No. 11-166

IN THE

Supreme Court of the United States

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

v.

AMALGAMATED BANK,
Respondent.

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

BRIEF FOR THE LOAN SYNDICATIONS AND TRADING ASSOCIATION AS AMICUS CURIAE IN SUPPORT OF PETITIONERS

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INTEREST OF AMICUS CURIAE

The Loan Syndications and Trading Association (LSTA) is a financial trade association whose mission is to promote a fair, orderly, efficient, and growing corporate loan market and to provide leadership in advancing and balancing the interests of all market participants.[1] Its interest in this case—which involves the treatment of secured creditors whose collateral is auctioned under a Chapter 11 plan—lies in protecting the integrity and efficiency of the bankruptcy process in general and bankruptcy auctions in particular. As a nationwide group with members under the jurisdiction of virtually every federal court of appeals, LSTA has a unique interest in ensuring regularity and predictability throughout the circuits, and in advocating for uniform rules that promote efficient bankruptcy administration.

LSTA participated below as an amicus in support of Respondent, and it believes the Seventh Circuit's decision is correct. Nonetheless, LSTA supports the petition for a writ of certiorari because it agrees with Petitioners that the merits of the question presented are critically important to the bankruptcy system, that there is a square circuit split with carefully reasoned opinions on both sides, and that this case presents a rare and ideal vehicle for resolving that split. Secured creditors' ability to credit bid at auctions of their collat-

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[1] Pursuant to Supreme Court Rule 37.6, counsel for LSTA states that no counsel for a party authored this brief in whole or in part, and that no person or entity other than LSTA or its counsel made a monetary contribution intended to fund the preparation and submission of this brief. Counsel of record for all parties have consented to the filing of this brief. Statements of consent have been submitted to the Clerk.

eral is central to the detailed scheme of protections that the Bankruptcy Code provides them. The Seventh Circuit recognized this and held that the Bankruptcy Code grants secured creditors the right to credit bid. The Third and Fifth Circuits have reached the opposite conclusion. The persistence of an incorrect legal rule in those circuits—and the ongoing uncertainty in other circuits that have not yet spoken on the question—will impose additional risks on secured lenders, raising the cost of capital at a particularly inopportune moment for the national economy. This Court should grant the petition for a writ of certiorari and affirm the decision below.

STATEMENT

I. Legal Background

This case is about the protections afforded to secured lenders in Chapter 11 bankruptcies—specifically, their right to "credit bid" at sales of their collateral.

Generally speaking, credit bidding allows a secured lender to bid at the sale of its collateral using the outstanding balance on the loan as credit instead of using cash. For example, if a debtor owes $100,000 on a mortgaged warehouse when it seeks Chapter 11 protection, and the debtor or trustee decides to auction the warehouse as part of the bankruptcy process, the mortgage lender may bid up to $100,000 to acquire the warehouse without committing any cash. If the creditor's bid is not the highest bid, it receives the proceeds from the sale; if the secured creditor's bid prevails, it gets the property and offsets its bid against the balance on the loan. *See* 11 U.S.C. §363(k) (providing that a secured lender "may bid at [a] sale [of its collateral], and, if [it] purchases such property, ... may offset [its] claim against the purchase price"). In effect, credit bidding allows the secured creditor to take possession of its collateral if it believes the property is worth more than does the next highest bidder, without incurring the significant transaction costs associated with preparing and financing a cash bid.

This right is central to Chapter 11's detailed scheme protecting the interests of secured creditors. In general, a Chapter 11 plan may be confirmed only if secured creditors consent or their claims are paid in full. Because that is not always possible, however, the Bankruptcy Code provides that a plan can be confirmed over a secured creditor's objection—"crammed down," in bankruptcy parlance—as long as the plan is "fair and equitable." 11 U.S.C. §1129(b)(2). A plan is "fair and equitable" to secured creditors in three circumstances, laid out in the three subsections of Section 1129(b)(2)(A):

- *First*, under subsection (i), the plan may provide that secured lenders will keep the full value of their liens and receive a stream of payments meeting certain requirements;
- *Second*, under subsection (ii), the plan may provide for the sale of collateral "free and clear" of existing liens and give the proceeds to the secured creditor, but the sale must conform to Section 363(k), which gives secured creditors the right to credit bid; or
- *Third*, under subsection (iii), the plan may provide "for the realization by ... holders [of secured claims] of the indubitable equivalent" of their claims.

