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Steven A. Meyerowitz

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FISKER AUTOMOTIVE PUTS THE BRAKES ON DISTRESSED INVESTORS' RIGHT TO CREDIT BID

PAUL V. SHALHOUB AND DANIEL I. FORMAN

The authors discuss a recent Delaware bankruptcy court opinion limiting the credit bidding rights of a secured lender.

On February 19, 2014, Judge Kevin Gross of the United States Bankruptcy Court for the District of Delaware approved the sale of Fisker Automotive to Wanxiang America Corporation (“Wanxiang”) for approximately \$149.2 million. However, Wanxiang’s bid may never have been considered were it not for Judge Gross’s earlier decision capping the credit bidding rights of Fisker’s secured creditor,¹ which will likely be cited going forward by those seeking to limit the rights of secured lenders (or acquirers of secured debt) to credit bid the full value of their claims in a 363 sale. In *Fisker Automotive Holdings, Inc., et. al.*,² Judge Gross was persuaded by the debtors and the creditors’ committee to cap the credit bid of the holder of a \$168.5 million claim (as discussed below, the parties disputed the extent to which the claim was secured) at \$25 million — the amount paid to purchase the claim approximately one month prior to filing. The case is noteworthy because it demonstrates certain pitfalls of purchasing distressed secured debt as an acquisition strategy.

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BACKGROUND

Fisker Automotive Holdings, Inc. and Fisker Automotive, Inc. (the “debtors”) were founded in 2007 to design, assemble and manufacture premium plug-in hybrid electric vehicles in the United States. In April 2010, the United States, through the Department of Energy (“DOE”), agreed to fund the development, production, sale and marketing of two automobile models through a senior secured loan. On October 11, 2013, Hybrid Tech Holdings, LLC (“Hybrid”) purchased DOE’s position of \$168.5 million outstanding principal for \$25 million. Prior to filing voluntary bankruptcy petitions on November 22, 2013, the debtors and Hybrid discussed the acquisition of the debtors’ assets through a credit bid of all or part of Hybrid’s acquired position in the senior loan. The parties negotiated an asset purchase agreement pursuant to which Hybrid would acquire substantially all of the debtors’ assets for a \$75 million credit bid. On the first day of the cases, the debtors filed a motion to approve the sale stating that they had “determined that a sale to a third party other than [Hybrid] was not reasonably likely to generate greater value than the debtors’ proposed sale transaction or advisable under the facts and circumstances of [the] chapter 11 cases.”³ The debtors further decided that the cost and delay arising from a competitive auction process or pursuing a potential transaction with an entity other than Hybrid would be reasonably unlikely to increase value for the estates, and therefore the motion reflected the debtors’ desire to effectuate the sale to Hybrid via an expedited private sale. Hybrid initially required that the sale be approved by January 6, 2014, or just 45 days from the bankruptcy filing.

The Official Committee of Unsecured Creditors (the “Committee”) opposed the sale motion and filed a separate motion proposing a competitive auction where Wanxiang would participate and bid against Hybrid’s offer. The Committee disputed Hybrid’s right to credit bid on the alternative bases that: (i) a material portion of the assets to be sold either were not subject to a properly perfected lien in favor of Hybrid, or were subject to a lien in favor of Hybrid that was in bona fide dispute; or (ii) cause existed to limit Hybrid’s right to credit bid because doing so would facilitate a competitive auction; or (iii) cause existed because the assets to be sold included both encumbered and unencumbered assets.

THE PARTIES' STIPULATIONS

At the hearing to consider the debtors' sale motion and the Committee's bidding procedures motion, the debtors and the Committee agreed to limit the areas of dispute and stipulated to the following (among other things):

- if Hybrid was either prohibited from credit bidding, or its credit bid was capped at \$25 million, then there was a strong likelihood that an auction would create material value for the estate over and above the present Hybrid bid;
- if Hybrid's ability to credit bid remained uncapped there would be no realistic possibility of an auction;
- limiting Hybrid's ability to credit bid would likely foster and facilitate a competitive bidding environment;
- the highest and best value for the estate could be achieved only through the sale of all of the debtors' assets as an entirety; and
- among the assets to be sold were (a) material assets believed to be properly perfected Hybrid collateral, (b) material assets not subject to properly perfected liens in favor of Hybrid, and (c) material assets where there is a dispute as to whether Hybrid had a properly perfected lien.

