

Limitations on Credit Bidding Under Fisker and Its Progeny: A Trend or an Aberration?

Section 363(k) of the Bankruptcy Code (the "Code") provides that a secured creditor may "credit bid," or bid at the sale of its collateral and then offset the purchase price at closing by the value of the outstanding claim secured by the collateral being purchased. The right of a secured creditor to credit bid, however, is not absolute, and may be modified or denied by the court "for cause." Recent cases might appear to indicate that there is an emerging trend toward broadening the definition of "for cause" by limiting a secured creditor's right to credit bid based upon policy considerations, such as a desire to foster a competitive bidding environment or to avoid chilled bidding. However, these cases may not be as significant a departure from existing case law as was first believed.

In the first of these cases, *In re Fisker Auto. Holdings, Inc.*, No. 13-13087-KG, 2014 Bankr. LEXIS 230, (Bankr. D. Del. Jan. 17, 2014), the U.S. Bankruptcy Court for the District of Delaware capped a senior secured creditor's right to credit bid for cause where no bidding would occur if the creditor were allowed to bid its full secured amount. In *Fisker*, Hybrid Tech Holdings, LLC ("Hybrid") purchased an outstanding \$168.5 million debt for \$25 million to become the senior secured lender to Fisker Automotive Holdings, Inc. (the "Fisker Debtors"). Hybrid sought to purchase substantially all of the Fisker Debtors' assets, and the Fisker Debtors proposed a private sale under section 363 of the Code just 24 business days after the bankruptcy filing. The Unsecured Creditors Committee (the "Committee") opposed the sale motion and, in particular, opposed Hybrid's right to credit bid. The Committee argued that if Hybrid's credit bidding were capped at \$25 million, there would be a strong likelihood that there would be an auction that could create material value for the estate. If Hybrid's bid was not capped, there would be no realistic possibility of an auction. The court agreed, stating "bidding [would] not only be chilled without the cap; bidding [would] be frozen." However, the court also pointed to the unfair, hurried process insisted upon by Hybrid and highlighted the fact that there was a portion of the assets being sold in which Hybrid did not have a perfected lien, and another portion in which there was a dispute as to whether Hybrid held a perfected lien. Based upon all of these considerations, the court ultimately determined that cause existed to cap Hybrid's right to credit bid at \$25 million. Given the additional reasons cited by the court,

POSTED:

Nov 4, 2014

RELATED SERVICES:

[Business Reorganization](#)

<https://www.reinhartlaw.com/services/business-reorganization>

the opinion cannot be read to find "cause" would exist merely because the size of the secured creditor's claim would chill other bidders.

In April, the U.S. Bankruptcy Court for the Eastern District of Virginia followed *Fisker's* lead by capping a secured creditor's right to credit bid. In *In re Free Lance-Star Publishing Co.*, No. 14-30315-KRH, 2014 Bankr. LEXIS 1611, (Bankr. E.D. Va. Apr. 14, 2014), the Free Lance-Star Publishing Company and William Douglas Properties, LLC (collectively, the "Free Lance Debtors") were a family-owned publishing, newspaper, radio and communications company, and a related entity that were parties to a \$50 million loan secured by certain assets of the Free Lance Debtors, but not by "tower assets" that were associated with the Free Lance Debtors' radio broadcasting company. The company that initially made the \$50 million loan sold its secured debt to DSP Acquisition LLC ("DSP"), which bought the debt as part of a "loan-to-own" strategy, whereby it intended to push the Free Lance Debtors into bankruptcy and then acquire the company by credit bidding its secured claim. DSP asserted a right to credit bid up to approximately \$39 million; however, this amount included liens on the Free Lance Debtors' tower assets, despite DSP not having valid, properly perfected liens on, or security interests in, those assets. Other potential buyers were confused by what assets DSP had liens on and were reluctant to participate in the sale process because of DSP's potential credit bid. Consequently, the court held that it was necessary to limit DSP's ability to credit bid to the value of those assets on which DSP had properly perfected liens based upon DSP's overzealous conduct, lack of valid liens in all the assets being sold, and the court's goal of fostering "a fair and robust sale."

Finally, the newest decision in which the court capped the amount of a secured creditor's credit bid is *In re RML Development, dba Pinetree Place Apartments dba Raintree Apartments*, No. 13-29244 (Bankr. W.D. Tenn. July 10, 2014). In this case, SPCP Group III CNI 1, LLC ("Silverpoint") asserted a valid first mortgage security interest in two apartment complexes owned by RML Development ("RML"), and intended to credit bid its claim. Silverpoint calculated its claim at \$2,543,579.65, while RML admitted that the claim was worth \$2,354,759.55. Section 363(k) specifies that a creditor may credit bid only "an allowed claim" as defined by section 502(a) of the Code. A filed proof of claim is deemed allowed until a timely objection is filed, after which there must be a hearing and determination by the court. Since RML objected to the amount of Silverpoint's claim, the court limited Silverpoint's credit bid to \$2,354,759.55, or the amount that RML had admitted. This was important because there were numerous pending allegations connected



to a Ponzi scheme in which RML may have been involved. Because of this, the court stated that it "[could not] turn a blind eye to these allegations and blindly ignore objections to claims."

These decisions are noteworthy for secured creditors or distressed-debt traders who use the purchase of distressed debt as an acquisition strategy, as well as competing bidders and creditor constituents participating in section 363 sales. Credit bidding by secured creditors in section 363 sales is commonplace, but these three cases serve as a reminder that the right to credit bid is not absolute, and can be limited by the Bankruptcy Court "for cause." Though much of the discussion surrounding *Fisker*, *Free Lance-Star* and *RML Development* focuses on the policy considerations that influenced the courts' decisions, it is important to note that these recent decisions each involved a dispute as to the validity or extent of the creditors' claims. Consequently, these decisions should not be read as allowing credit bidding to be capped solely to avoid bid chilling.

If you have any questions about the effects of *Fisker* or its progeny, please contact your Reinhart attorney or any member of Reinhart's [Business Reorganization group](#).

These materials provide general information which does not constitute legal or tax advice and should not be relied upon as such. Particular facts or future developments in the law may affect the topic(s) addressed within these materials. Always consult with a lawyer about your particular circumstances before acting on any information presented in these materials because it may not be applicable to you or your situation. Providing these materials to you does not create an attorney/client relationship. You should not provide confidential information to us until Reinhart agrees to represent you.