Educational Materials

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NCBJ Plenary Session

Whose Case Is This Anyway? Should a Chapter 11 Case Be Run Solely for the Benefit of the Secured Creditors?

Materials for "Whose Case Is This Anyway? Should a Chapter 11 Case Be Run Solely for the Benefit of the Secured Creditors?"

October 10, 2014

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Select Developments in the World of Secured Credit

I. Timelines and Plan Support Agreements

- At least partly in response to rising costs and complexity of chapter 11 cases and capital structures, secured lenders have been pushing in cases for rapid timelines for restructurings

- One of the ways these rapid proposed timelines play out is through Plan Support Agreements – with Debtors and certain creditors entering into restrictive agreements to support and seek approval of plans of reorganization within specified timeframes

- Some argue that the balance sheet pre-packaged plans of the past have been largely replaced with pre-arranged plans whereby unsecured creditors (mainly litigation claimants, lease rejection claimants and non-essential trade) are offered essentially no recovery thereby incentivizing creditors' committees to aggressively challenge the restructuring process

II. Credit Bidding

- In *Fisker Automotive* (2014), the Bankruptcy Court for the District of Delaware capped a credit bid at the price the secured creditor paid for the debt in the secondary market (rather than bidding principal amount), holding that "a court may deny a lender the right to credit bid . . . to foster a competitive bidding environment"

- In *Free Lance-Star Publishing* (2014), the Bankruptcy Court for the Eastern District of Virginia limited a secured creditor's right to credit bid, citing the *Fisker* decision as support

- The impact of the *Fisker* and *Free Lance* cases on the future of credit bidding is questionable. Some argue that these decisions are the start of a trend whereby secured creditors' rights will be watered down with unintended consequences to financing markets, others believe that these two decisions are not remarkable and are more a cautionary warning to secured lenders not to go too far in trying to control the bidding process

III. Floating Liens and Goodwill

- Section 552(b)(1) allows security interests created by pre-petition security agreements to extend to after-acquired proceeds where they would otherwise be barred; typically restricted to after-acquired property that is directly attributable to pre-petition collateral, without the addition of estate resources

- In ResCap (2013), the Bankruptcy Court for the Southern District of New York found that the goodwill generated by a sale of assets post-petition on which creditors had a floating lien did not constitute proceeds because the creditors failed to demonstrate that a separate, traceable portion of the value was directly attributable to the collateral rather than to the debtor's ability to negotiate settlements using bankruptcy powers (treated here as estate resources)

IV. Recent Academic Scholarship

A. Proposals to Limit 363 Sales in Chapter 11

- "Ice Cube Bonds"—a mandatory holdback of a portion of 363 sales to allow later resolution of disputes about value and priority (Melissa Jacoby & Edward Janger, Ice Cube Bonds: Allocating the Price of Process in Chapter 11 Bankruptcy, 123 Yale L.J. 862 (2014))

- "Option-Preserving Priority"—senior creditors should be required to purchase the option value from junior creditors (Anthony Casey, The Creditors' Bargain and Option-Preservation Priority in Chapter 11, 78 U. Chi. L. Rev. 759 (2011))

B. Proposals to Limit Scope of Blanket Liens

- Soft Assets—unsecured creditors should benefit from the value of soft assets like goodwill (Michelle Harner, The Value of Soft Assets in Corporate Reorganizations, in ABI Illinois Symposium on Chapter 11 Reform, 51 (2014))

- Timing—value of secured creditors' entitlements should be measured as of the petition date so as to bar them from benefiting from bankruptcy-created value (Edward Janger, The Logic and Limit of Liens, in ABI Illinois Symposium on Chapter 11 Reform, 123 (2014))

- Duty of Directors—state corporate law should limit boards' ability to grant all-encompassing secured loans by imposing a fiduciary duty on the board of directors to carefully consider any decision that will foreclose a future board's choices, including future restructuring options (Stephen Lubben, The Board's Duty Is to Keep Its Options Open, in ABI Illinois Symposium on Chapter 11 Reform, 319 (2014))

- Surcharges—secured creditors with a blanket lien would be required to pay the estate a portion of the value realized in bankruptcy, whether through reorganization or sale (Barry Adler, Priority in Going Concern Surplus, in ABI Illinois Symposium on Chapter 11 Reform, 307 (2014) (arguing against))