The Committee also agreed that if the court determined that there was no basis to limit Hybrid's ability to credit bid, the Committee would withdraw all objections to the proposed sale.

THE BANKRUPTCY COURT'S DECISION

Section 363(k) of the Bankruptcy Code provides that if property subject to a lien that secures an allowed claim is proposed to be sold, the holder of such claim may credit bid the claim "unless the court for cause orders otherwise."⁴ Judge Gross first observed that failure to limit Hybrid's bid would not merely chill bidding, but would in fact result in no auction being held as there was no realistic possibility of any party bidding more than Hybrid's asserted secured claims. Second, Judge Gross noted the presence of a highly

attractive, capable and motivated competing bidder. Wanxiang had recently purchased, through a bankruptcy auction, the primary component of Fisker electric cars — the lithium ion battery, and thus demonstrated a vested interest in purchasing the debtors' assets. Therefore, Judge Gross limited Hybrid's credit bid to \$25 million "for cause," on the basis that if he did not do so, bidding would not only be chilled, but frozen.

Judge Gross also was troubled by the expedited nature of the private sale process required by Hybrid and originally proposed by the debtors, which was never satisfactorily justified to the court. The debtors filed the cases on November 22, 2013 and proposed to conduct the sale hearing no later than January 3, 2014, which left parties only 24 business days to challenge the debtors' sale motion and even less time for the Committee, which was not appointed until December 5, 2013. In the court's view, the expedited nature of the private sale was inconsistent with notions of fairness, and Judge Gross would not permit Hybrid to "short-circuit the bankruptcy process."

Finally, the court noted that the situation before it was distinct from that addressed by the Third Circuit in *In re SubMicron Systems Corp.*⁵ In *SubMicron*, the Third Circuit held that a secured creditor was permitted to credit bid the full face amount of its secured claim even though the secured debt had no actual/economic value. In *SubMicron*, it was clear that the bidder held a properly classified and perfected secured claim. In *Fisker*, however, the Committee had raised legitimate questions as to the whether (and by which assets) Hybrid's claims were secured.

THE DISTRICT COURT'S RULING

Immediately following Judge Gross's decision to limit its credit bid, Hybrid filed emergency motions for leave to appeal in the district court and for certification for direct appeal to the Third Circuit.⁶ The district court denied Hybrid's motions, finding that the bankruptcy court order was not a final order subject to appeal and that Hybrid was unable to demonstrate that any of the factors necessary for the court to grant leave for interlocutory appeal or direct appeal weighed in favor of the relief sought by Hybrid in this case.⁷ Tellingly, the district court was particularly troubled by Hybrid's "barrage of emergency motions of dubious merit and even more dubious urgency" and

viewed such litigious tactics as evidence of Hybrid's "attempt to short circuit the bankruptcy process for which the bankruptcy court chastised Hybrid in its January 17th order."⁸

ASSET AUCTION

Following denial of Hybrid's appeal related motions, the debtors conducted an auction of their assets over three days, between February 12 and 14, 2014. Ultimately, Wanxiang emerged as the successful bidder, with its winning bid of approximately \$149.2 million comprised of \$126.2 million of cash, \$8 million of assumed liabilities, and a 20 percent equity stake in the acquired assets.⁹ Wanxiang's winning bid represented a significant increase in value over Hybrid's initial \$75 million credit bid.¹⁰

