

ALERTS**Finance, Insolvency & Restructuring Alert -
Delaware Bankruptcy Court Limits Ability Of
Purchaser Of Secured Claim To Credit Bid**

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The United States Bankruptcy Court for the District of Delaware recently limited the ability of a secured creditor to credit bid for substantially all of the debtors' assets because (i) the credit bid would chill, or even freeze, the bidding process, (ii) the proposed expedited private sale pursuant to a credit bid would be inconsistent with notions of fairness in the bankruptcy process, and (iii) the amount of the secured claim was uncertain. *In re Fisker Automotive Holdings, Inc.*, Case No. 13-13087 (Bankr. D. Del. Jan. 17, 2014).

In *Fisker*, prior to their bankruptcy filing, the debtors were original equipment manufacturers of plug-in hybrid electric vehicles. The United States Department of Energy had provided a secured loan to the debtors in the approximate principal amount of \$168 million. After the debtors began suffering financial distress for various reasons, the DOE terminated the debtor's lending facility and sold its position as senior secured lender to Hybrid Tech Holdings, LLC. Hybrid and the debtors thereafter began discussing Hybrid's potential purchase of the debtors' assets through a credit bid of all or part of the senior secured loan. Eventually, the debtors and Hybrid agreed that the debtors would sell substantially all of their assets to Hybrid for \$75 million in the form of a credit bid. Importantly, the debtors determined that the proposed sale to Hybrid should be private, as a sale to a third party was allegedly not likely to generate more than the sale to Hybrid.

After filing voluntary petitions for relief under Chapter 11, the debtors requested that the bankruptcy court expedite the sale process so as to allow immediate consummation of the proposed sale to Hybrid. Upon appointment, the official committee of unsecured creditors filed an objection to the proposed sale, disputed Hybrid's ability to credit bid, and requested that the bankruptcy court order that the debtors conduct an auction for their assets. Moreover, the committee identified a competing bidder which expressed interest in participating in an auction, but only to the extent that Hybrid's ability to credit bid was limited.

At a hearing on the motion to approve the sale of assets to Hybrid, the debtors and the committee narrowed the issues pursuant to the following stipulations: (i) if Hybrid's ability to credit bid was capped at \$25 million (the amount for which it purchased the secured claim), a strong likelihood existed that an auction would create material benefit to the estate, (ii) if Hybrid's credit bid was not capped, no auction would occur, (iii) limiting Hybrid's ability to credit bid would facilitate competitive bidding, and (iv) certain assets of the debtors were subject to Hybrid's security interests, other assets of the debtors were not subject to Hybrid's security interests,

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and a dispute existed as to whether Hybrid had a properly perfected security interest in still other assets of the debtors. The committee thus argued that credit bidding should not be permitted because a material portion of the assets were either not subject to a properly perfected security interest or the existence of such a security interest was in dispute. In addition, the committee contended that “cause” existed to deny credit bidding because limitation of the credit bid would facilitate a cash auction for all of the debtors’ assets.

In deciding whether to limit or cap the amount of Hybrid’s credit bid, the bankruptcy court first noted that pursuant to section 363(k) of the Bankruptcy Code, a secured creditor is generally entitled to credit bid its allowed secured claim. However, the court observed that a court may modify or even deny credit bidding “for cause.” After identifying various decisions by other courts where credit bidding was limited or denied for, among other things, inequitable conduct and to foster competitive bidding environments, the court emphasized that absent a limitation on credit bidding, no auction would occur in the Fisker case. The court based its determination on the fact that the third party purchaser identified by the committee had previously stated that it would not participate in any auction where Hybrid was allowed to credit bid the face amount of the claim. As such, the court found that allowing Hybrid to credit bid more than \$25 million would not only chill bidding; rather, it would freeze the bidding.

The court also questioned the timing of the proposed sale and referred to the aggressive timetable as “troublesome” given the fact that the debtors were no longer operating. The debtors filed their petitions on November 22, 2013, but “insisted” that the hearing on the motion to sell be scheduled by no later than January 3, 2014. Therefore, the court noted, creditors and other parties in interest were given at most twenty-four business days to object to the sale motion. According to the court, such timetable was inconsistent with fairness in the bankruptcy process.

Finally, the court found cause to limit the amount of the credit bid because, as set forth in the stipulated agreements, Hybrid’s claim was partially secured, partially unsecured and disputed with respect to the remainder. The court distinguished Third Circuit precedent where the issue was simply the value of the collateral, not the extent of the secured claim. See *In re Submicron Systems Corp.*, 432 F.3d 448 (3d Cir. 2006). In Fisker, however, the issue was how much of the claim would constitute an allowed secured claim. Because it was uncertain as to how much of Hybrid’s claim was secured, the court found it appropriate to cap the credit bid at \$25 million.

The decision in Fisker is not groundbreaking by any means, as Hybrid was not precluded from participating in the auction or credit bidding in part. Instead, based on the facts and circumstances before it and similar to decisions from other courts, the Fisker court limited Hybrid’s ability to credit bid the face amount of its alleged secured claim. Hybrid – maybe not originally anticipated by it – will need to submit a revised bid partially comprised of cash. Fisker serves as a reminder to secured creditors and especially purchasers of secured claims to examine whether or not material assets are encumbered by the secured creditor’s security interest. Purchasers of secured claims should carefully scrutinize the extent of the secured creditor’s security interests and liens prior to purchasing the secured claim and, if necessary, reformulate any offer to

purchase the claim based on potential credit bidding limitations. Finally, Fisker provides some support to committees and other parties in interest objecting to fast-track sales, especially where a debtor is no longer operating.

To obtain more information regarding credit bidding parameters or a copy of the decision, please contact the Barnes & Thornburg attorney with whom you work or the following attorneys: Patrick E. Mears at (616) 742-3936 or pmears@btlaw.com, or David M. Powlen at (302) 300-3435 or dpowlen@btlaw.com. You can also visit us online at <http://www.btlaw.com/financeinsolvencyandrestructuring/>.

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