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CREDIT BID CAPPED IN CHARGED *FISKER* BANKRUPTCY AUCTION

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The recent Delaware Bankruptcy Court decision in *In re Fisker Automotive Holdings, Inc.* is not a sweeping threat to a secured creditor's right to credit bid for its collateral, but is a roadmap to limit credit bidding before the validity and extent of the liens has been decided—particularly in an expedited sale to the secured lender that freezes out competitive bidding at the beginning of the case.

In January 2014, the Court capped the credit bid on a $168.5 million outstanding Department of Energy loan ("*DOE Loan*") at $25 million—the amount it was purchased for at auction—finding "cause" to limit the credit bid under Section 363(k) of the Bankruptcy Code.[1]

The DOE Loan was secured by a first-priority lien in substantially all of Fisker's assets. Hybrid Tech Holdings, LLC ("*Hybrid*"), an entity controlled by Hong Kong billionaire Richard Li, purchased the DOE Loan in an open auction conducted by the Department of Energy a month prior to Fisker's bankruptcy. Hybrid immediately entered into an agreement with Fisker to purchase all of its assets in a private bankruptcy sale for a credit bid of $75 million.

The Official Committee of Unsecured Creditors (the "*Committee*") challenged Hybrid's right to credit bid and alternatively requested to cap it at $25 million. Additionally, the Committee sought a competitive auction to maximize value for creditors. Wanxiang America Corporation ("*Wanxiang*"), a Chinese auto-parts conglomerate that purchased the assets of bankrupt battery-maker A123 Systems, Inc. for $300 million, agreed to bid only if Hybrid's credit bid was capped.

Relying on *Radlax Gateway Hotel, LLC v. Amalgamated Bank*, 132 S.Ct. 2065 (2012) and *In re Philadelphia Newspapers, LLC*, 599 F.3d 298 (3d Cir. 2010), the Court recognized that as a secured creditor Hybrid had a right to credit bid. But the right to credit bid is "not absolute." Further, the Court found that "cause" to deny credit bidding is not limited to a secured creditor that engaged in inequitable conduct, but extends to "the interest of any policy advanced by the Code, such as to ensure the success of the reorganization or to foster a competitive bidding environment."[2]

The Court found "cause" to cap Hybrid's credit bid at $25 million because without such limit no auction would go forward and the competitive bidding process would be frozen. The Court was troubled by Hybrid's effort to "short-circuit" the bankruptcy process by fast tracking the sale, over the holiday season and before the Committee was up to speed, with a fabricated "drop dead" date to freeze out competitors.

The Court relied on the fact that the amount of Hybrid's secured claim was uncertain as the Debtors and Committee stipulated that the claim is partially secured, partially unsecured, and partially in dispute. The Court distinguished *In re SubMicron Systems Corp.*, 432 F.3d 448 (3d Cir. 2006) that held that a secured creditor may credit bid the face value of its secured claim and is not limited to the "value" of the collateral because credit bidding itself sets the market value of the assets. Here, while the sale is for the entirety of Fisker's assets, the Court does not know which assets (if any) are subject to an unavoidable, perfected first-priority lien entitling Hybrid to credit bid for those assets. The Court seemed to implicitly accept the Committee's argument that the $25 million winning bid for the DOE Loan at auction reflected "a market-tested (and Government-approved) valuation of the underlying DOE Loan Collateral."[3] Without a trial on the validity and extent of Hybrid's lien, the $25 million winning bid stood as the best assessment of the extent and validity of Hybrid's lien. This reflects the Supreme Court's recognition in *Radlax Gateway* that the secured creditor may credit bid "up to the amount of its security interest."

Hybrid's effort to freeze out bidders clearly influenced the Court's decision. Hybrid is not a defensive secured creditor being cramdowned in a noncompetitive sale with no ability to protect its secured interest. Hybrid is a loan-to-own secured creditor on the offensive seeking to shut out bidding in a quick private sale with a questionable (at least in part) security interest.