ANALYSIS

The *Fisker* case stands in contrast to the holding of the Supreme Court in *RadLAX Gateway Hotel, LLC v. Amalgamated Bank*,¹¹ which denied the debtors' attempt to confirm a plan that did not provide a secured creditor the right to credit bid its claim. In doing so, the Supreme Court expressly noted the policy concern supporting a creditor's right to credit bid: "The ability to credit-bid helps to protect a creditor against the risk that its collateral will be sold at a depressed price."¹² Instead, the *Fisker* decision echoes the Third Circuit's older decision in *In re Philadelphia Newspapers, LLC*, where the court held that the debtor could proceed with a plan that sold collateral secured by a lien, if the holder of such lien was provided with the "indubitable equivalent" of its collateral (which did not necessarily have to include the right to credit bid).¹³ In support of its holding in *Philadelphia Newspapers*, the Third Circuit recognized the ability of a court to limit the right to credit bid "for cause" codified in Section 363(k). The Third Circuit cited to case law where the "for cause" standard was invoked to promote a competitive auction or when the classification and priority of a secured lender's claim was in dispute¹⁴ — situations arguably analogous to the facts in the *Fisker* case. The *Philadelphia Newspapers* decision concluded its discussion of Section 363(k) by noting that "a court may deny a lender the right to credit bid in the inter-

est of any policy advanced by the Code, such as to ensure the success of the reorganization or to foster a competitive bidding environment.”¹⁵

Following the Supreme Court’s decision in *RadLAX*, secured creditors were able to take comfort that their ability to credit bid under Section 363(k) could not be circumvented through the use of a plan process. However, the *Fisker* decision reminds us that the *RadLAX* decision did not address the ability of the court to restrict the right to credit bid “for cause,”¹⁶ and reanimates previous decisions that limited credit bidding in order to create a competitive bidding atmosphere. It remains to be seen to what extent the decision in *Fisker* will serve as precedent for limiting credit bidding “for cause,” or whether its application will be limited by the specific facts of the case — *i.e.*, when a bona fide dispute exists as to the extent of the debtor’s collateral secured by a first priority perfected lien. At a minimum, the *Fisker* opinion indicates that a secured lender’s right to credit bid is safest from attack when the lien is secured by substantially all of the assets being purchased and the priority and classification of the lien are undisputed. However, because the *Fisker* decision unlocked substantial value well in excess of Hybrid’s initial credit bid, it should surprise no one when Judge Gross’s opinion is trumpeted in the future by parties seeking to limit credit bidding rights of secured lenders based upon the amorphous principle that doing so will foster competitive bidding.

NOTES

¹ *Memorandum Opinion, In re Fisker Automotive Holdings, Inc., et. al.*, Case No. 13-13087 (KG) (Bankr. D. Del. Jan. 17, 2014) (Docket No. 483).

² Case No. 13-13087 (KG) (Bankr. D. Del.).

³ *Motion of the Debtors for the Entry of: (I) an Order (A) Approving Form and Manner of Notices and (B) Scheduling a Sale Hearing and Establishing Dates and Deadlines Related Thereto; and (II) an Order (A) Authorizing the Sale of Substantially all of the Debtors’ Assets Free and Clear of Liens, Claims, Encumbrances, and other Interests, (B) Granting the Purchaser the Protections Afforded to a Good Faith Purchase, and (C) Granting Related Relief, In re Fisker Automotive Holdings, Inc., et. al.*, Case No. 13-13087 (KG) (Bankr. D. Del. Nov. 22, 2013) (Docket No. 13).

⁴ 11 U.S.C. § 363(k). Through credit bidding, the holder of an allowed secured claim is permitted to offset such claim against the purchase price of the property

subject to its lien.

⁵ 432 F.3d 448 (3d. Cir. 2006).

⁶ *Emergency Motion of Hybrid Tech Holdings, LLC, Pursuant to 11 U.S.C. § 105(a), 28 U.S.C. § 158(a), and Fed. R. Bankr. P. 8001, 8002, and 8003 for Leave to Appeal Decision Limiting Credit Bid, Hybrid Tech Holdings v. Official Comm. of Unsecured Creditors of Fisker Automotive Holdings, Inc. (In re Fisker Automotive Holdings, Inc.)*, Case No. 14-cv-00099 (GMS) (D. Del. Jan. 24, 2014) (Docket No. 1); *Emergency Motion of Hybrid Tech Holdings, LLC, Pursuant to 11 U.S.C. § 105(a), 28 U.S.C. § 158(d)(2), and Fed. R. Bankr. P. 8001(f), for Certification for Direct Appeal from Order Limiting Credit Bid to United States Court of Appeals for Third Circuit*, Case No. 14-cv-00099 (GMS) (D. Del. Jan. 27, 2014) (Docket No. 9). In fact, Hybrid filed four emergency motions in the space of three days attempting to overturn the impact of Judge Gross' decision of January 17, 2014. See *Memorandum*, Case No. 14-cv-00099 (GMS) (D. Del. Feb. 12, 2014) (Docket No. 35) (denying Hybrid's motion for direct appeal to Third Circuit).

