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Client Alert: Delaware Decision Limits Lender's Credit Bid in Bankruptcy Sale

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In a recent decision in a Delaware Chapter 11 case, the court took the unusual step of capping the amount of a secured lender's loan that could be used in the lender's credit bid in a Section 363 sale.

The case involved Fisker Automotive Holdings, Inc. and affiliates, a luxury hybrid automobile manufacturer that had been backed in part by the U.S. Department of Energy (DOE). When Fisker ran into trouble, the DOE auctioned its $168 million loan. The loan was purchased for $25 million by Hybrid Tech Holdings, LLC, an acquisition vehicle of Hong Kong billionaire Richard Li. Hybrid Tech and Fisker later entered into a stalking horse Asset Purchase Agreement (APA), with a $75 million credit bid purchase price. Fisker entered Chapter 11 and sought approval of the APA.

Hybrid Tech imposed an exceedingly short timeline under the APA (24 business days from the filing of the Chapter 11 case until the date of the hearing to approve the sale) that clearly was not appreciated by the bankruptcy judge. The judge pointedly noted that "Hybrid's rush to purchase and to persist in such effort is inconsistent with the notions of fairness in the bankruptcy process" and would "short-circuit the bankruptcy process."

The Unsecured Creditors' Committee pushed back hard on the Hybrid Tech credit bid APA. There emerged a potential bidder supported by the Committee, Wanxiang America Corporation, a major Chinese auto parts manufacturer. Wanxiang was interested in bidding, but only if Hybrid Tech's credit bid was capped at $25 million. That is exactly what the bankruptcy court ordered.

The general rule in bankruptcy sales is that a secured creditor is entitled to credit bid; however, the Bankruptcy Code permits the court to limit or even deny a credit bid "for cause." The Bankruptcy Code does not define what "cause" is. Most cases in which a credit bid has been limited or prohibited outright involve a creditor whose lien was subject to a bona fide dispute as to its validity or perfected status on all or part of the assets being sold. In the *Fisker* case, it was undisputed that

Hybrid Tech's claim was "partially secured, partially unsecured and of uncertain status for the remainder" but no dollar amounts or other details were provided in the bankruptcy court's January 17, 2014 order. However, the uncertainty as to the extent of Hybrid Tech's lien was only one of three factors for the bankruptcy court's finding of "cause." The court also noted that it was certain that Wanxiang would withdraw its proposal and refuse to participate in an auction without the cap on Hybrid Tech's credit bid. The court also expressed concern that Hybrid Tech "if unchecked of its purchase, might well have frozen out other suitors for Fisker's assets" – a nod to the potential "short-circuiting" of the bankruptcy process.

When Hybrid Tech sought to appeal the bankruptcy court's order, the U.S. District Court denied that effort, essentially agreeing with the bankruptcy court's decision. In a February 7, 2014 ruling, discussing the "for cause" exception, the district court said that a lender may be denied the right to credit bid in order "to foster a competitive bidding environment."

As a post-script, a highly competitive auction between Hybrid Tech and Wanxiang indeed took place, lasting over three days during the week of February 10, 2014. Wanxiang emerging as the winning bidder, with a bid valued at approximately $149 million. So, regardless of the legal correctness of the court decisions, the auction certainly played out in a way that fulfilled the courts' desire for a competitive sale process, resulting in significant cash value, however the proceeds may ultimately be distributed.

With the caveats that the factual record before the bankruptcy court was quite limited and that the district court's decision was technically not one "on the merits," both of which counsel against drawing firm conclusions from the decisions, we offer the following takeaways:

- Unsecured and other junior creditors are sure to rely on the *Fisker* case in an attempt to thwart secured lenders (particularly secured lenders of the "loan-to-own" variety) that try to acquire assets by freezing out competition. There well may be grounds upon which courts in future cases will distinguish *Fisker* on its facts and refuse to impose a cap on the credit bid, whether that cap is placed at the amount paid for a loan or some other amount. Yet, the *Fisker* courts' reliance on the general notion that fostering a competitive auction supports capping a credit bid will allow these challengers to get their foot in the door, at the least. At bottom, *Fisker* injects a level of uncertainty regarding the "right" to credit bid regardless of the particular facts that drove the decision.
- More generally, the *Fisker* case also illustrates that a secured lender (or asset acquirer), at various stages in a bankruptcy case, must carefully navigate the fine line between aggressively pursuing its interests and, in the court's eyes, overreaching. That is not to say that this was the deciding factor in the court's decision in *Fisker*, but the lender's insistence on such an expedited sale process clearly was an important factor. In light of *Fisker*, lenders seeking to credit bid will need to carefully analyze the factors upon which a bankruptcy court might impose limitations on a credit bid in a given case, and tailor their strategy accordingly.