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Client Alert

Financial Restructuring Practice Group

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In re Fisker Automotive Holdings, Inc.—Delaware District Court Refuses to Hear Distressed Investor's Appeal of Order Limiting Right to Credit Bid

On January 17, 2014, the United States Bankruptcy Court for the District of Delaware (the "Bankruptcy Court") entered an order in the Fisker Automotive ("Fisker") chapter 11 bankruptcy cases limiting the ability of Fisker's secured lender, Hybrid Tech Holdings, LLC ("Hybrid"), to credit bid at an auction for the sale of substantially all of Fisker's assets.[1] Hybrid immediately sought an appeal of the Bankruptcy Court's decision, but on February 7, 2014, the United States District Court of the District of Delaware (the "District Court") issued an opinion denying Hybrid's Motion for Leave to Appeal, effectively ensuring that Hybrid would not be permitted to credit bid the full amount of its secured claim.[2] In doing so, the District Court embraced the view that a bankruptcy court may deny a lender the right to credit bid if doing so will "foster a competitive bidding environment."[3]

Background

When Fisker stopped manufacturing vehicles in July 2012, its capital structure consisted primarily of a $170 million secured loan held by the Department of Energy (DOE). After the parties failed to negotiate a restructuring, the DOE initiated a marketing process for the sale of its outstanding loan. The DOE retained Houlihan Lokey to run the loan sale process, which culminated in an active auction among several potential buyers. Hybrid won the auction with a bid of $25 million—acquiring the $170 million loan for approximately 15 cents on the dollar.

Hybrid had been formed by a group of investors that included David Manion, a member of Fisker's Board of Directors. After winning the auction but prior to effecting the note purchase, Hybrid engaged Fisker in negotiations for the purchase of substantially all of Fisker's assets. These negotiations resulted in a definitive Asset Purchase Agreement (the "APA") pursuant to which Fisker agreed to file for bankruptcy under Chapter 11 of the Bankruptcy Code and then consummate an asset sale to Hybrid. The agreed purchase price consisted primarily of a $75 million credit bid and cash in the approximate amount of $4 million for payment of administrative expenses and a small distribution to unsecured creditors.

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On November 22, 2013, the DOE closed its loan sale to Hybrid, David Manion resigned from the Fisker board to serve as an officer of Hybrid, Hybrid and Fisker executed the APA, and Fisker initiated its Chapter 11 bankruptcy proceedings.

Bankruptcy Court Proceedings

Fisker immediately sought approval from the Bankruptcy Court of the proposed sale to Hybrid on an expedited baasis. Several parties in interest, including the Official Committee of Unsecured Creditors (the "Committee"), opposed the sale. The Committee argued that Fisker should conduct a competitive auction for the sale of its assets instead of selling to Hybrid without any market exposure.

The Committee also argued that Hybrid's ability to credit bid for Fisker's assets should be eliminated. Section 363(k) of the Bankruptcy Code gives a secured creditor the right to credit bid at a sale of its collateral, but provides that the court may limit that right "for cause."[4] The Committee argued that there was sufficient cause to limit Hybrid's right to credit bid because: (a) the proposed sale included certain unencumbered assets; (b) if Hybrid were permitted to credit bid, it would chill bidding; (c) the $25 million price paid by Hybrid for the DOE loan constituted the market-tested value of Hybrid's collateral; and (d) David Manion's involvement in Hybrid constituted bad faith and a breach of fiduciary duty. The Committee further noted that Wanxiang America Corporation ("Wanxiang"), a competing bidder, was willing to enter into an asset sale transaction that would be more beneficial to Fisker's bankruptcy estate.