C. Arguments for Congressional Limitation of Secured Creditors' Rights

- Constitutional—the Takings Clause of the Fifth Amendment does not constrain the powers of Congress to modify rights of secured creditors (Charles Tabb, The Bankruptcy Clause, the Fifth Amendment, and the Limited Rights of Secured Creditors in Bankruptcy, in ABI Illinois Symposium on Chapter 11 Reform, 271 (2014))

- Federal—security interests under Chapter 11 are a matter of federal policy, not state property law (Juliet Moringiello, When Does Some Federal Interest Require a Different Result? An Essay on the Use and Misuse of Butner v. United States, in ABI Illinois Symposium on Chapter 11 Reform, 181 (2014))

D. Other Proposed Reforms

- Intercreditor Agreements—judges should ignore waivers or assignments of bankruptcy rights when the enforcement will affect the distribution of proceeds among creditors not party to the agreement (Edward Morrison, Rules of Thumb for Intercreditor Agreements, in ABI Illinois Symposium on Chapter 11 Reform, 231 (2014))

- Derivatives—there should be no safe harbor for derivative counterparties under the automatic stay (Steven L. Schwarcz, Derivatives and Collateral: Balancing Remedies and Systemic Risk, in ABI Illinois Symposium on Chapter 11 Reform, 213 (2014))

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Two New Cases Cast A Shadow Over **Credit Bidding**

BY DAMIAN S. SCHAIBLE AND DARREN S. KLEIN

Two recent bankruptcy court decisions have increased uncertainty over the right of secured creditors to credit bid in sales of debtors' assets. Relying on and expanding a rarely used "for cause" limitation on a secured creditor's right to credit bid under §363(k) of the Bankruptcy Code, these decisions may ultimately affect credit bidding rights in a broad swath of cases.

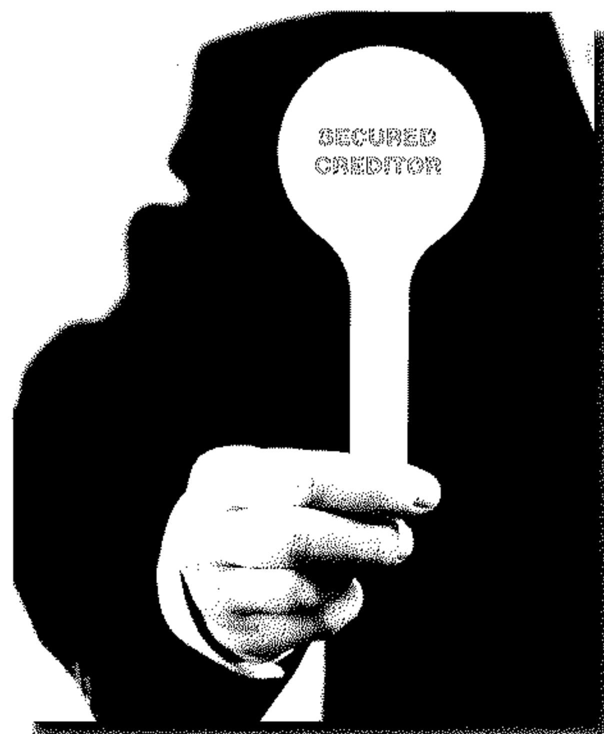
Whereas courts have historically found "cause" to limit credit bidding in the limited circumstances where there is a bona fide dispute regarding the extent or validity of a secured claim or egregious conduct on the part of a secured creditor, recent decisions in *Fisker Automotive Holdings*[1] and *Free Lance-Star Publishing*[2] have suggested that merely the furtherance of general bankruptcy goals, such as the desire to foster a competitive bidding environment, might constitute "cause" sufficient to limit credit bidding rights.

It remains to be seen whether these cases will be followed or narrowly interpreted. But by increasing uncertainty with respect to the rights of secured creditors in bankruptcy sales, these decisions have the potential to have a dramatic and deleterious impact on the market for secured claims.