See 11 U.S.C. §1129(b)(2)(A)(i)-(iii).

In this case, the debtors proposed a Chapter 11 plan under which they would conduct the kind of asset sale contemplated by subsection (ii) *without* allowing secured lenders to credit bid as subsection (ii) requires, on the theory that the proceeds of the sale might provide the lenders with the "indubitable equivalent" of their claims under subsection (iii). *See* Pet. 5. A divided panel of the Third Circuit had recently approved this theory in *In re Philadelphia Newspapers*, 599 F.3d 298 (3d Cir. 2010), and the debtors modeled their plan directly upon that precedent. *See* Pet. 8-9. But the bankruptcy court found Judge Ambro's dissent in *Philadelphia Newspapers* more persuasive, and rejected the plan as incompatible with subsection (ii). Pet. App. 42a.

Recognizing the importance of the legal question presented, the bankruptcy court certified the issue to the Seventh Circuit. *See* 28 U.S.C. §158(d)(2)(A). The Seventh Circuit affirmed in a fully reasoned opinion, likewise agreeing with the reasoning of Judge Ambro's dissent. The result is a square split between the circuits on the question whether a Chapter 11 plan may provide for the sale of collateral free and clear of existing liens while denying secured creditors the right to credit bid.[2]

II. FACTUAL BACKGROUND

In general, LSTA agrees with Petitioners' statement of the factual background. Pet. 4-5. Certain facts merit special attention, however, not because they are

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[2] Section 363(k) permits the denial of credit bidding "for cause," but the bankruptcy court found that cause was lacking, Pet. App. 43a-45a, and that finding was not appealed.

unique, but because they are typical of the cases in which this question arises.

1. As is true of more and more bankruptcies, the "reorganization" at issue here is in every meaningful sense an asset sale. *See* Baird & Rasmussen, *Chapter 11 at Twilight*, 56 Stan. L. Rev. 673, 675 (2003); Buccola & Keller, *Credit Bidding and the Design of Bankruptcy Auctions*, 18 Geo. Mason L. Rev. 99, 99 (2010) ("In high-stakes cases, bankruptcy judges now serve primarily as auctioneers."). As their names suggest, Petitioners are single-asset real-estate affiliates created to quarantine the financial risk associated with an individual development project. The project has gone "underwater"—meaning that its current value is below the outstanding balance on Petitioners' secured loans—and a stalking-horse bidder has offered to buy the project for only a fraction of the existing debt.[3] There is no other ongoing business to reorganize. Thus, the debtors' "plan" consists of nothing more than erasing the liens on their property by selling it to new owners. This is a valid, and indeed common, use of the bankruptcy process. *See In re Peachtree Lane Assocs., Ltd.*, 150 F.3d 788, 795 (7th Cir. 1998) ("'The typical chapter 11 case for a single asset real estate entity is about raising new capital, renegotiating loan terms, ... attempting to "cram down" a plan on the secured creditors, or selling the asset.'"). But in such cases, where a Chapter 11 plan amounts merely to selling secured assets and giving the lender the proceeds, the terms of the sale are crucial to protecting the secured lender's rights and ensuring a fair and orderly bankruptcy process.

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[3] The debtors owe "at least $120,000,000," Pet. App. 5a; the stalking-horse offer is $47,500,000, *id.* 6a.

