Delaware Court Finds "Cause" to Limit Credit-Bid to Facilitate Bankruptcy Auction

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In *In re Fisker Automotive Holdings, Inc.*, 2014 BL 13998 (Bankr. D. Del. Jan. 17, 2014), *leave to app. denied*, 2014 BL 33749 (D. Del. Feb. 7, 2014), *certification denied*, 2014 BL 37766 (D. Del. Feb. 12, 2014), a Delaware bankruptcy court limited a creditor's ability to credit bid its debt in connection with the sale of a hybrid car manufacturer's assets. Although the court limited the amount of the credit-bid to the distressed purchase price actually paid for the debt, the court's focus was on the prospect that the credit-bid would chill bidding and that the full scope of the underlying lien was as yet undetermined. The court also expressed concern as to the expedited nature of the sale, which in the court's view was never satisfactorily explained.

After the distressed debt buyer's credit-bid was limited by the court, an auction ensued and a third-party strategic purchaser prevailed over the distressed debt buyer. Given the importance of credit bidding as a distressed acquisition tool, and the court's ruling limiting the credit-bid to the amount paid for the debt, distressed debt purchasers are sure to focus on how subsequent courts interpret and apply *Fisker*.

Credit Bidding Under the Bankruptcy Code

Section 363(b) of the Bankruptcy Code allows for the sale of a debtor's assets outside the ordinary course of its business, including the sale of all or substantially all of those assets. Subject to certain requirements, section 363(f) of the Bankruptcy Code provides that such a sale may be made "free and clear" of all liens, claims, and encumbrances. That is, the sale can be consummated, notwithstanding the fact that a party other than the debtor asserts an interest in the property up for sale.

The Bankruptcy Code recognizes that a creditor with a lien on the assets for sale may "credit bid" its indebtedness in connection with such a sale, "unless the court for cause orders otherwise." This authorization applies to both a sale outside a chapter 11 plan and a sale pursuant to a nonconsensual plan. Specifically, section 363(k) of the Bankruptcy Code 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.

As set forth above, a credit-bid is nothing more than the offset of a claim against the property's purchase price. That is, rather than having (i) the creditor pay the purchase price to the debtor, and (ii) the debtor return the purchase price to the creditor as proceeds of its collateral, the creditor can make a bid that would simply cancel out the two obligations and short-cut the back-and-forth payment of cash. The U.S. Supreme Court recently explained in *RadLAX Gateway Hotel, LLC v. Amalgamated Bank*, 132 S. Ct. 2065, 2070 n.2 (2012), that "[t]he ability to credit-bid helps to protect a creditor against the risk that its collateral will be sold at a depressed price[,]" and "[i]t enables the creditor to purchase the collateral for what it considers the fair market price (up to the amount of its security interest) without committing additional cash to protect the loan."

Section 363(k) of the Bankruptcy Code assumes a valid lien on the property being purchased—specifically, it refers to "property that is subject to a lien that secures an allowed claim."

However, even where a valid lien exists, the court may nonetheless prohibit credit bidding "for cause."

The holding in *Fisker* provides some guidance regarding the meaning of "for cause" for purposes of section 363(k), in the context of that case.

Fisker

Prior to filing for chapter 11 protection in 2013, Fisker Automotive ("Fisker") manufactured hybrid electric cars in the U.S. In 2010, Fisker received a loan from the U.S. Department of Energy ("DOE") in order to fund the development, commercial production, sale, and marketing, as well as all related engineering integration, of various of Fisker's hybrid electric cars.

Business did not go well for Fisker, which had to deal with the bankruptcy filing of a key battery supplier, with product recalls, and with other adverse incidents. In 2012, Fisker was substantially impacted by the effects of Hurricane Sandy, losing a material portion of its existing unsold-vehicle inventory.

In October 2013, the DOE auctioned off Fisker's senior indebtedness. At the auction, Hybrid Tech Holdings, LLC ("Hybrid") was the prevailing bidder and purchased all of Fisker's outstanding senior loan facility debt ($168.5 million face amount) from the DOE for $25 million—approximately 15 cents on the dollar.

On November 22, 2013, Fisker filed for bankruptcy relief in Delaware and initially sought to sell its assets to Hybrid by means of a private sale. As proposed, Hybrid would acquire substantially all of Fisker's assets in exchange for $75 million in the form of a credit-bid of the debt acquired from the DOE.

Pressing for an auction instead of a private sale, the official committee of unsecured creditors (the "committee") opposed Fisker's proposed deal with Hybrid and sought to limit Hybrid's ability to credit bid its debt. The committee strongly endorsed an auction process in which at least one third-party strategic purchaser, Wanxiang America Corporation ("Wanxiang"), would participate.

For its part, Wanxiang had recently purchased certain assets of bankrupt A123 Systems, LLC, which produced a primary component of Fisker's electric cars—namely, the lithium ion batteries. This made Wanxiang a potentially highly attractive auction participant. However, there was a catch—Wanxiang refused to participate in any auction process unless Hybrid's ability to credit bid was capped at $25 million.

More *Fisker* Facts

On January 10, 2014, the bankruptcy court held a hearing to consider Fisker's motion to approve the proposed private sale of assets to Hybrid. Fisker and the committee stipulated to the relevant facts, which included the following:

- "[I]f at any auction Hybrid either would have no right to credit bid or its credit bidding were capped at $25 million, there is a strong likelihood that there would be an auction that has a material chance of creating material value for the estate over and above the present Hybrid bid."
- "[I]f Hybrid's ability to credit bid is not capped, it appears to both the Debtors and the Committee that there is no realistic possibility of an auction . . . ."