The Right to Credit Bid

Section 363(k) of the Bankruptcy Code provides secured creditors the right to "credit bid" the value of their debt in certain auctions or sales of their collateral—effectively exchanging all or a portion of the secured creditors' debt for the assets securing it.[3] Credit bidding provides protection to a secured creditor against the sale of the creditor's collateral at a depressed price without the need to commit additional cash.[4] Importantly, regardless of the value of the collateral, a secured creditor is empowered "to bid the total face amount of [its] claim."[5]

Section 363(k) includes a safety valve, whereby a court may limit or disallow credit bids "for cause." This exception has only been discussed in a handful of reported decisions, and in previous cases sufficient cause was usually limited to a bona fide dispute over the validity of the relevant claim or lien[6] or misconduct by the secured creditor.[7] Otherwise, courts have described the right to credit bid as "fundamental"[8] and, while not absolute, near absolute.[9]



Expanding the 'For Cause' Limitation

On Nov. 13, 2013, Fisker Automotive filed for Chapter 11 protection in the U.S. Bankruptcy Court for the District of Delaware. Prior to the bankruptcy filing, Hybrid Tech Holdings had purchased a $168.5 million senior secured claim against Fisker from the U.S. Department of Energy for $25 million. Hybrid then negotiated with Fisker to buy substantially all of its assets in a bankruptcy sale for a $75 million credit bid. The official committee of unsecured creditors (the Creditors' Committee) appointed in Fisker's case objected to the sale, arguing that Hybrid's credit bid should be capped at the $25 million Hybrid paid for the claim.[10]

The Creditors' Committee's argument hinged on the appearance of a competing potential purchaser, Wanxiang America Corporation, which would participate in an auction for Fisker's assets only if Hybrid's credit bid were limited. Importantly, Fisker and the Creditors' Committee stipulated that if Hybrid's credit bid were capped at $25 million, "there [would be] 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" and that if Hybrid's credit bid were not capped, "there [would be] no realistic possibility of an auction."[11]

Relying largely on this stipulation, the bankruptcy court held that a "court may deny a lender the right to credit bid in the interest of any policy advanced by the [Bankruptcy] Code, such as to ensure the success of the reorganization or *to foster a competitive bidding environment.*"[12]

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Finding that permitting Hybrid to credit bid $75 million would not just chill bidding, but "freeze bidding," the court capped Hybrid's credit bid at $25 million. Wanxiang ended up as the successful bidder at the auction for Fisker's assets with a $149.2 million cash bid.[13]

It is worth noting that the court seems to have been at least partly motivated by the more traditional factors used to limit credit bidding for cause. The court wrote that Hybrid had "insisted on an unfair [sale] process, i.e., a hurried process," and that "the validity of its secured status had not been determined."[14] However, the thrust of the court's ruling emphasized the effects of an uncapped credit bid on the auction process—a rationale that, standing alone, had not been used before by a court to restrict a credit bid.

Recently, a second bankruptcy court adopted in part *Fisker's* rationale in limiting a credit bid. On Jan. 23, 2014, Free Lance-Star Publishing Company filed for Chapter 11 protection with the intent of selling substantially all of its assets in a §363 sale. Free Lance-Star argued that its secured creditor, DSP Acquisition, should have its credit bidding rights restricted for three reasons: (1) DSP did not have a valid lien on all of the property being sold, (2) DSP had engaged in inequitable conduct that had "damped interest in the auction" and (3) restricting DSP's credit bid would "restore enthusiasm for the sale and foster a robust bidding process."[15] Free Lance-Star's first two rationales are in line with the historic standards for limiting a credit bid, but the third rationale follows Fisker's expansion of those standards.

The bankruptcy court relied upon all three rationales to limit DSP's credit bid, finding a "perfect storm, requiring the curtailment of DSP's credit bidding rights."[16] According to the court, DSP pressured the debtor for a "speedy bankruptcy filing," objected to the debtor's hiring of a financial advisor to market the assets, and insisted that any marketing materials contain "on the front page, in bold font, a statement that DSP had a right to a $39 million credit bid."[17] Moreover, the court found that DSP had secretly recorded financing statements with respect to assets over which DSP knew it did not have liens.[18]

After an evidentiary hearing, the court concluded that DSP's credit bid should be capped at a total of $13.9 million. It is not clear from the ruling or the record of the hearing (which was partially conducted under seal) how the cap was determined. The court noted merely that it relied on Free Lance-Star's financial advisor, which "eliminated the unencumbered assets ... and applied a market analysis to develop an appropriate case for a credit bid that would foster a competitive auction process."[19] DSP ended up as the winning bidder for Free Lance-Star's assets, but instead of a $39 million credit bid, it paid $16.3 million in cash on top of its $13.9 million credit bid.[20]

Takeaways

It is too early to tell if other courts will adopt *Fisker's* expanded rationale for restricting credit bidding, but secured creditors of distressed companies have reason to be concerned. Viewed most expansively, *Fisker* stands for the proposition that a credit bid can be restricted absent any indication of misconduct or challenges to the creditor's liens or claims.