2. As is also typical, the debtors in this case have not explained how denying secured lenders the right to credit bid will serve the central aim of the bankruptcy process: "maximizing the value of the bankruptcy estate." *Toibb* v. *Radloff*, 501 U.S. 157, 163 (1991). Indeed, there is no way in which constraining a secured lender's ability to bid, and thus limiting the number of potential bidders at an auction, can possibly maximize the value of the auctioned property. To the contrary, "credit bidding is an unalloyed good" for the bankruptcy estate, and "keeping a credit bidder from participating ... is an unsupportable strategy, at least for a debtor intent on maximizing its sale proceeds." Buccola & Keller, 119-120.

Debtors, however, are not always primarily concerned with maximizing the sale proceeds: A cheap sale to a stalking-horse bidder can benefit existing equity-holders while harming the estate. Here, for example, one of the debtors' principals has an equity stake in the stalking-horse bidder, and the stalking horse has agreed to preserve the existing management if its bid prevails. Denying credit bidding in this case—and, LSTA believes, in almost every case—thus presents a serious risk of favoritism to equity-holders or corporate managers, jeopardizing the paramount aim of estate maximization for the benefit of creditors.

REASONS FOR GRANTING THE WRIT

This case is an ideal candidate for certiorari. As Petitioners have demonstrated, there is a square split on this question among the Third, Fifth, and Seventh Circuits, each of which administers a substantial bankruptcy docket. The question presented is critically important to the administration of Chapter 11 bankruptcies and to secured lending in general, and the erroneous rule adopted by the Third and Fifth Circuits undermines Congress's careful scheme for the fair treatment of secured creditors. Finally, bankruptcy disputes' tendency to be mooted by the parties' common preference for expedition may well deprive this Court of future opportunities to resolve this division of authority—as occurred in *Philadelphia Newspapers* itself.

I. THE CIRCUITS ARE SPLIT

The circuit split on the credit-bidding question is plain and squarely presented. The plan language in this case is substantively identical to the language considered by the Third Circuit in *Philadelphia Newspapers*, and the Seventh Circuit reached the opposite conclusion because it "f[ou]nd the statutory analysis articulated by Judge Ambro in his *Philadelphia Newspapers* dissent to be compelling." Pet. App. 17a.

The split is also fully formed, with fully reasoned opinions on both sides. In addition to *Philadelphia Newspapers*, Petitioners' position derives support from the Fifth Circuit's decision in *In re Pacific Lumber Co.*, 584 F.3d 229 (5th Cir. 2009). That case concerned a judicial valuation and transfer rather than a public auction, but the Fifth Circuit nonetheless concluded that "a sale occurred," *id.* at 245, and held that this sale could be allowed notwithstanding that it "depriv[ed] [secured creditors] of the right to credit bid," *id.* at 247. The Fifth Circuit considered whether Section 1129(b)(2)(A)(ii) mandates that all "free and clear" sales under a plan provide for credit bidding, and held that it does not. *Id.* at 245-249. Meanwhile, the contrary interpretation has been fully explicated in the decision below and in Judge Ambro's detailed dissent. These are extensively reasoned opinions from judges with substantial commercial law and bankruptcy experience. Additional percolation is unlikely to develop the arguments further in any meaningful way.

Moreover, the split will almost certainly persist unless this Court intervenes. The Third Circuit denied rehearing en banc in *Philadelphia Newspapers* despite another dissent from Judge Ambro and amicus support for rehearing. The erroneous rule is thus fully entrenched in the Third Circuit, where many business bankruptcies are filed and many more could be if debtors choose, given the number of businesses incorporated in Delaware. *See* 28 U.S.C. §1408 (providing venue for Chapter 11 cases in any jurisdiction in which the debtor, or any affiliate seeking bankruptcy protection, is incorporated). And the positions of the Fifth and Seventh Circuits are likewise clear and unlikely to alter. This is particularly true because the extended bankruptcy appeal process and the incentives for quick resolution of such cases make it unlikely that these courts will even encounter the opportunity to revise their positions.

In short, this is a circuit split that is ready for resolution, and there is little to gain in deferring the question for another day. There is, however, much to lose: Credit bidding is a cornerstone of the Bankruptcy Code's carefully designed structure for protecting secured creditors' rights, and the Third and Fifth Circuits' holdings seriously weaken that structure.