⁷ See *Memorandum*, Case No. 14-cv-00099 (GMS) (D. Del. Feb. 7, 2014) (Docket No. 34) (denying Hybrid's motion for leave to appeal); *Memorandum*, Case No. 14-cv-00099 (GMS) (D. Del. Feb. 12, 2014) (Docket No. 35) (denying Hybrid's motion for direct appeal to Third Circuit).

⁸ *Memorandum*, Case No. 14-cv-00099 (GMS) at n. 1 (D. Del. Feb. 12, 2014) (Docket No. 35) (denying Hybrid's motion for direct appeal to Third Circuit).

⁹ See *Notice of (A) Successful Bidder and (B) Sale Hearing on February 18, 2014 at 9:30 A.M. (ET), In re Fisker Automotive Holdings, Inc., et. al.*, Case No. 13-13087 (KG) (Bankr. D. Del. Feb. 14, 2014) (Docket No. 628); *Order (I) Authorizing (A) the Sale of Certain Assets of the Debtors Free and Clear of all Claims, Liens, Liabilities, Rights, Interests and Encumbrances, (B) the Debtors' Entry into and Performance of their Obligations under the Asset Purchase Agreement and Ancillary Agreements, and (C) the Debtors' Assumption and Assignment of Certain Executory Contracts and Unexpired Leases; and (II) Granting Related Relief, In re Fisker Automotive Holdings, Inc., et. al.*, Case No. 13-13087 (KG) (Bankr. D. Del. Feb. 19, 2014) (Docket No. 653) (the "Sale Order"); *Transcript of Sale Hearing, In re Fisker Automotive Holdings, Inc., et. al.*, Case No. 13-13087 (KG) (Bankr. D. Del. Feb. 18, 2014) ("Sale Hearing Transcript"), at p. 16.

¹⁰ Hybrid was the only bidder other than Wanxiang to submit a bid prior to the deadline of February 7th, 2014, and the only competing bidder at the auction. After declining to top Wanxiang's final bid, and instead of pressing an objection to the proposed sale to Wanxiang, Hybrid negotiated for provisions in the Sale Order that reserve all parties' rights with respect to the allocation and/or distribution of sale proceeds in satisfaction of creditors' claims. See *Sale Hearing Transcript*, at pp. 13,

23-24; 30-33, 37-38; Sale Order, at ¶¶ 45-49.

¹¹ 132 S. Ct. 2065 (2012).

¹² *Id.* at 2070 n.2 (2012).

¹³ *In re Philadelphia Newspapers, LLC*, 599 F.3d 298, 318 (3d. Cir. 2010).

¹⁴ *Philadelphia Newspapers* at 315-16 (citing *Greenblatt v. Steinberg*, 339 B.R. 458, 463 (N.D. Ill. 2006) (upholding bankruptcy court's decision to preclude credit bid because court had not determined whether bidder was first priority lien holder) and *In re Antaeus Technical Servs., Inc.*, 345 B.R. 556, 565 (Bankr. W. D. Va. 2005) (denying right to credit bid to facilitate "fully competitive" cash auction)).

¹⁵ *Philadelphia Newspapers* at n.14 (citing 3 *Collier on Bankruptcy* 363.09[1]).

¹⁶ The Supreme Court did not address whether cause existed in *RadLAX* to limit the right to credit bid because the lower court had determined that there was no "cause" to deny credit bidding in that case, and the debtors did not appeal that decision. *RadLAX* at 2070, n.3.