Importantly, the facts of both *Fisker* and *Free Lance-Star* may have exhibited the historic bases for finding cause to limit a credit bid. The court in *Fisker* found that the sale process Hybrid imposed was "inconsistent with the notions of fairness in the bankruptcy process" and amounted to an attempt to "short-circuit the bankruptcy process."[21] The court in *Fisker* also questioned the allowed value of Hybrid's secured claims.[22]

Likewise, the court in *Free Lance-Star* discussed at length what it viewed to be "inequitable" conduct by DSP.[23] The court's reliance on that conduct, and the fact that DSP's claim was not secured by all of the assets being sold, aligns closely with pre-*Fisker* precedent.

Neither court was faced with a secured creditor with unimpeachably clean hands and unchallenged liens. Moreover, the next reported decision limiting a credit bid post-*Free Lance-Star* had "no occasion to address *Fisker's* rationale" because the debtor "expressly disavow[ed] any reliance" on that decision.[24] In that case, the court held that potential challenges to the secured creditor's liens did not warrant a limitation on credit bidding, but the court did limit the credit bid to the extent necessary to pay a cash break-up fee to the "stalking-horse" bidder.[25]

However, there are important takeaways from both decisions in any event. First, both *Fisker* and *Free Lance-Star* can be viewed as reactions by bankruptcy courts to what they viewed as "loan-to-own" investors seeking to exert excessive control over debtors and the bankruptcy process.[26] Secured creditors are well advised to be sensitive to how they may be viewed by courts when negotiating with distressed companies and seeking to craft and implement sales on a tight timeline. These negotiations could ultimately be subject to scrutiny by a court and a potentially hostile official committee of unsecured creditors.

Second, bad facts make bad law, and these decisions will certainly be relied upon in future bankruptcy cases by debtors, committees and other parties that are seeking to limit secured creditors' rights to credit bid. *Fisker* and *Free Lance-Star* provide these parties with additional leverage to negotiate concessions from secured creditors. In this regard, the uncertainty engendered by both decisions is likely to live long past their facts.

Third, while there is no indication that either court viewed the distressed purchase price of the secured debt as particularly relevant to its analysis, the court in *Fisker* did cap Hybrid's credit bid at the $25 million Hybrid paid for the secured debt. This fact will undoubtedly be raised in future bankruptcy cases as an argument for limiting credit bids based on claims purchased at a discount. Ultimately, however, the amount of the credit bidding cap in *Fisker* appears to have been happenstance: The court relied upon a stipulation between Fisker and the Creditors' Committee that $25 million was the limit that would permit a robust auction process.[27]

Whether or not the *Fisker* and *Free Lance-Star* expansion of the "for cause" limitation is ultimately adopted by other courts, in the near term, the increased uncertainty and additional lines of attack regarding credit bidding rights will likely negatively impact the market for secured claims of distressed companies.

