American Bar Association
www.supremecourtpreview.org

No. 11-166

IN THE

Supreme Court of the United States

RADLAX GATEWAY HOTEL, LLC, ET AL.,

Petitioners,

v.

AMALGAMATED BANK,

Respondent.

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

BRIEF OF *AMICUS CURIAE* G. ERIC BRUNSTAD, JR. IN SUPPORT OF RESPONDENT

G. Eric Brunstad, Jr.
Counsel of Record
Collin O'Connor Udell
Matthew J. Delude
DECHERT LLP
90 State House Square
Hartford, Connecticut 06103
(860) 524-3999

Counsel for Amicus Curiae

TABLE OF CONTENTS

Page

TABLE OF CONTENTS .... *i*

TABLE OF AUTHORITIES .... *ii*

INTEREST OF THE *AMICUS CURIAE* 1

STATEMENT 3

SUMMARY OF THE ARGUMENT 13

ARGUMENT 16

CONCLUSION 25

TABLE OF AUTHORITIES

Page

CASES

Associates Comm'l Corp. v. Rash,
520 U.S. 953 (1997) 6

Bank of Am. Nat'l Trust & Sav. Ass'n v. 203 North LaSalle St. P'ship,
526 U.S. 434 (1999) ....*passim*

BFP v. Resolution Trust Corp.,
511 U.S. 531 (1994) 22

Case v. Los Angeles Lumber Prods. Co.,
308 U.S. 106 (1939) 16

Consolidated Rock Prods. Co. v. Du Bois,
312 U.S. 510 (1941) 16

Di Pierro v. Taddeo (In re Taddeo),
685 F.2d 24 (2d Cir. 1982) 8

Kansas City Terminal Ry. Co. v. Central Union Trust Co.,
271 U.S. 445 (1926) 16

Louisville Trust Co. v. Louisville, N.A. & C. Ry. Co.,
174 U.S. 674 (1899) 16

In re Murel Holding Corp.,
75 F.2d 941 (2d Cir. 1935) 23, 24

TABLE OF AUTHORITIES
(continued)

Page

Northern Pac. Ry. Co. v. Boyd,
228 U.S. 482 (1913) 16

Norwest Bank Worthington v. Ahlers,
485 U.S. 197 (1988) 10, 17

STATUTES AND RULE

11 U.S.C. § 101(10)...5

11 U.S.C. § 362(a)...4

11 U.S.C. § 362(d)...5

11 U.S.C. § 363(k) 12, 13, 21

11 U.S.C. § 501(a)...5

11 U.S.C. § 502(b)...5

11 U.S.C. § 506(a)... 5, 6

11 U.S.C. § 541 4

11 U.S.C. § 1101(1)...4

11 U.S.C. § 1107 4

11 U.S.C. § 1108 4

11 U.S.C. § 1111(b)(2) 6

TABLE OF AUTHORITIES
(continued)

Page

11 U.S.C. § 1121(b) 7

11 U.S.C. § 1123 .... 6, 9

11 U.S.C. § 1123(a)(1) 8

11 U.S.C. § 1123(a)(2) 8

11 U.S.C. § 1123(a)(4) 8

11 U.S.C. § 1123(b)(4) 6

11 U.S.C. § 1123(b)(5) 9, 13

11 U.S.C. § 1124 8

11 U.S.C. § 1126 10

11 U.S.C. § 1129 .... 6, 8

11 U.S.C. § 1129(a) 8

11 U.S.C. § 1129(a)(8) 10, 11

11 U.S.C. § 1129(b) ....*passim*

11 U.S.C. § 1129(b)(2) 10, 15, 17

11 U.S.C. § 1129(b)(2)(A) 12

11 U.S.C. § 1129(b)(2)(A)(ii) 3, 21, 23

11 U.S.C. § 1129(b)(2)(A)(iii) 3, 23, 24

TABLE OF AUTHORITIES
(continued)

Page

Bankruptcy Act of 1898, 11 U.S.C. § 205, 48 Stat. 911 (1934) (repealed 1938) 16, 17, 23

Bankruptcy Act of 1898, 11 U.S.C. § 621(2), 52 Stat. 883 (1938) (repealed 1979) 17

OTHER AUTHORITIES

4 COLLIER ON BANKRUPTCY ¶ 506.02 (16th ed. 2009)..................................9

4 COLLIER ON BANKRUPTCY ¶ 506.03 (16th ed. 2009)..................................6

7 COLLIER ON BANKRUPTCY ¶ 1122.03[3][c] (16th ed. 2010) 8

G. Eric Brunstad, Jr., *Bankruptcy and the Problems of Economic Futility: A Theory on the Unique Role of Bankruptcy Law*, 55 BUS. LAW. 499 (2000) 22