II. THE THIRD AND FIFTH CIRCUITS' ERRONEOUS INTERPRETATION UNDERMINES CORE BANKRUPTCY PURPOSES

The interpretation of Section 1129(b)(2)(A) adopted by the Third and Fifth Circuits is wrong, and it opens a dangerous loophole in the Bankruptcy Code's meticulous design. Credit bidding is an essential protection for secured creditors at bankruptcy sales, and the prospect of its routine denial poses a substantial risk to lenders and lending markets. Moreover, the denial of credit bidding is not only contrary to the Bankruptcy Code's carefully crafted scheme, but also serves no economically sound, bankruptcy-related purpose. The rule permitting its denial is thus an invitation to serious mischief with no offsetting benefits for bankruptcy administration.

A. The Third And Fifth Circuits' Interpretation Has No Basis In The Text And Undermines The Protections For Secured Creditors

The Third Circuit concluded, and Petitioners maintain, that Section 1129(b)(2)(A) *unambiguously* permits asset sales without credit bidding because it uses the word "or" to separate its three subsections, one of which speaks broadly of any plan that provides the "indubitable equivalent" of a secured lender's claim. *See Philadelphia Newspapers*, 599 F.3d at 304-314. As explained below, this reading is seriously at odds with the Code's intricate scheme of protections for secured creditors. But even the text of Section 1129(b)(2)(A) examined in isolation cannot support the Third Circuit's conclusion.

Indeed, the Third and Fifth Circuits' reading signally fails to harmonize the statute's three subsections: If a debtor may conduct an asset sale without credit bidding under subsection (iii)'s catch-call provision, then subsection (ii)'s language mandating credit bidding in such sales serves no purpose. The "indubitable equivalent" exception of subsection (iii) thus swallows the specific rules set out in subsections (i) and (ii). It is far more plausible that subsection (ii), in specifically dealing with sales under a plan and requiring credit bidding, was intended to control the terms of *all* such sales. That is consistent with the ordinary rule favoring specific provisions over general ones, *see D. Ginsberg & Sons, Inc.* v. *Popkin*, 285 U.S. 204, 208 (1932), and with the canon disfavoring statutory surplusage, *see Duncan* v. *Walker*, 533 U.S. 167, 174 (2001).

Indeed, this Court recently addressed a statutory provision with an almost identical structure and rejected the approach that the Third and Fifth Circuits employed in interpreting Section 1129(b)(2)(A). In *Bloate* v. *United States*, 130 S. Ct. 1345, 1355 (2010), this Court held that even where a list of options is conjoined by the word "or," the best reading is that "each of the ... sub[sections] ... govern[s], conclusively unless the sub[section] itself indicates otherwise ..., the category of proceedings it addresses." As in *Bloate*, the fact that there are other types of plans that may be confirmed over a secured creditor's objection "in no way undermines [the] conclusion that a [plan] that falls *within* the category ... addressed by sub[section (ii)]"—in this case, plans providing for free-and-clear sales of secured creditors' collateral—"is governed by the limits in that sub[section]." *Id.* at 1354.

The Third and Fifth Circuit's reading also conflicts with the overall structure of the Bankruptcy Code and undermines its carefully designed protections for secured creditors' property interests in their collateral. For over a century, courts have adhered to the principle that bankruptcy law does not permit an "involuntary reduction of the amount of a creditor's lien for any reason other than payment on the debt." *Dewsnup* v. *Timm*, 502 U.S. 410, 419 (1992). The general rule is that absent consent, full payment, or surrender of the collateral, a secured creditor's lien must survive the bankruptcy. *Id.* at 417.

Several interlocking provisions of the Bankruptcy Code are relevant to this protective treatment for secured claims. First, Section 506(a) typically "bifurcates" an under-secured claim: If a lien is secured by property worth less than the amount owed, the creditor's claim is divided into a secured claim equal to the present value of the collateral and an unsecured claim for the balance. This ensures that a secured creditor keeps its right to priority treatment in the disposition of its collateral, but may also vote with the other unsecured creditors as to the disposition of the assets that might satisfy the balance of its claim.