1. No. 14-CV-99 (GMS), 2014 WL 210593 (Bankr. D. Del. Jan. 17, 2014).
2. Case No. 14-30315-KRH, 2014 Bankr. LEXIS 1611 (Bankr. E.D. Va. April 14, 2014).
3. 11 U.S.C. §363(k).
4. See *RadLAX Gateway Hotel v. Amalgamated Bank*, 182 L. Ed. 2d 967, 973 n.2 (2012).
5. *In re Submicron Systems*, 432 F.3d 448, 459 (3d Cir. 2006).
6. See, e.g., *In re L.L. Murphrey*, No. 12-03837-8-JRL, 2013 WL 2451368 (Bankr. E.D.N.C. June 6, 2013) (restricting a credit bid due to issues regarding the validity of the relevant liens); *Morgan Stanley Dean Witter Mortg. Capital v. Alon USA LP (In re Akard Street Fuels, L.P.)*, Civ. A. No. 3:01-CV-1927-D, 2001 U.S. Dist. LEXIS 21644 (N.D. Tex. Dec. 4, 2001) (same).
7. See, e.g., *In re Aloha Airlines*, Case No. 08-00337, 2009 Bankr. LEXIS 4588 (Bankr. D. Haw. May 14, 2009) (denying a secured creditor the right to credit bid due to misconduct, including creating side deals with a competitor regarding the sale of confidential information).
8. *Paul T. v. Fifth Third Mortg. Co. (In re J & M Salupo Dev. Co.)*, 388 B.R. 795, 803 n.2 (B.A.P. 6th Cir. 2008).
9. *In re Phila. Newspapers*, 599 F.3d 298, 315-16 (3d Cir. Pa. 2010) (collecting cases showing the right to credit bid is not absolute because the court may deny a credit bid for cause).
10. *Fisker*, No. 14-CV-99 (GMS), 2014 WL 210593, at *4 n.2.
11. Id. at *2.
12. Id. at *4-5 (emphasis added) (quoting *Phila. Newspapers*, 599 F.3d at 315-16).
13. See Tom Hals, "Court clears sale of hybrid car maker Fisker to China's Wanxiang," REUTERS (Feb. 18, 2014, 12:32 PM), http://www.reuters.com/article/2014/02/18/us-fisker-wanxiang-sale-idUSBREA1H1LM20140218.
14. *Fisker*, No. 14-CV-99 (GMS), 2014 WL 210593, at *6.
15. *Free Lance-Star*, 2014 Bankr. LEXIS 1611, at *19.
16. Id. at *25.
17. Id. at *11-13.
18. Id. at *14-15 (the court noted that DSP attempted to obtain liens on those assets as part of an adequate protection package in the bankruptcy proceeding, indicating that DSP understood it did not previously have liens on those assets).
19. Id. at *24-25.
20. See Maria Chutchian, "Free Lance-Star Newspaper Co. Gets Go-Ahead For $30M Sale," LAW360 (May 28, 2014, 6:26 PM), http://www.law360.com/private-equity/articles/542270?nl_pk=b91a5140-350f-4c60-b97d-24cb9a2c6f03&utm_source=newsletter&utm_medium=email&utm_campaign=private equity.
21. See *Fisker*, No. 14-CV-99 (GMS), 2014 WL 210593, at *5.
22. Id. at *5.
23. *Free Lance-Star*, 2014 Bankr. LEXIS 1611, at *22.
24. *In re Charles St. African Methodist Episcopal Church*, Case No. 12-12292-FJB, 2014 Bankr. LEXIS 2264 at *9 (Bankr. D. Mass. May 14, 2014).
25. Id. at *16.
26. See *Free Lance-Star*, 2014 Bankr. LEXIS 1611, at *22, 25; *Fisker*, 2014 WL 210593, at *5.
27. *Fisker*, 2014 WL 210593, at *6.

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FISKER AND FREE LANCE STAR – A DEVELOPING TREND TO RESTRICT CREDIT BIDDING OR A CAUTIONARY WARNING TO O SECURED CREDITORS NOT TO OVERREACH?[1]

In the bankruptcy sale context, generally, a secured creditor may bid the amount of its secured claim on assets constituting its collateral and offset such amount against the purchase price. *See generally* 11 U.S.C. § 363(k). A secured creditor's right to credit bid under section 363(k) typically extends to the full face amount of its claim, thereby giving the creditor an advantage in an auction of the collateral. Arguably, two recent bankruptcy cases may be viewed as possibly portending a material judicial curtailment of secured creditors' credit bid rights.