G. Eric Brunstad, Jr. & Mike Sigal, *Competitive Choice Theory and the Broader Implications of the Supreme Court's Analysis in* Bank of America v. 203 North LaSalle Street Partnership, 54 BUS. LAW. 1475 (1999)........... 10, 11, 15, 16

TABLE OF AUTHORITIES
(continued)

Page

G. Eric Brunstad, Jr. & Mike Sigal, *Competitive Choice Theory and the Unresolved Doctrines of Classification and Unfair Discrimination in Business Reorganizations Under the Bankruptcy Code*, 55 BUS. LAW. 1 (1999) 11

G. Eric Brunstad, Jr. et al., *Review of the Proposals of the National Bankruptcy Review Commission Pertaining to Business Bankruptcies: Part One*, 53 BUS. LAW. 1381 (1988) 7

H.R. DOC. NO. 93-137, pt. I (1973).................... 22

H.R. REP. NO. 95-595 (1977)....................... 17, 22

S. REP. NO. 95-989 (1978) 23

INTEREST OF THE *AMICUS CURIAE*[1]

The undersigned *amicus curiae* is a frequent Visiting Lecturer in Law at the Yale Law School where he teaches courses on bankruptcy law, domestic and international business reorganizations, commercial transactions, secured transactions, federal courts, and argument and reason. He began teaching at Yale in 1990 and has also taught at the Harvard Law School. In addition to his teaching, the undersigned is a contributing author to COLLIER ON BANKRUPTCY, responsible for writing several chapters of the Treatise. He is also a partner at the law firm of Dechert LLP; a prior Chair of the ABA Business Bankruptcy Committee; a former member of the Judicial Conference Advisory Committee on the Federal Bankruptcy Rules; and a Fellow of the American College of Bankruptcy.

The undersigned has briefed and argued numerous bankruptcy matters before the Court, including *Schwab v. Reilly*, 130 S. Ct. 2652 (2010); *Milavetz, Gallop & Milavetz, P.A. v.*

---

[1] No counsel for any party has authored this brief in whole or in part, and no party or counsel for a party has made a monetary contribution to the preparation or submission of this brief. *See* Sup. Ct. R. 37.6. All parties have been timely notified of the undersigned's intent to file this brief; both petitioners and respondent have consented to the filing of this brief. Copies of petitioners' and respondent's consents are filed herewith.

United States, 130 S. Ct. 1324 (2010); *Florida Dep't of Revenue v. Piccadilly Cafeterias, Inc.*, 554 U.S. 33 (2008); *Travelers Cas. & Sur. Co. v. Pacific Gas & Elec. Co.*, 549 U.S. 443 (2007); *Marrama v. Citizens Bank of Mass.*, 549 U.S. 365 (2007); *Till v. SCS Credit Corp.*, 541 U.S. 465 (2004); and *Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1 (2000). He has otherwise participated as counsel for one of the parties in numerous other bankruptcy matters before the Court, including *Stern v. Marshall*, 131 S. Ct. 2594 (2011); *Hamilton v. Lanning*, 130 S. Ct. 2464 (2010); *Central Virginia Community College v. Katz*, 546 U.S. 356 (2006); *Rousey v. Jacoway*, 544 U.S. 320 (2005); *Kontrick v. Ryan*, 540 U.S. 443 (2004); *Lamie v. United States Trustee*, 540 U.S. 526 (2004); *FCC v. NextWave Personal Commc'ns Inc.*, 537 U.S. 293 (2003); and *Connecticut Nat'l Bank v. Germain*, 503 U.S. 249 (1992). In addition, he has prepared and filed with the Court several amicus briefs in bankruptcy cases, including *Hall v. United States*, no. 10-875 (2012); *Ransom v. FIA Card Services*, 131 S. Ct. 716 (2011); *United Student Aid Funds, Inc. v. Espinosa*, 130 S. Ct. 1367 (2010); *Howard Delivery Serv., Inc. v. Zurich American Ins., Co.*, 547 U.S. 651 (2006); *Tennessee Student Assistance Corp. v. Hood*, 541 U.S. 440 (2004); *Archer v. Warner*, 538 U.S. 314 (2003); and *Things Remembered, Inc. v. Petrarca*, 516 U.S. 124 (1995).