But this provision makes judicial valuation of collateral risky for secured lenders in cases (like this one) where the estate has no other assets: The secured lender gets nothing on its deficiency claim, so if the court undervalues the collateral, the lender will end up recovering less than it should. For example, if a loan for $100 is secured by property that the court believes is worth $40 but the lender believes is worth $80, and unsecured creditors will recover nothing because the debtor has no other assets, Section 506(a) might force the secured lender to accept $40 in satisfaction of its claim when it would much prefer the collateral itself.

Accordingly, Section 1111(b)(2) of the Code provides the under-secured creditor with an alternative: It may elect to have its entire claim treated as secured and give up its unsecured claim for the deficiency. *See* 7 *Collier on Bankruptcy* ¶¶1111.03[2][a], 1111.03[3][c], 1111.03[5] (16th ed. 2011). The creditor thereby protects itself from being forced to accept less than it believes its collateral is worth. If the debtor wants to keep the collateral (perhaps because the debtor believes it is worth more than the court valuation), the secured creditor can keep its whole lien.

These provisions interact with the cram-down provisions through Section 1129(b)(2)(A)(i), which applies whenever the debtor chooses to keep the collateral subject to the secured creditor keeping its lien. Subsection (i) entitles the lien-holder to deferred cash payments that both "total[] at least the allowed amount of [the lien-holder's] claim" and have "a value, as of the effective date of the plan, of at least the value of such holder's interest in the estate's interest in such property." 11 U.S.C. §1129(b)(2)(A)(i)(II). In plainer terms, the deferred payments must eventually equal the total face value of the loan, and that extended stream of payments must have a present discounted value equal to the collateral's present value. In the hypothetical above where the court values collateral securing a $100 loan at $40, the creditor is entitled to cash payments equal to $100 over time that, discounted for the time value of money, are worth $40 today.

It might seem that the difference between keeping a lien together with a $100 stream of payments worth $40 today and actually receiving $40 today is trivial, but it is not. By keeping its lien, the secured creditor who believes its collateral is really worth $80 prevents the debtor from exiting bankruptcy and selling the property the next day for more than the $40 court valuation, keeping the upside for itself. Indeed, both the leading treatise and the legislative history make clear that one of the core reasons for allowing secured creditors to make the Section 1111(b) election is to prevent the debtor from attempting to cash out the creditor at the present value of the collateral when the creditor thinks the collateral is worth more. *See* 7 *Collier on Bank-*

ruptcy ¶1111.03[3][c] ("The election can be utilized to prevent an attempted cash out .... A secured creditor, by electing to be fully secured under section 1111(b)(2), can require payment of the full amount of the claim, regardless of the value of the collateral."); 124 Cong. Rec. 32,408 (1978) (Rep. Edwards) ("The advantage [of the election] is that ... if the value of the collateral increases after the case is closed, the deferred payments will be secured claims."). The context of cases like this one makes this protection especially important:

> Since the issue relates so often to single-asset real estate cases, it is useful to recall exactly what Congress enacted in that particular regard. Through sections 1111(b), 1124 and 1129(b)(2)(A), Congress specifically legislated to prevent ... the debtor [from] retain[ing] the property subject to the mortgage by paying an appraised value, over the objection of the secured creditor.

7 *Collier on Bankruptcy* ¶1129.03[4][c][ii][B].

Together, these provisions ensure that a secured creditor is not forced to accept anything other than its full lien if the debtor keeps the collateral—an involuntary "cash out" at a judicial estimate of present value is off limits. Indeed, if the secured creditor is not to keep the full value of its lien (or be paid in full), the only thing it can be forced to accept is the property itself.