FISKER

In *In re Fisker Auto. Holdings, Inc.*, 2014 Bankr. LEXIS 230 (Bankr. D. Del. Jan. 17, 2014), *leave to app. denied*, 2014 U.S. Dist. LEXIS 15497 (D. Del. Feb. 7, 2014) and *certif. denied*, 2014 U.S. Dist. LEXIS 17689 (D. Del. Feb. 12, 2014), the debtors filed their bankruptcy cases to accomplish the sale of substantially all of their assets to Hybrid Tech Holdings, LLC ("Hybrid"), which had bought for $25 million the senior, purportedly secured claim of the Department of Energy (DOE) –approximately $168.5 million in principal amount– less than a month and a half before the petition date. After Hybrid's purchase of the DOE loan, Hybrid and the debtors entered into negotiations regarding Hybrid's acquisition of the debtors' assets through a credit bid of a part of that senior loan. Ultimately, the parties entered into an asset purchase agreement, with $75 million of the consideration being in the form of a credit bid (Hybrid would also, among other things, assume certain liabilities and waive $4 million of the debtors' DIP facility liabilities). According to the debtors, the cost and delay arising from a competitive auction process were reasonably unlikely to increase value for the estates, and thus, the debtors proposed a private sale to Hybrid. The creditors' committee objected to the sale motion, opposing Hybrid's right to credit bid and proposing an auction with another entity, Wanxiang America Corp. ("Wanxiang"). At a hearing held about a month and a half after the petition date, the debtors and committee stipulated that, among other things, if Hybrid's credit bid right were eliminated or 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," and if Hybrid's credit bid right were not capped, "it appears to both the Debtors and the Committee there is no realistic possibility of an auction, as we have no reason to believe that Wanxiang or anyone else would bid more than the amount of Hybrid's asserted secured claims." 2014 Bankr. LEXIS 230, at *6-*7. Wanxiang made it clear that it was prepared to increase its already appealing bid if there was an auction. *Id.* at *10. The debtors and committee further stipulated that there were material assets for sale that were not subject to properly perfected liens in favor of Hybrid, and material assets where there was a dispute as to whether Hybrid had a properly perfected lien, which dispute was not likely subject to prompt or easy resolution. *Id.* at *8.

[1] This article was written by Jeffrey N. Pomerantz, a partner with Pachulski Stang Ziehl & Jones with the assistance of Jonathan Kim, of counsel with the firm.

The *Fisker* court proceeded to cap Hybrid's right to credit bid its claim at $25 million (as noted, the price at which Hybrid had purchased the claim from the DOE). The court relied upon the reasoning in Circuit Judge Fisher's opinion in *In re Philadelphia Newspapers, LLC*, 599 F.3d 298 (3d Cir. 2010) that, as evidenced by the plain statutory language of section 363(k) allowing credit bidding "unless the court for cause orders otherwise," "the right to credit bid is not absolute." 2014 Bankr. LEXIS 230, at *12. The *Fisker* court relied upon and springboarded off the further observations by the *Philadelphia Newspaper* court (which dealt specifically with the import of section 1129(b)(2)(A)) that "cause" for purposes of section 363(k) is not limited to only situations where the lender acted inequitably and that a court may deny credit bid rights in the interest of other Code policies "such as to ensure the success of the reorganization or to foster a competitive bidding environment." 2014 Bankr. LEXIS 230, at *12-*13 (quoting *Philadelphia Newspapers*, 599 F.3d at 316 n.14).[2]

Given the debtors' stipulations with the committee, in *Fisker*, there was express, unrebutted evidence that there would be no bidding at all if Hybrid's credit bid right were not limited. Wanxiang, the other potential acquirer, was a highly attractive participant which "has a vested interest in purchasing Fisker"; it had recently purchased certain assets of the bankrupt battery manufacturer for Fisker cars. Thus, the *Fisker* court held that "the 'for cause' basis upon which the Court is limiting Hybrid's credit bid is that bidding will not only be chilled without the cap; bidding will be frozen." *Id.* at *14. The court was also particularly troubled by the inexplicably expedited sale process that had been demanded by Hybrid; the debtors filed their cases on November 22, 2013, three business days before the Thanksgiving holiday, and requested that the sale hearing occur no later than January 3, 2014 (*i.e.*, immediately after the New Year holiday). The requested schedule would have given parties only 24 business days to challenge the sale, and even less time for the committee which had not been appointed till early December 2013. The *Fisker* court found Hybrid's January 3rd "drop dead" date to be "pure fabrication, designed to place maximum pressure on creditors and the Court." *Id.* at *15 n.4. "Hybrid's rush to purchase and … persist[ence] in such [rushed] effort is inconsistent with the notions of fairness in the bankruptcy process" and "[t]he Fisker failure has damaged too many people, companies and taxpayers to permit Hybrid to short-circuit the bankruptcy process." *Id.* at *15. Finally, the court predicated its holding on the uncertainty and disputes relating to whether Hybrid's liens were properly perfected; the debtors stipulated that some assets were not encumbered by properly perfected liens and the status of some liens were disputed. "[T]he holder of a lien the validity of which has not been determined, as here, may not bid its lien" based on other reported cases. *Id.* at *16. Ultimately, Wanxiang won the auction with a bid valued at approximately $149.2 million (*see* notice, docket no. 628 in Case No. 13-13087).