The undersigned is deeply interested in the subject of bankruptcy law and has written, taught, and lectured on the subject of Chapter 11 plans, and specifically the proper treatment of secured claims under these plans. The purpose of this brief is to address matters that bear on the Court's determination of an important issue of bankruptcy law: whether a Chapter 11 debtor that proposes in a plan to sell an asset encumbered by a secured creditor's lien may strip away the creditor's right to credit bid at the sale of the asset. In particular, this brief explains the concept of credit bidding prescribed in section 1129(b)(2)(A)(ii) as a subset of the master requirement of section 1129(b) that a plan must be "fair and equitable" to the holders of secured claims who have voted to reject the plan. Because credit bidding in the context of asset sales is integral to the fair and equitable requirement, it cannot be disregarded under the guise of "indubitable equivalence" set forth in section 1129(b)(2)(A)(iii). In context, a sale that strips away a secured creditor's right to credit bid is simply not "fair and equitable" as this Court has explained the concept. Accordingly, the decisions below should be affirmed.

STATEMENT

Petitioners RadLAX Gateway Hotel, LLC and RadLAX Gateway Deck, LLC (the "Debtors") own and operate a hotel and parking structure. Respondent Amalgamated Bank ("Amalga-

mated") holds liens on these and other assets of the Debtors to secure repayment of a $142 million loan. Pet. App. 3a-4a.

In 2009, the Debtors filed for bankruptcy under Chapter 11 of the Bankruptcy Code. By operation of law, when a debtor commences a bankruptcy case, an estate is created consisting of all of the debtor's property. 11 U.S.C. § 541. Thus, after the Debtors commenced their bankruptcy case, their assets, including the hotel and parking structure, passed to their estate.

A trustee is not usually appointed in Chapter 11 cases, and the debtor typically continues to manage its business as the "debtor in possession" of the estate. 11 U.S.C. §§ 1101(1) (defining "debtor in possession" in a chapter 11 case), 1107 (prescribing the duties of the debtor in possession), 1108 (authorizing operation of business during chapter 11 proceedings). Accordingly, after they commenced their bankruptcy case, the Debtors continued to operate their hotel business as "debtors in possession."

After a bankruptcy case is filed, the provisions of the automatic stay apply, preventing creditors from taking action against estate property, or otherwise dismantling the estate. 11 U.S.C. § 362(a). Following the Debtors' bankruptcy filing, Amalgamated was thus enjoined from taking action to collect its debt or foreclose

its liens on the Debtors' assets, absent obtaining "relief from stay" from the bankruptcy court. *See* 11 U.S.C. § 362(d).

Under the Bankruptcy Code, a debtor's monetary obligations constitute "claims" against the debtor's estate, and the Code provides that any creditor holding a claim is entitled to file a proof of claim with the bankruptcy court. 11 U.S.C. §§ 101(10) (defining "creditor"), 501(a) (providing for the filing of proofs of claim), 502(b) (providing for the allowance or disallowance of claims). Accordingly, after the Debtors commenced their bankruptcy case, Amalgamated held a claim against the Debtors' estate and was entitled to file a proof of claim for the approximately $120 million the Debtors owed under the parties' lending arrangement. Pet. App. 4a-5a.

Under section 506(a) of the Code, a creditor holding a claim secured by liens on the debtor's property is generally treated as the holder of a "secured claim" to the extent of the value of its collateral. 11 U.S.C. § 506(a). Under section 506(a), if the value of the creditor's collateral exceeds the amount of its claim, the creditor is treated as "oversecured." On the other hand, if the value of the collateral is less than the amount of the claim, the creditor is generally treated as "undersecured" and becomes the holder of two claims: a secured claim equal to the value of the collateral, and an unsecured claim

equal to the deficiency (*i.e.*, an unsecured claim equal to the difference between the amount of the debt and the value of the collateral). *Associates Comm'l Corp. v. Rash*, 520 U.S. 953, 961 (1997) (section 506(a) "tells us that a secured creditor's claim is to be divided into secured and unsecured portions, with the secured portion of the claim limited to the value of the collateral"); *see also* 4 COLLIER ON BANKRUPTCY ¶ 506.03 at 506-10 (16th ed. 2009). The operation of section 506(a), however, is subject to certain exceptions. In Chapter 11 cases, section 1111(b)(2) permits a secured creditor to elect to have the entire amount of its claim treated as secured notwithstanding that the value of its collateral is less than the amount of its claim. 11 U.S.C. § 1111(b)(2). In this case, the Debtors proposed to bifurcate Amalgamated's claim under section 506(a) into a secured portion equal to the value of its collateral, and an unsecured portion equal to the deficiency. J.A. 37-38.