Credit bidding is permitted so that secured creditors can protect their interest in collateral by bidding their claim to ensure that the assets are not sold below value. Here, the Court was concerned about the opposite result—that allowing Hybrid to credit bid the full outstanding amount of the DOE Loan would undervalue the assets at a time Hybrid's liens and collateral remain uncertain. No one (including Wanxiang) would bid if Hybrid could credit bid up to $168.5 million of the DOE Loan and Hybrid would acquire all of Fisker's assets (including those outside of its liens) for no cash consideration. The estate would be substantially harmed as its creditors are entitled to any proceeds from assets ultimately determined to be outside of Hybrid's security interest.

Moreover, Hybrid will not be significantly harmed because its billionaire owner has the resources to finance a cash bid and there are no coordination issues (that exist in syndicated loans or bonds) that make cash bidding ineffective. The proceeds of the highest and best bid will be preserved until the Court determines the validity and extent of Hybrid's security interest and Hybrid can be paid from the winning bid.

Hybrid is seeking an expedited appeal prior to the scheduled auction on February 12, 2014. Hybrid concedes that it is not entitled to credit bid for unencumbered assets, but argues that it agreed to pay, in addition to its credit bid, cash and other consideration that provides fair and reasonable value for any unencumbered assets.[4] Hybrid asks the appellate court to reverse and remand to the Bankruptcy Court for such determination.

But as Hybrid recognizes, this would require the Court to decide the relative value of the encumbered and unencumbered assets or sell the unencumbered assets separately after

determining which assets are unencumbered. Additionally, although not an issue in the decision or appeal, the Committee has argued that Hybrid's security interest is avoidable as a preference or fraudulent transfer or should be equitably subordinated.[5] These issues would have to be decided before any sale. Of course, Hybrid's new approach conflicts with its initial push for a quick sale notwithstanding that this is not the typical "melting ice cube" bankruptcy considering Fisker stopped production back in late 2012.

The appeal and any subsequent bankruptcy rulings should be closely watched on this important issue balancing the credit bidding rights of a secured creditor with a full examination of its security interest and a fair Section 363 sale process to maximize value for the estate and its creditors. This becomes critically important as prepackaged bankruptcy sales to secured creditors increase. Even if the decision is ultimately stayed and reversed, the Court will have time to properly determine the validity and extent of Hybrid's security interest and Hybrid will be unable to "short-circuit" the bankruptcy process. Other bankruptcy courts may follow this approach where a quick sale is not critical or substantial questions exist with respect to the validity and extent of the underlying liens.

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[1] Memorandum Opinion, *In re Fisker Automotive Holdings, Inc.*, Case No. 13-13087 (Bankr. D. Del. Jan. 17, 2014) (Bankruptcy Judge Kevin Gross) (Dkt. No. 483).

[2] "Cause" to deny or limit credit bidding was not at issue in the Supreme Court's *Radlax Gateway* decision. The issue in both *Radlax Gateway* and *Philadelphia Newspapers* was whether a plan of reorganization could be cramdowned under the "indubitable equivalent" prong of Section 1129(b)(2)(A)(iii) over a dissenting secured creditor denied the right to credit bid despite Section 1129(b)(2)(A)(ii) expressly incorporating credit bidding for sales of collateral free and clear of liens.

[3] The Official Committee of Unsecured Creditors' Omnibus Objection to (I) the Debtors' (A) Sale Motion, (B) DIP Financing Motion, (C) Plan of Liquidation and (D) Disclosure Statement and (II) the Allowance of Claims of Hybrid against the Debtors, *In re Fisker Automotive Holdings, Inc.*, Case, No. 13-13087 (Bankr. D. Del. Dec. 30, 2014) (Dkt. No. 264) (the "*Committee Objection*"), p. 18. The Committee described a number of categories of non-collateral assets including commercial tort claims, directors' and officers' insurance coverage, Chapter 5 causes of action, certificated automobiles, foreign intellectual property, and foreign inventory for which Hybrid was not entitled to credit bid. *Id.*, pp. 20-27.

[4] Opening Brief of Appellant Hybrid Tech Holdings, LLC, *Hybrid Tech Holdings, LLC v. The Official Committee of Unsecured Creditors of Fisker Automotive Holdings, Inc. and Fisker Automotive, Inc. (In re Fisker Automotive Holdings, Inc.)*, Civ. No. 14-cv-00099-UNA (D. Del. Jan. 27, 2014) (Dkt. No. 16), pp. 16-19.

[5] Committee Objection, pp. 18-21.