At the sale hearing, the Committee and Fisker announced several stipulated agreements, which limited the matters in dispute. Among other things, they agreed that: (a) a competitive auction would take place if Hybrid's right to credit bid was limited, but an auction would almost certainly not take place if Hybrid was allowed to credit bid the full amount of its claim; (b) limiting Hybrid's ability to credit bid would foster and facilitate a competitive bidding environment; and (c) certain assets to be sold were unencumbered by Hybrid's liens and the validity of Hybrid's liens on certain other assets was in dispute.[5]

After hearing evidence and argument, the Bankruptcy Court ruled (from the bench) that: (a) approval of the proposed sale to Hybrid should be denied; (b) Fisker should conduct an open auction for the sale of its assets; and (c) Hybrid's right to credit bid at such auction should be limited to $25 million (the price Hybrid paid to acquire the DOE loan).

Shortly after the sale hearing, the Bankruptcy Court issued a memorandum opinion discussing its ruling. In reaching its decision, the Bankruptcy Court looked primarily to an opinion issued by the Third Circuit Court of Appeals in *In re Philadelphia Newspapers*. Citing a footnote in the *Philadelphia Newspapers* opinion, the Bankruptcy Court stated that a court may deny a lender the right to credit bid in order to foster a competitive bidding environment.[6] Given the parties' stipulation that an auction was only possible if Hybrid's right to credit bid was limited, the Bankruptcy Court concluded that there was sufficient cause to limit Hybrid's credit bid.[7] In its opinion, the Bankruptcy Court also noted that Fisker and Hybrid had insisted upon an unnecessarily hurried time table for the sale and that the Committee had raised concerns about the amount of Hybrid's secured claim.[8] For these reasons, the Bankruptcy Court held that the proposed sale to Hybrid should not be approved and Hybrid's credit bid should be capped at $25 million.

District Court Order Denying Leave To Appeal

Hybrid immediately filed an appeal of the decision and sought an expedited hearing from the District Court. Hybrid argued that the Bankruptcy Court's decision contradicted recent pronouncements from the United States Supreme

Court noting the importance of a secured creditor's right to credit bid at an auction for the sale of its collateral. The Committee opposed the request for appeal arguing that: (a) the Bankruptcy Court's decision did not constitute a "final order" from which an appeal as of right could be taken; and (b) Hybrid had not satisfied the factors necessary to show that an interlocutory appeal was appropriate.

The District Court agreed with the Committee and denied Hybrid's emergency motion for leave to appeal. As an initial matter, the District Court held that the Bankruptcy Court's decision capping Hybrid's credit bid did not constitute a final order appealable as of right. The District Court noted that "there are many issues other than Hybrid's credit bid that are as yet unresolved by the Bankruptcy Court's order and will impact the process and results of the sale", including "the nature of Hybrid's statutory rights and whether Hybrid's lien is even valid."[9] Furthermore, the District Court rejected Hybrid's argument that it would be without a remedy after the auction takes place. Even with its credit bid limited, the District Court reasoned, Hybrid could still participate in the auction by submitting a cash bid.[10]

The District Court also held that Hybrid had failed to establish the factors necessary to justify an appeal of an interlocutory (*i.e.*, non-final) order.[11] Importantly, the District Court rejected Hybrid's assertion that there was substantial grounds for a difference of opinion regarding a controlling question of law. No such difference of opinion exists, the District Court stated, because the plain language of Section 363(k) of the Bankruptcy Code provides that a court may limit a creditor's right to credit bid "for cause."[12] Like the Bankruptcy Court, the District Court noted that the Third Circuit's opinion in *Philadelphia Newspapers* recognized that a court may deny a secured lender the right to credit bid in order to foster a competitive bidding environment.[13] The District Court likewise rejected Hybrid's remaining arguments in favor of an interlocutory appeal; according to the District Court, there was "no evidence at all that whether Hybrid's credit bid should be capped is an issue that must be resolved in order for the sale of the Debtors' assets to proceed," and Hybrid had "not articulated any exceptional circumstances that warrant granting it leave to appeal the interlocutory order in question here."[14]

The Auction

In the week that followed the District Court's opinion, Fisker conducted a three-day auction at which both Wanxiang and Hybrid participated. On February 14, 2014, Fisker filed a notice with the Bankruptcy Court indicating that Wanxiang had won the auction with a final bid of approximately $150 million.