The practical aim of Chapter 11 is the successful confirmation of a negotiated plan that provides for the debtor's retention or sale of its assets, and the payment of claims. *See* 11 U.S.C. §§ 1123 (prescribing the contents of a chapter 11 plan), 1123(b)(4) (stating that a chapter 11 plan may "provide for the sale or all or substantially all of the property of the estate, and the distribution of the proceeds of such sale among holders of claims or interests"), 1129 (prescribing the rules

governing confirmation of a plan); *Bank of Am. Nat'l Trust & Sav. Ass'n v. 203 North LaSalle St. P'ship*, 526 U.S. 434, 457 n.28 (1999) (quoting G. Eric Brunstad, Jr. et al., *Review of the Proposals of the National Bankruptcy Review Commission Pertaining to Business Bankruptcies: Part One*, 53 BUS. LAW. 1381, 1406 n.136 (1988)) ("the Chapter 11 process relies on creditors and equity holders to engage in negotiations toward resolution of their interests"). To this end, section 1121(b) of the Code gives a Chapter 11 debtor a limited, exclusive right to propose a Chapter 11 plan. 11 U.S.C. § 1121(b). In this case, the Debtors proposed a Chapter 11 plan that called for the sale at auction of their assets. Pet. App. 5a.

As part of their sales strategy, the Debtors endeavored to line up a "stalking horse" bid prior to their proposed auction – an advance bid by a potential purchaser subject to higher and better bids. Pet. App. 5a-6a. In this case, the stalking horse bid was for $47.5 million – far less than the Debtors' indebtedness to Amalgamated. *Id.* at 6a. In addition, the Debtors' proposed arrangement with the stalking horse bidder was potentially lucrative for the Debtors' insiders. If the stalking horse bid were successful, The Harp Group, Inc., an entity owned and controlled by the Debtors' principal, had the right to purchase an interest in the entity purchasing the assets. J.A. 105. Further, the existing management company, also controlled by the Debtors' princip-

al, would continue to manage the hotel. *Id.* In other words, at least one insider of the Debtors stood to gain if the proposed sale were successful by (1) enjoying the right to obtain an interest in the new owner of the assets, and (2) continuing to manage the hotel into the future.

In order for a plan to be effective, the bankruptcy court must confirm it, and section 1129 provides the general standards for confirmation. 11 U.S.C. § 1129. Among other things, a plan must comply with all applicable provisions of the Code, 11 U.S.C. § 1129(a), and these include the requirements that the plan divide claims into classes, specify whether each class is "impaired," and specify the treatment of each class. 11 U.S.C. §§ 1123(a)(1) (requiring the classification of claims), 1123(a)(2) (requiring designation of a class as impaired or unimpaired), 1123(a)(4) (requiring the plan to specify the treatment of each class). In general, because they hold specific lien rights against the debtor's property, secured creditors are entitled to be classified separately into their own individual classes. 7 COLLIER ON BANKRUPTCY ¶ 1122.03[3][c] at 1122-15 (16th ed. 2010) ("as a general rule each holder of an allowed claim secured by a security interest in specific property of the debtor should be placed in a separate class."). A class is "impaired" if the plan modifies the legal rights of the members of the class. 11 U.S.C. § 1124; *see Di Pierro v. Taddeo (In re Taddeo)*, 685 F.2d 24,

28-29 (2d Cir. 1982). In this case, the Debtors' plan classified Amalgamated's secured claim into its own class and properly designated Amalgamated's claim as "impaired." J.A. 38, 48, 52.

Under section 1123, a debtor may propose in its plan to modify the rights of secured creditors. 11 U.S.C. § 1123(b)(5) (providing that a plan may "modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence"). A debtor's ability to modify the rights of secured creditors, however, is limited by a number of other specific provisions of the Code designed to protect the secured creditors' rights. As explained in the Collier treatise, "the protections afforded secured creditors under the Code generally adhere first to the principle that the secured creditor is entitled to priority payment out of its collateral, and second to the principle that the secured creditor is entitled to receive the equivalent value of its collateral." 4 COLLIER ON BANKRUPTCY ¶ 506.02 at 506-9 (16th ed. 2009) (footnotes and citations omitted). As discussed below, among the key protections for secured creditors in Chapter 11 cases are those found in section 1129(b), including the requirement that a plan must be "fair and equitable" to the secured party. In this case, the Debtors proposed in their plan to modify Amalgamated's rights as a secured party, including by proposing the sale of Amalgamated's collateral

without permitting Amalgamated to credit bid its indebtedness. J.A. 52-53, 118, 149. The question presented is whether the Debtors may do so consistent with the provisions of section 1129(b)(2).