FREE LANCE-STAR

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[2] The district court in *In re Fisker Auto. Holdings, Inc.*, 2014 U.S. Dist. LEXIS 17689 (D. Del. Feb. 12, 2014), found that the *Philadelphia Newspaper* court's observations were not simply dicta as contended by Hybrid. While the specific issue at hand there was whether section 1129(b)(2)(A) required that lenders be allowed to credit bid, "[i]n essence, the lenders [there] argued that Section 1129(b)(2)(A) worked in conjunction with Section 363(k) to ensure that lenders' right to credit bid is absolute. [citation omitted] In ruling on this matter, the Third Circuit explained that the lenders' argument regarding the absolute nature of the right to credit bid was wrong in light of Section 363(k)'s for-cause exception …." *Id.* at *6-*7.

In *In re The Free Lance-Star Publ'g Co. of Fredericksburg, VA*, 2014 Bankr. LEXIS 1611 (Bankr. E.D. Va. April 14, 2014) (the "Credit Bid Opinion"), *denying motion for expedited appeal, DSP Acquisition, LLC v. Free Lance-Star Publ'g Co. of Fredericksburg, VA*, 2014 U.S. Dist. LEXIS 63274 (E.D. Va. May 7, 2014), the debtors sought to sell substantially all of their assets relating to their radio stations and printing/newspaper businesses, and in connection therewith, to limit their purported secured creditor's right to credit bid approximately $39 million.

In a separate opinion (2014 Bankr. LEXIS 1644 (Bankr. E.D. Va. Apr. 14, 2014)) (the "Lien Opinion"), the court ruled that the secured creditor –which was apparently an affiliate of an entity which prepetition had bought and acquired the applicable secured note from the original, unaffiliated lender– did not have valid, properly perfected liens on certain broadcasting tower related assets (the "Tower Assets") and certain other assets, and thus, the creditor could not credit bid a claim against such assets on which it lacked valid liens. The court reiterated this point in its Credit Bid Opinion and also found that the creditor had engaged in inequitable conduct, which required the court to further limit the creditor's credit bid right. Among other things, the creditor had urged the court to grant it adequate protection liens (in connection with the debtors' use of cash collateral) on assets over which the creditor knew it did not have a valid lien but nonetheless had recorded such liens shortly prior to the bankruptcy filing: "[After learning it did not have a lien on the Tower Assets,] DSP [the creditor] made the unilateral decision to expand the scope of its security interest when DSP's overt requests for the Debtors to grant such liens ... failed.... DSP knew it did not have a valid lien on the Tower Assets when [unbeknownst to the debtors] it filed the Financing Statements [including some right before the bankruptcy filing]." 2014 Bankr. LEXIS 1611, at *21. DSP had also tried prepetition to pressure the debtors to limit their marketing and sale efforts, with DSP suggesting to the debtors that there was no reason to market at all, objecting to the debtors engaging financial consultants, requiring the debtors to put language in the marketing materials conspicuously highlighting DSP's purported credit bid rights, pushing for a rushed 6-week bankruptcy sale process (from petition date to closing), and insisting to the debtors that they obtain a postpetition credit facility although the debtors' advisors' projections showed that no DIP facility was necessary ("[o]therwise, DSP would not be able to get the liens it coveted on the Tower Assets," according to the court). According to the court, DSP also attempted to further frustrate the bankruptcy process by, for example, filing a false/misleading declaration with the court and failing to provide evidence concerning its acquisition of the original prepetition secured debt.