This is where credit bidding comes in, and why it is so important. A secured creditor is not entitled to make the Section 1111(b) election if the collateral will be sold. *See* 11 U.S.C. §1111(b)(1)(A)(ii), (B)(ii). But this is because the "creditor has the opportunity to protect its position. *It may bid its debt at the sale of the collateral and recover the collateral.* This ability gives it the benefit of its bargain[.]" 7 *Collier on Bankruptcy* ¶1111.03[3][b] (emphasis added); *see also* 124 Cong. Rec. 32,407 ("Sale of property ... is excluded from treatment under section 1111(b) because of the secured party's right to bid in the full amount of his allowed claim at *any* sale of collateral[.]" (emphasis added)). Thus, as the leading treatise recognizes, the right to credit bid is, in essence, the right to take title to the collateral unless someone else will pay more than the full value of the lien. *See* 7 *Collier on Bankruptcy* ¶1129.04[2][b][ii] ("[I]f the secured party thinks the collateral is worth more than the debtor is selling it for, it may effectively bid its debt and take title to the property.").

Together, these provisions of the Code ensure that a secured lender can always either keep its full lien or get all of its collateral. It need not accept what the debtor, or the court, or a stalking-horse bidder thinks the collateral is worth—it can bid what it thinks the collateral securing its loan is worth and thus obtain the collateral, or it can retain its lien.

When Congress referred to providing a secured creditor with the "indubitable equivalent" of its claim, it had these rights in mind. According to the Bankruptcy Code's sponsors, "[a]bandonment of the collateral to the creditor would clearly satisfy indubitable equivalence, as would a lien on similar collateral." 124 Cong. Rec. 32,407. In other words, the creditor can keep its lien (secured by collateral of equal value), or the creditor must get the property. And that is exactly what Judge Hand said when he coined the phrase "indubitable equivalent" in *In re Murel Holding Corp.*: "[A secured creditor] wishes to get *his money or at least the property*. We see no reason to suppose that the statute was intended to deprive him of *that* ...

unless by a substitute of the most indubitable equivalence." 75 F.2d 941, 942 (2d Cir. 1935) (emphasis added).

There is thus no merit to the Third Circuit's suggestion—echoed by Petitioners—that the proceeds of a no-credit-bidding sale might eventually provide the indubitable equivalent under subsection (iii), making it appropriate to defer the question of equivalence until after the sale. *See* Pet. 10 (citing *Philadelphia Newspapers*, 599 F.3d at 312-313). As the foregoing makes clear, there is only one (trivial) way that a sale without credit bidding can provide the indubitable equivalent of a secured lender's claim. The creditor begins with alternative rights either to have his whole claim treated as secured under Section 1111(b) or to bid his whole claim as credit at any sale of the collateral under Section 1129(b)(2)(A)(ii). The no-credit-bidding sale deprives the creditor of his right to elect secured treatment for his whole claim without providing the Code's offsetting guarantee of credit bidding at the asset sale. Thus, the only way for such a sale to provide the indubitable equivalent of the rights it has destroyed is if it generates cash sufficient to pay the secured creditor's *whole* initial claim. But that is a trivial case: If a creditor is to be paid in full, then Section 1129(b)(2)(A)'s protections need not apply at all.[4]

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[4] Indeed, the plan the Third and Fifth Circuits have sanctioned is the paradigmatic *violation* of the indubitable equivalence standard. The Code's sponsors and the leading treatise agree that "present cash payments less than the secured claim would not satisfy the standard because the creditor is deprived of an opportunity to gain from a future increase in value of the collateral." 124 Cong. Rec. 32,407; 7 *Collier on Bankruptcy* ¶1129.04[2][c].

Accordingly, a leading scholar has called it "mystifying" how a plan sale without credit bidding could provide the indubitable equivalent of the secured creditor's lien, "[g]iven that credit-bidding allows the secured creditor to gain control over the asset and any other plan necessarily gives it something less." Baird, *Car Trouble* 16 (unpublished manuscript), https://editorialexpress.com/cgi-bin/conference/download.cgi?db_name=ALEA2010&paper_id=9 (last visited Sept. 8, 2011). Exactly so. The Third and Fifth Circuits' position allows debtors to take one of the three ways that the Code protects the same property right, subtract a protection of "significant value," and call the result the "indubitable equivalent." That cannot be right as a matter of statutory interpretation, and it undermines the basic purposes of the Bankruptcy Code.