Creditors whose claims are impaired are entitled to vote on the proposed plan. 11 U.S.C. § 1126. The right to vote is significant because, under section 1129(a)(8), the bankruptcy court cannot confirm a plan unless each impaired class votes in favor of it. In general, the voting requirement serves two purposes. First, it permits creditors to determine for themselves whether the plan lies in their best interests, rather than have that determination made by the debtor, the court, or some administrative agency. *See LaSalle*, 526 U.S. at 457 n.28; *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 207 (1988). Second, it ensures that creditors will have a voice in the plan negotiation process – because creditors have the right to vote on the plan, the debtor has an incentive to seek their input and obtain their consent. *See* G. Eric Brunstad, Jr. & Mike Sigal, *Competitive Choice Theory and the Broader Implications of the Supreme Court's Analysis in* Bank of America v. 203 North LaSalle Street Partnership, 54 BUS. LAW. 1475, 1494 (1999) [hereinafter *Brunstad & Sigal, LaSalle*].

The creditors' ability to vote down a plan under section 1129(a)(8) is not absolute and is

subject to an important exception known as the "cram down" rule. Specifically, section 1129(b) permits the bankruptcy court to confirm a plan notwithstanding the dissenting vote of a particular class of claims (*i.e.*, "cram down" the plan over their dissenting vote) so long as the plan "does not discriminate unfairly" and is "fair and equitable" to the dissenting class. 11 U.S.C. § 1129(b); *LaSalle*, 526 U.S. at 441.[2] The cram-down rule of section 1129(b) thus counterbalances the voting requirement of section 1129(a)(8). Whereas the voting requirement provides an incentive for the debtor to negotiate the terms of its plan with its creditors, the cram down feature of section 1129(b) provides an incentive for creditors to be reasonable in their demands because if the plan is objectively "fair and equitable," it may be confirmed notwithstanding their dissenting vote. *See Brunstad & Sigal, LaSalle*, at 1494-95.

---

[2] The unfair discrimination test is not implicated in this matter. For a discussion of the Chapter 11 voting regime and the doctrine of unfair discrimination, see G. Eric Brunstad, Jr. & Mike Sigal, *Competitive Choice Theory and the Unresolved Doctrines of Classification and Unfair Discrimination in Business Reorganizations Under the Bankruptcy Code*, 55 BUS. LAW. 1 (1999).

With respect to a class of secured claims, a plan is "fair and equitable" and may be crammed down over the secured creditors' dissenting vote if certain criteria are satisfied. These criteria are set out in section 1129(b)(2)(A), which provides in relevant part that "the condition that a plan be fair and equitable with respect to a class includes" three basic requirements:

> (i) . . . that the holders of [secured] claims retain the liens securing such claims . . . and [] that each holder of a claim of [the secured] 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).

In this case, the Debtors' plan does not propose that Amalgamated retain its liens on its collateral. Instead, the plan provides that Amalgamated would be entitled to receive the proceeds from the sale of the collateral after the payment of certain expenses and priority claims. J.A. 52-53. Because Amalgamated will not retain its liens, option (i) is not applicable.

Nor does the Debtors' plan satisfy the requirements of option (ii). By its terms, option (ii) cross-references and incorporates section 363(k) of the Code, and section 363(k) provides that a secured creditor may "credit bid" its debt at the sale of its collateral (*e.g.*, use its debt like cash during the bidding process). 11 U.S.C. § 363(k). The Debtors' plan, however, specifically denies Amalgamated the right to credit bid. J.A. 118, 149. The precise question presented is whether the Debtors may proceed under option (iii) – the "indubitable equivalent" provision.

The courts below determined that the Debtors may not do so. Pet. App. 17a, 42a. Because these decisions are sound, they should be affirmed.