Looking Forward

Although the Bankruptcy Court indicated that its decision should not be viewed as precedential, the reasoning underlying both the Bankruptcy Court's opinion and the District Court's opinion stands as a source of concern for secured lenders. Debtors, creditors' committees, and competing bidders opposing a secured lender's ability to credit bid will almost certainly look to these opinions for support. All secured creditors—but particularly distressed investors that acquire debt at a discount immediately prior to bankruptcy—should be prepared to face challenges to their credit bidding rights.

Both the District Court and the Bankruptcy Court relied heavily on the idea that the need to foster competitive bidding for a debtor's assets constitutes sufficient cause to impair a secured lender's ability to credit bid under Section 363(k) of the Bankruptcy Code. There are, however, strong arguments against this notion. First, although both courts cited *Philadelphia Newspapers* as supporting their position, the issue was not directly before the court in that case. Furthermore, simply because a secured lender with a credit bid right has the ability to outbid a cash bidder does not necessarily mean that the secured lender will actually do so. If the cash bidder places a higher value on the assets than the secured lender, the cash bidder will win the auction regardless of the secured lender's ability to credit

bid because the secured lender would rather receive the proceeds from the sale than the assets of the company.[15] Accordingly, there is good reason to question the argument that limiting a secured lender's ability to credit bid will foster competitive bidding in a way that positively impacts the value of a debtor's estate. Nonetheless, secured lenders should expect opposing parties to argue that credit bid rights chill bidding and that a limitation on credit bidding can be a useful tool for a debtor seeking to sell substantially all of its assets through a competitive process. Although this argument is subject to valid criticism, the Fisker bankruptcy proceedings demonstrate that it is gaining traction.

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[1] Memorandum Opinion, *In re Fisker Auto. Holdings, Inc.*, Case No. 13-13087(KG) (Bankr. D. Del. Jan. 17, 2014) ("Bankr. Ct. Op.").

[2] Memorandum, *Hybrid Tech Holdings, LLC v. Official Comm. Of Unsecured Creditors (In re Fisker Auto. Holdings, Inc.)*, Case No. 14-CV-99 (GMS) (D. Del. Feb. 7, 2014) ("Dist. Ct. Op.")

[3] *Id.* at 9.

[4] Section 363(k) of the Bankruptcy Code states: "At a sale under subsection (b) of this section of property that is subject to a lien that secures an allowed claim, unless the court for cause orders otherwise the holder of such claim may bid at such sale, and, if the holder of such claim purchases such property, such holder may offset such claim against the purchase price of such property."

[5] Bankr. Ct. Op. at 5–6.

[6] *Id.* at 8–9 (citing *In re Philadelphia Newspapers, LLC*, 599 F.3d 298, 315–16 n.14 (3d Cir. 2010)). In *RadLAX Gateway Hotel v. Amalgamated Bank*, 132 S. Ct. 2065, the United States Supreme Court resolved a circuit split on credit bidding against the Third Circuit's holding in *Philadelphia Newspaper*. The Supreme Court's decision in *RadLAX* did not, however, address the footnote cited by the Bankruptcy Court.

[7] *Id.* at 9.

[8] *Id.* at 10.

[9] Dist. Ct. Op. at 6.

[10] *Id.* at 7.

[11] *Id.* at 8.

[12] *Id.* at 9.

[13] *Id.*

[14] *Id.* at 10–11. A few days after the District Court issued its order denying Hybrid's Motion for Leave to Appeal, it issued another order, based on substantially the same reasoning, denying Hybrid's Request for Certification of Direct Appeal to the United States Court of Appeals for the Third Circuit.

[15] *See* Vincent S. J. Buccola and Ashley C. Keller, *Credit Bidding and the Design of Bankruptcy Auctions*, 18 George Mason L. Rev. 99, 123 (2010).