; and

(iii) in a manner not less favorable than the most favored nonpriority unsecured claim provided for by the plan (other than cash payments made to a class of creditors under section 1122(b)); and

(D) with respect to a secured claim which would otherwise meet the description of an unsecured claim of a governmental unit under section 507(a)(8), but for the secured status of that claim, the holder of that claim will receive on account of that claim, cash payments, in the same manner and over the same period, as prescribed in subparagraph (C).

(10) If a class of claims is impaired under the plan, at least one class of claims that is impaired under the plan has accepted the plan, determined without including any acceptance of the plan by any insider.

(11) Confirmation of the plan is not likely to be followed by the liquidation, or the need for further financial reorganization, of the debtor or any successor to the debtor under the plan, unless such liquidation or reorganization is proposed in the plan.

(12) All fees payable under section 1930 of title 28, as determined by the court at the hearing on confirmation of the plan, have been paid or the plan provides for the payment of all such fees on the effective date of the plan.

(13) The plan provides for the continuation after its effective date of payment of all retiree benefits, as that term is defined in section 1114 of

this title, at the level established pursuant to subsection (e)(1)(B) or (g) of section 1114 of this title, at any time prior to confirmation of the plan, for the duration of the period the debtor has obligated itself to provide such benefits.

(14) If the debtor is required by a judicial or administrative order, or by statute, to pay a domestic support obligation, the debtor has paid all amounts payable under such order or such statute for such obligation that first become payable after the date of the filing of the petition.

(15) In a case in which the debtor is an individual and in which the holder of an allowed unsecured claim objects to the confirmation of the plan –

(A) the value, as of the effective date of the plan, of the property to be distributed under the plan on account of such claim is not less than the amount of such claim; or

(B) the value of the property to be distributed under the plan is not less than the projected disposable income of the debtor (as defined in section 1325(b)(2)) to be received during the 5-year period beginning on the date that the first payment is due under the plan, or during the period for which the plan provides payments, whichever is longer.

(16) All transfers of property of the plan shall be made in accordance with any applicable provisions of nonbankruptcy law that govern the transfer of property by a corporation or trust that

is not a moneyed, business, or commercial corporation or trust.

(b)(1) Notwithstanding section 510(a) of this title, if all of the applicable requirements of subsection (a) of this section other than paragraph (8) are met with respect to a plan, the court, on request of the proponent of the plan, shall confirm the plan notwithstanding the requirements of such paragraph if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan.

(2) For the purpose of this subsection, the condition that a plan be fair and equitable with respect to a class includes the following requirements:

(A) With respect to a class of secured claims, the plan provides –

(i)(I) that the holders of such claims retain the liens securing such claims, whether the property subject to such liens is retained by the debtor or transferred to another entity, to the extent of the allowed amount of such claims; and

(II) that each holder of a claim of such class receive on account of such claim deferred cash payments totaling at least the allowed amount of such claim, of a value, as of the effective date of the plan, of at least the value of such holder's interest in the estate's interest in such property;

(ii) for the sale, subject to section 363(k) of this title, of any property that is subject to the liens securing such claims, free and clear of such liens, with such liens to attach to the proceeds of such sale, and the treatment of such liens on proceeds under clause (i) or (iii) of this subparagraph; or

(iii) for the realization by such holders of the indubitable equivalent of such claims.

(B) With respect to a class of unsecured claims –

(i) the plan provides that each holder of a claim of such class receive or retain on account of such claim property of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or

(ii) the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property, except that in a case in which the debtor is an individual, the debtor may retain property included in the estate under section 1115, subject to the requirements of subsection (a)(14) of this section.

(C) With respect to a class of interests –

(i) the plan provides that each holder of an interest of such class receive or retain on account of such interest property of a value, as of the effective date of the plan, equal to the greatest of the allowed amount of any fixed liquidation preference to which such

holder is entitled, any fixed redemption price to which such holder is entitled, or the value of such interest; or

(ii) the holder of any interest that is junior to the interests of such class will not receive or retain under the plan on account of such junior interest any property.

(c) Notwithstanding subsections (a) and (b) of this section and except as provided in section 1127(b) of this title, the court may confirm only one plan, unless the order of confirmation in the case has been revoked under section 1144 of this title. If the requirements of subsections (a) and (b) of this section are met with respect to more than one plan, the court shall consider the preferences of creditors and equity security holders in determining which plan to confirm.

(d) Notwithstanding any other provision of this section, on request of a party in interest that is a governmental unit, the court may not confirm a plan if the principal purpose of the plan is the avoidance of taxes or the avoidance of the application of section 5 of the Securities Act of 1933. In any hearing under this subsection, the governmental unit has the burden of proof on the issue of avoidance.

(e) In a small business case, the court shall confirm a plan that complies with the applicable provisions of this title and that is filed in accordance with section 1121(e) not later than 45 days after the

plan is filed unless the time for confirmation is extended in accordance with section 1121(e)(3).