SUMMARY OF THE ARGUMENT

It is axiomatic that a Chapter 11 debtor may propose in its plan to modify the rights of secured creditors. 11 U.S.C. § 1123(b)(5). At the

same time, it is also axiomatic that the ability of a debtor to modify the rights of secured parties is constrained by a number of pivotal provisions of the Bankruptcy Code, including the requirement of section 1129(b) that the plan must be "fair and equitable" before it may be confirmed over the secured creditor's dissenting vote. 11 U.S.C. § 1129(b). As applied to secured claims, the fair and equitable standard has certain specific statutory requirements, but the overarching principle is one of absolute priority. Hierarchically, absolute priority means that (1) secured creditors are entitled to receive the value of their collateral ahead of both unsecured creditors and the debtor's equity holders; and (2) creditors as a whole are entitled to receive payment of their claims before equity holders receive or retain anything on account of their equity interests.

The right to credit bid in the context of a Chapter 11 sale of a debtor's assets is integral to the absolute priority concept embedded in section 1129(b). It is integral because, without it, debtors have an enhanced incentive to propose and seek to consummate asset transfers designed to benefit the debtors' insiders at the expense of the debtors' secured creditors. That is exactly what happened in this case: the Debtors here proposed to sell their assets to a stalking horse at a low value in a transaction that offered the Debtors' insiders lucrative benefits. Without the right to credit bid, secured creditors are han-

dicapped in their ability to block such violations of absolute priority: in order to participate in the auction process, they would have to raise substantial sums of additional cash, which under the circumstances may be difficult or impossible, particularly during periods of economic contraction. In reality, the right to credit bid ensures the secured creditor's ability to police and enhance the auction process efficiently and avoid violations of absolute priority of the kind at issue here.

This Court has addressed the contours of the absolute priority principle before, most recently in *Bank of Am. Nat'l Trust & Sav. Ass'n v. 203 North LaSalle St. P'ship*, 526 U.S. 434 (1999). Critically, the long history of the absolute priority concept reveals two dominant values: the preservation of hierarchical priorities in bankruptcy, and the prevention of collusive arrangements designed to erode this hierarchical order. *Brunstad & Sigal, LaSalle*, at 1488. Section 1129(b)(2) enforces these values through the medium of the "fair and equitable" standard generally, and the requirement of credit bidding specifically. Because the Debtors' plan violates both the letter and spirit of section 1129(b), the decisions of the courts below should be affirmed.

ARGUMENT

This Court is no stranger to the concept of absolute priority. In fact, the Court invented it over a century ago in the context of railroad equity receiverships. *Brunstad & Sigal, LaSalle* at 1497-98. The seminal early decisions discussing the absolute priority concept include *Louisville Trust Co. v. Louisville, N.A. & C. Ry. Co.*, 174 U.S. 674 (1899), where the Court recited "the familiar rule that the stockholder's interest in the property [of the debtor] is subordinate to the rights of creditors. First, of secured, and then of unsecured, creditors," concluding that "any arrangement of the parties by which the subordinate rights and interests of stockholders are attempted to be secured at the expense of the prior rights of either class of creditors comes within judicial denunciation." *Id.* at 684; *see also Consolidated Rock Prods. Co. v. Du Bois*, 312 U.S. 510, 529 (1941); *Case v. Los Angeles Lumber Prods. Co.*, 308 U.S. 106, 115-16 (1939); *Kansas City Terminal Ry. Co. v. Central Union Trust Co.*, 271 U.S. 445, 455 (1926); *Northern Pac. Ry. Co. v. Boyd*, 228 U.S. 482, 508 (1913).

In the business reorganization context, Congress codified the absolute priority rule as part of the "fair and equitable" requirement of section 77B(f) of the former Bankruptcy Act of 1898, 11 U.S.C. § 205, 48 Stat. 911, 919 (1934) (repealed 1938). Similar to section 1129(b), sec-

tion 77B(f) provided in relevant part that "the judge shall confirm the plan if satisfied that . . . it is fair and equitable and does not discriminate unfairly in favor of any class of creditors or stockholders . . . ." *Id.* The rule next appeared as part of the "fair and equitable" requirement of Chapter X of the former Act, which replaced section 77(B). *See* Bankruptcy Act of 1898, 11 U.S.C. § 621(2), 52 Stat. 883, 897 (1938) (repealed 1979). As explained in the legislative history to the current Bankruptcy Code enacted in 1978, the "fair and equitable" requirement of section 1129(b)(2) likewise codifies the concept of absolute priority: "[t]he general principle of the subsection permits confirmation notwithstanding nonacceptance by an impaired class if that class and all below it in priority are treated according to the absolute priority rule." H.R. REP. No. 95-595, at 413 (1977). As the legislative history further explains, in accordance with the absolute priority rule, "[t]he dissenting class must be paid in full before any junior classes may share," and while "[t]reatment of classes of secured creditors is slightly different because they do not fall in the priority ladder, [] the principle is the same." *Id.*; *see also Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 202 (1988) (observing that the absolute priority rule had its origins in judicial interpretations of "the undefined requirement of the early bankruptcy statute that reorganization plans be 'fair and equitable'").