B. Denying Credit Bidding Serves No Valid Bankruptcy Purpose

If the Third and Fifth Circuits' interpretation is allowed to stand, secured creditors will be able to protect their claims only by organizing, preparing, and financing cash bids sufficient to ensure that their liens are not erased through cheap sales to stalking-horse bidders. This self-help remedy is inadequate protection, and it serves no economically sound, bankruptcy-related purpose to impose this burden on secured creditors.

In general, a creditor may not be ready or able to obtain the financing required to make a cash bid on its collateral at an expedited sale. It may also have to pay sizable fees to investment banks to facilitate such a payment. Moreover, in the common case in which the loan was made by a group of many lenders under a syndicated loan agreement, the difficulty of reaching agreement on cash bidding terms may make it effectively impossible. In fact, some creditors—such as mutual funds or collateralized loan obligations—may not be permitted to cash bid at all.[5] Thus, many secured creditors will be completely unable to bid on their collateral or able to do so only at great expense. *See* Buccola & Keller, 123-124. A sale at which secured creditors cannot get their collateral, or can do so only by paying new costs, cannot provide the indubitable equivalent of a secured claim. Rather, that entitlement is protected only at a sale at which the secured creditor retains the "significant value" of the power to credit bid. 3 *Collier on Bankruptcy* ¶363.09.

In fact, a recent scholarly article demonstrates that credit bidding tends to provide substantial benefits for the bankruptcy estate with essentially no countervailing harms. *See* Buccola & Keller, 100, 117-124. It finds that "credit bidding is an unalloyed good" for the bankruptcy estate for three reasons. *Id.* at 120.

First, credit bidding increases the number of available bidders, and having more bidders tends to produce higher bids. Auction theory (and common sense) make clear that the winning bid is based only on what the highest and next-highest bidders are willing to pay. Thus, adding more bidders can increase the winning bid, but cannot decrease it. *See* Buccola & Keller, 119

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[5] Securitization of loans has become very common. In a typical scenario, sometimes called a "collateralized loan obligation" (CLO), an entity buys loans and issues securities representing claims of various priority on principal and interest payments under the loans. The CLO manager is bound by an indenture specifying the permissible treatment of any cash on hand. The indenture is unlikely to permit the purchase of property, making cash bidding exceedingly difficult, if not impossible, for a significant group of secured creditors.

("Excluding an interested buyer, ... where every bidder potentially represents the auction participant with the highest or second-highest reservation price, creates a risk the seller has no reason to take."). "It follows that keeping a credit bidder from participating ... is an unsupportable strategy ... for a debtor intent on maximizing its sale proceeds," *id.* at 119-120, especially at expedited sales where there is a real prospect that the stalking horse will be the only party prepared to come with cash in hand. An auction with N+1 bidders is always better than an auction with only N, but this is especially so where N is very small.

Second, the secured lender is not just any bidder: It has unique information and a unique interest in preventing inside dealing by existing management. At expedited sales, lack of information may discourage some parties from participating at all, and may cause others to discount their bids in light of the risk that they have misvalued the asset. The secured lender likely knows the value of the asset better than most, and so may bid more confidently at higher values. Excluding or discouraging its participation is thus particularly damaging. Buccola & Keller, 120.

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

Finally, credit bidding minimizes transaction costs that reduce value for the estate. Readying and financing a cash bid is costly, and a cash bidder must deduct these costs from its asset valuation to determine what it can profitably bid. These fees are diverted from the estate and flow instead to outside attorneys and banks. Because credit bidding avoids these costs, it allows the secured lender to offer that much more for the asset. From the standpoint of estate maximization, forcing the secured lender to pay in cash is manifestly ill-conceived. *See* Buccola & Keller, 121.