According to the *Free Lance-Star* court, while the right to credit bid generally serves important functions, "[c]redit bidding ... is not an absolute right" as made clear by section 363(k)'s plain language that a court may "for cause" eliminate or modify such right. Citing *Fisker* and other authorities, the court explained that the right to credit bid may be denied in the interest of policies advanced by the Code, such as to ensure a successful reorganization or to foster a competitive bidding process. The court appeared most troubled by the creditor's inequitable conduct (discussed above). According to the court, DSP's unreasonably aggressive loan-to-own strategy (as opposed to a lender's typical, general motivation to have the loan repaid) "interfered with the sales process," with DSP trying "to depress the sales price of the Debtors' assets, not to maximize the value of those assets." *Id.* at *22. The court found that limiting DSP's credit bid rights would help restore a competitive bidding environment. DSP

chose not to present any evidence to refute the debtors' advisor's testimony on this point or on its methodology to calculate an appropriate credit bid cap. Based on the "perfect storm" created by the confluence of DSP's less than fully-secured lien status, its "overly zealous loan-to-own strategy" and the negative impact DSP's misconduct had on the auction process, and in order to foster "a robust and competitive bidding environment," the court limited DSP's credit bid rights (asserted by DSP to be $39 million total) to $1.2 million for assets related to the debtors' radio business on which DSP had a valid perfected lien, and $12.7 million for assets related to the debtors' newspaper and printing business on which DSP had valid perfected liens. *Id.* at *25-*26. Subsequently, an auction was conducted, at which DSP was selected as having submitted the highest and best bid, comprised of a credit bid of $13.9 million and $16.3 million in cash; this sale transaction was ultimately approved by the court and consummated (*see* docket nos. 264 & 292 in Case No. 14-30315).

OBSERVATIONS

It could be argued that the *Fisker* and *Free Lance-Star* cases may signal the beginning of a shift in courts' willingness to curtail secured creditors' credit bidding rights. However, credit bidding has generally been a well-accepted and frequently-used mechanism in bankruptcy sales, designed to ensure that a lender's right to receive the value of its collateral is preserved and protected. Importantly, the *Fisker* and *Free Lance-Star* cases involved rather unique situations of loan-to-own creditors (which had apparently bought the original loans at a discount), with material uncertainties or disputes over the extent of their liens, pushing the envelope in multiple respects, including overly aggressive sale timelines and inequitable or otherwise (arguably) unreasonable conduct. As discussed by the *Fisker* and *Free Lance-Star* courts, various cases dealing with varying situations have recognized that section 363(k) credit bid rights are not absolute. If there are legitimate disputes over the validity of a lender's liens, the lender's credit bid rights should be modified and limited accordingly. *See, e.g., In re Daufuskie Island Props., LLC*, 441 B.R. 60, 63-64 (Bankr. D.S.C. 2010) (denying credit bid right where, among other things, secured creditor's liens were in dispute); *National Bank of Commerce v. McMullan (In re McMullan)*, 196 B.R. 818, 835 (Bankr. W.D. Ark. 1996) (precluding credit bid where validity of liens was unresolved). *Compare with In re Charles St. African Methodist Episcopal Church of Boston*, 2014 Bankr. LEXIS 2264, *12 (Bankr. D. Mass. May 14, 2014) (subject to one qualification imposed by the court, debtor did not establish cause to limit secured creditor's credit bid right under 363(k); for tactical reasons, debtor had sought limitation of credit bid right solely on basis that secured claim was subject to bona fide dispute; court ruled that debtor's asserted counterclaims might offset the overall secured claim but debtor did not challenge underlying secured claim and thus, "there is no dispute about the validity or extent of [the] secured claims"). And, if the lender has engaged in egregious or other inequitable or unreasonable conduct that adversely impact the bidding/sale process, bankruptcy courts should have at least some flexibility to better ensure a fairer playing field and reasonable auction process in the best interest of the estate and its other creditors. The *Fisker* and *Free Lance-Star* cases seem to suggest not a new abrupt change in the legal landscape but instead, they underscore that section 363(k) will be flexibly applied in extreme cases.

Notwithstanding the foregoing, given the broad observations by these courts that credit bid rights are not unconditional, creditors' committees and other parties in interest may still be

incentivized by the *Fisker* and *Free Lance-Star* cases to try to litigate the amount of a secured creditor's credit bid right, which may or may not facilitate overall a robust bidding and sale process, depending on the particular circumstances of the bankruptcy case. Indeed, it is conceivable to imagine circumstances where capping a lender's credit bid right to an unreasonably reduced amount might lessen the ability to bid up and maximize the purchase price. To minimize the risks of litigation and objections by committees and other parties in light of the *Fisker* and *Free Lance-Star* cases, secured creditors would be well-advised in many cases to be particularly reasonable in the tailoring of full and fair marketing, bidding and sale processes.