As the Court stated in *LaSalle*, the longstanding reason for the "fair and equitable" requirement is "the danger inherent in any reorganization plan proposed by a debtor, then and now, that the plan will simply turn out to be too good a deal for the debtor's owners." 526 U.S. at 444 (citing the 1973 Report of the Commission on the Bankruptcy Laws of the United States, H.R. DOC. No. 93-137, pt. I, at 255 (1973), which discussed Congress' concern over "the ability of a few insiders, whether representatives of management or major creditors, to use the reorganization process to gain an unfair advantage."). As the Court observed, "[h]ence the pre-Code judicial response known as the absolute priority rule, that fairness and equity required that 'the creditors . . . be paid before the stockholders could retain [equity interests] for any purpose whatsoever.'" *Id.* (quoting *Boyd*, 228 U.S. at 508).

As this Court's decision in *LaSalle* demonstrates, these principles apply in full force here. In *LaSalle*, the debtor proposed in its plan to retain its main asset (a portion of an office building), *id.* at 438, without proposing to pay its secured creditor in full, *id.* at 439-40. Critically, the plan granted the debtor's old equity owners the exclusive right to purchase ownership interests in the new, reorganized entity. *Id.* at 440. As the Court viewed the matter, the chief problem with this arrangement was that it gave the old equity holders a right of purchase "without

extending an opportunity to anyone else either to compete for that equity or propose a competing reorganization plan," *id.* at 454, thereby violating absolute priority because of the arrangement's "protection against the market's scrutiny of the purchase price by means of competing bids or even competing plan proposals," *id*. at 456. It did not matter, the Court reasoned, that the arrangement might seem fair to "a judge in bankruptcy court" because in crafting the Code, Congress "narrow[ed] the occasions for courts to make valuation judgments," preferring instead "some form of market valuation" over "decisions untested by competitive choice." *Id*. at 457. In other words, the debtor's plan violated absolute priority (and was thus not "fair and equitable") because, by avoiding a competitive market test for the value of the ownership interests in the reorganized debtor, it failed to protect against the problem of old equity holders getting too good a deal.

The same considerations doom the Debtors' plan in this case. As Amalgamated explains in its brief, one of the key purposes of credit bidding is to ensure competition in the bidding process. Resp. Br. at 51-54 (citing Vincent S. J. Buccola & Ashley C. Keller, *Credit Bidding and the Design of Bankruptcy Auctions*, 18 GEO. MASON L. REV. 99 (2010); 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 (2011)). Credit bidding permits the secured creditor to participate in the auction process efficiently – the secured creditor is likely to be knowledgeable about the relevant assets and their value and may participate without having to come up with additional cash on top of the money it has already lent to the debtor. Critically, with increased participation, the auction price is more likely to be bid up. Resp. Br. at 51. In addition to maximizing the value of the debtor's assets, this competition also ensures that the debtor's old equity holders do not obtain value from the sale in violation of absolute priority. Without credit bidding, the debtor has an enhanced incentive to arrange a low-price sale to a friendly purchaser in a transaction that bestows lucrative benefits on the debtor's old equity owners because the denial of credit bidding deprives the secured creditor of its most efficient means to police the auction process. In this case, the Debtors' principal stands to gain significantly if the purchaser is the stalking horse bidder. J.A. 105. The proper way to superintend proposed transactions of this kind and ensure that they do not violate absolute priority is through the increased market-driven competition that credit bidding fosters.

It is not a valid counterargument that a secured creditor denied its right to credit bid

may participate in the auction process by offering cash bids. Large loans are often syndicated with numerous participants contributing portions of the funds lent to the debtor. Coordinating an additional advance of funds to make cash bids entails at a minimum significant costs and, in some instances, may be impossible altogether if, for example, one of the lending participants has become insolvent or otherwise unable to make additional advances. Because making cash bids at auction is costly (and sometimes impossible), requiring them can only discourage secured creditors from participating, thereby undermining the values that credit bidding was designed to promote.