In short, denying the right to credit bid discourages participation by a low-cost, high-information bidder with interests unquestionably aligned with the estate. It is hard to explain how—if at all—such a choice can serve the best interests of the creditors.[6]

In any event, in the rare case in which there might be a reason to deny credit bidding, the Bankruptcy Code already provides that the bankruptcy court may do so "for cause." 11 U.S.C. §363(k). The debtors made

[6] The suggestion that credit is somehow worse for the estate than cash is wholly illogical; the payment of cash and the release of secured debt equally reduce the estate's liabilities. *See* Buccola & Keller, 122 ("Forbidding credit bidding on the ground that credit is not cash is tantamount to prohibiting cash bidders from bidding with two fifty-dollar bills in lieu of a single, hundred-dollar note.").

such a motion below, and it was denied. Thus, the question presented here is whether a plan may provide for the free-and-clear sale of collateral, without allowing the lien-holders to credit bid, in a case in which there is—by definition—no cause for this denial. The Code should not be read to support such strange and unfair outcomes.

Indeed, such a rule ultimately favors no one—not even borrowers. Judicial rules granting inefficient rights to debtors drive up interest rates, and allowing evasion of secured creditors' right to credit bid will almost certainly have that result. The logical reaction to the increased risk of undervaluation created by the present rule in the Third and Fifth Circuits is an increased cost of capital for borrowers at a time when U.S. credit markets are still recovering from a historic crisis of confidence. Their rule thus poses a needless impediment to lending, investment, and economic growth.

III. Opportunities To Resolve This Split Are Unlikely To Recur

Bankruptcy appeals are frequently cut short by the parties' common need for expedited resolution. That is particularly true of the kind of single-asset sales that typically present the credit-bidding question. This case thus affords a potentially rare opportunity to resolve this important issue.

Credit bidding matters to creditors when their loans are under-secured and the estate lacks the assets to satisfy the deficiency. But these are also the circumstances under which delay is most harmful. An underwater real-estate asset leaks value every day in multiple ways. *First,* it depreciates—meaning it will fetch less when sold. *Second,* it accumulates more bills—

under Section 506(c), the secured creditor can be surcharged for all the costs of maintaining the property, "including the payment of all ad valorem property taxes." *Third*, it creates a mounting opportunity cost—the interest owed each month will now never be paid, and the creditor would like to salvage its funds from the sinking project and get them back to work.

At the same time, bankruptcy appeals can be protracted, often interposing an extra level of review between the initial decision and the court of appeals. *See* 28 U.S.C. §158. This is particularly likely in circuits like the Third and Fifth where the rule is now settled and bankruptcy courts are unlikely to certify no-credit-bidding plans for direct review. Creditors harmed by the rule may therefore need to engage in extended litigation through several levels of review even to be in a position to petition for en banc rehearing or certiorari.

Under these circumstances, most creditors can be expected to acquiesce in the detrimental denial of credit bidding simply to avoid the long delay that the path to this Court entails. Indeed, it will be no surprise if future cases presenting this question go the way of *Philadelphia Newspapers*: resolved by the rational, business-driven decisions of secured lenders to obviate their disputes before they can reach this Court.

Nonetheless, it is clear that Chapter 11 plans like the one presented will become more prevalent in the wake of their authorization by the Third Circuit: Petitioners admits that it modeled its plan on that decision, and others can be expected to do the same. The Third and Fifth Circuits' interpretation was unheard of in 30 years of experience under the Bankruptcy Code. *See Philadelphia Newspapers*, 599 F.3d at 319 (Ambro, J., dissenting). But now that a plan stripping secured lenders of the right to credit bid has been approved, such plans will undoubtedly become more and more common, given their obvious (if inappropriate) attractions for debtors' equity-holders and existing management. And the increasing number of single-asset real-estate "reorganizations" that are essentially asset sales makes such plans more attractive still. The potential ubiquity of no-credit-bidding proposals for bankruptcies of this type requires, now more than ever, that the rules of asset sales be fair, uniform, and consistent with the purposes of the Code.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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