- “[The] limiting of Hybrid’s ability to credit bid . . . would likely foster and facilitate a competitive bidding environment . . . .”
- “[W]ithin th[e] entirety of the assets offered for sale are (i) material assets that . . . consist of properly perfected Hybrid collateral, (ii) material assets that are not subject to properly perfected liens in favor of Hybrid and (iii) material assets where there is a dispute as to whether Hybrid has a properly perfected lien . . . .”
- If “the Court rules that there is no basis to limit Hybrid’s ability to credit bid as proposed, the Committee will withdraw all of its oppositions to the Debtors’ present sale . . . .”

The Bankruptcy Court’s Ruling

The bankruptcy court, reciting the language of section 363(k), acknowledged that the Bankruptcy Code gives a secured creditor the right to credit bid its claim. However, the court also observed that the provision expressly gives it the power to limit that right “for cause.”

To determine what “cause” means in this context, the court turned to the Third Circuit’s ruling in *In re Philadelphia Newspapers, LLC*, 599 F.3d 298 (3d Cir. 2010). There, the Third Circuit held that the “right to credit bid is not absolute.” Further, in a footnote, the court of appeals observed that imposing a limit on credit bidding “for cause” does not require that the secured creditor “engage[] in inequitable conduct.” *Id.* at 315 n.14. On the contrary, according to the Third Circuit, “[a] court may deny a lender the right to credit bid in the interest of any policy advanced by the Code, such as to ensure the success of the reorganization or to foster a competitive bidding environment.” *Id.*

Picking up on this language, the court in *Fisker* held that the stipulated evidence showed that there would be *no* bidding (not merely the *chilling* of bidding) if limits were not placed on Hybrid’s ability to credit bid.

The bankruptcy court further reasoned that the holder of a lien whose validity has yet to be determined may not credit bid a claim secured by such a lien. Emphasizing that the parties had stipulated that Hybrid had a valid lien on some Fisker assets, did not have a valid lien on other assets, and had a lien of uncertain status on the remainder, the court concluded that no one could know the scope of Hybrid's collateral or what portion of Hybrid's claim would ultimately be allowed as a secured claim.

In reaching this conclusion, the bankruptcy court expressly distinguished the Third Circuit's decision in *In re Submicron Systems Corp.*, 432 F.3d 448 (3d Cir. 2006), explaining that the issue there was one of value, not of validity. In other words, it is one thing to allow credit bidding where the collateral's *value* is undetermined—indeed, one of the principal benefits of credit bidding is that it protects a creditor against the risk that collateral will be sold at a depressed price. It is another thing, however, to allow credit bidding where the validity of the lien is at issue, because the statute itself contemplates that a valid lien exists.

On the basis of this reasoning, the bankruptcy court in *Fisker* allowed Hybrid to credit bid but held that cause existed to limit its credit-bid to the $25 million it paid for the distressed debt. The court, however, did not explain why it selected $25 million as the amount of the limitation.

The After Story

After the adverse ruling, Hybrid sought leave to appeal to the district court as well as certification of a direct appeal to the Third Circuit. The district court denied both requests. In doing so, it determined that the bankruptcy court's order limiting the credit-bid was not a final order. While not strictly tasked with deciding the merits, the district court by its opinions generally reinforced the view that, under *Philadelphia Newspapers*, bankruptcy judges have the authority to limit credit bidding in order to foster a competitive bidding environment.

After Hybrid's ability to credit bid was limited to $25 million, a competitive auction between Hybrid and Wanxiang ensued. Wanxiang prevailed, the aggregate value of its bid reported at $149.2 million. Now the battle has shifted to the portion of the sales proceeds to which Hybrid, as secured creditor, is entitled.

The Takeaway

At least in Delaware, *Fisker* helps to clarify what can constitute "cause" for purposes of limiting a party's right to credit bid its secured claims. The lede touting this ruling—namely, "court limits credit bid to distressed debt price"—is undoubtedly troubling to some distressed debt investors. However, it is far from clear how subsequent courts will interpret and apply the case.

For one thing, *Fisker* is an unpublished ruling that arguably has limited precedential effect. Moreover, although the court explains in some detail why imposing a limit on credit bidding was appropriate under the circumstances, it is unclear why the court chose $25 million—Hybrid's debt acquisition price—as the appropriate cap. One might argue that the $25 million cap was driven by the parties' stipulation that limiting the credit-bid to that amount would foster bidding and, therefore, the amount of the cap approved by the court was unrelated to the purchase price of the debt. It seems more than coincidental, however, that the $25 million was equal to the debt purchase price. In either event, the principal focus of the decision was whether the court could limit credit bidding under the specific circumstances presented. The bankruptcy court answered that question with a resounding "yes."

The *Fisker* bankruptcy court expressed its displeasure with what it perceived as the rushed nature of the sale process. In the opinion, the court complained that the schedule proposed by Fisker afforded only 24 business days for the parties to challenge the sale and that Fisker failed to provide satisfactory reasons why the private sale of a nonoperating debtor required such speed. The court further cautioned against the creation of artificial deadlines that put unnecessary pressure on bankruptcy judges and creditors. Accordingly, *Fisker* also acts as a reminder from the Delaware bankruptcy court that, while there are appropriate circumstances to conduct expedited section 363 sales in bankruptcy, the reasons for doing so must be clearly articulated to the court.