It is likewise not a valid counterargument that credit bidding may be denied because it tends to chill or otherwise hamper the bidding process. By including a right to credit bid in sections 363(k) and 1129(b)(2)(A)(ii), Congress presumably thought otherwise – certainly the presumptive norm is that credit bidding *enhances* the auction process; otherwise, Congress would not have provided for it in the Code. In any event, it is not plausible to assume that credit bidding chills the process any more than the presence of a stalking horse bidder the debtor favors.

As this Court has observed, a potential difficulty with distressed asset sales outside the

bankruptcy process is that property sold through foreclosure may be liquidated in ways that generate seriously depressed prices. *BFP v. Resolution Trust Corp.*, 511 U.S. 531, 539 (1994) ("property that must be sold [through a quick liquidation procedure] is simply worth less" because "[n]o one would pay as much to own such property as he would pay to own real estate that could be sold at leisure and pursuant to normal marketing techniques.") (emphases omitted). As a potential means to ameliorate this problem, an insolvent debtor may file for bankruptcy and propose to liquidate its assets in ways that offer a better prospect of maximizing their value. *See* G. Eric Brunstad, Jr., *Bankruptcy and the Problems of Economic Futility: A Theory on the Unique Role of Bankruptcy Law*, 55 BUS. LAW. 499, 565-66 (2000) (discussing reduced realizations at foreclosure sales as a problem that bankruptcy law properly addresses).

On the other hand, as this Court acknowledged in *LaSalle* (discussed above), the debtor's ability to propose the terms of a sale in bankruptcy carries with it the risk that the debtor will seek to feather its own nest (or at least that of its equity owners) improperly. 526 U.S. at 444; H.R. DOC. No. 93-137, pt. I, at 255 (1973). Congress addressed this second-order challenge by incorporating into the Code the fair and equitable standard and the principle of absolute priority that the standard enforces. H.R. REP.

No. 95-595, at 413 (1977). And as section 1129(b)(2)(A)(ii) makes plain in the context of asset sales under a Chapter 11 plan, the right to credit bid is one of the key tools that ensures compliance with this standard.

It is certainly true that section 1129(b)(2)(A)(iii) also recognizes that a debtor may satisfy the fair and equitable test by proposing a plan that yields to the secured creditor the "indubitable equivalence" of its secured claim. 11 U.S.C. § 1129(b)(2)(A)(iii). But as the legislative history explains, "[t]he indubitable equivalent language is intended to follow the strict approach taken by Judge Learned Hand in the [case of] *In re Murel Holding Corp.*, 75 F.2d 941 (2d Cir. 1935)." S. REP. No. 95-989, at 127 (1978). Critically, the "strict" approach of *Murel Holding* is also one of absolute priority, and under it, the secured creditor's rights may not be stripped away unless the secured creditor receives alternative treatment that is completely compensatory for what it has been denied. The Debtors' plan in this case simply cannot meet this standard.

In *Murel Holding*, the debtor proposed a plan that would have allowed it to retain its property (an apartment building) while modifying the lien rights of its secured creditor over the secured creditor's objection. 75 F.2d at 941-42. Under section 77B of the former Bankruptcy Act,

the debtor might have crammed down its plan if the debtor had been able to provide the secured creditor "equitably and fairly" with "adequate protection" of its interest. *Id.* at 942. As the Second Circuit observed, however, in order to be "adequate," the secured creditor's "protection" had to be "completely compensatory." *Id.* The debtor's plan failed this standard (apparently because it was too risky), prompting the court to remark that there was "no reason to suppose that [section 77B] was intended to deprive [the secured creditor of his right either to receive payment or foreclose on his collateral for the sake of] junior holders, unless by a substitute of the most indubitable equivalence." *Id.*

Outside of bankruptcy, secured creditors generally enjoy the right to credit bid, and a sale that does not have the protection of credit bidding simply cannot be the "indubitable equivalent" of one that does, at least not in a manner consistent with the "fair and equitable" standard of section 1129(b) and the concept of absolute priority that credit bidding is designed to serve. Accordingly, the Debtors in this case cannot invoke the "indubitable equivalence" option set forth in section 1129(b)(2)(A)(iii) to avoid Amalgamated's right to credit bid.

CONCLUSION

For the foregoing reasons, as well as those offered by respondent, the decisions of the courts below should be affirmed.

Respectfully submitted,

G. Eric Brunstad, Jr.
Counsel of Record
Collin O'Connor Udell
Matthew J. Delude
DECHERT LLP
90 State House Square
Hartford, Connecticut 06103
(860) 524-3999

March 9, 2012 *Counsel for Amicus Curiae*