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How Fisker Changes The Bankruptcy Asset Sale Landscape

Law360, New York (February 25, 2014, 1:26 PM ET) -- In the Chapter 11 bankruptcy of Fisker Automotive Holdings Inc., a manufacturer of hybrid electric vehicles, the U.S. Bankruptcy Court for the District of Delaware recently ruled that the proposed stalking horse purchaser of substantially all of Fisker's assets in a sale under Section 363 of the Bankruptcy Code was entitled to credit bid only a fraction of its secured claim. In re Fisker Auto. Holdings Inc., No. 13087 (Bankr. D. Del. Jan. 17, 2014) [Docket No. 483].

Reasoning that permitting the stalking horse, Hybrid Tech Holdings LLC, to credit bid the full amount of its roughly $168 million claim — which it had purchased from the U.S. Department of Energy at a steep discount — would preclude a competitive auction, Judge Kevin Gross capped Hybrid's right to credit bid at $25 million. Hybrid appealed the bankruptcy court's decision to the U.S. District Court for the District of Delaware, which on Feb. 7, 2014, issued an order treating the appeal as interlocutory and denying the appeal request.

On Feb. 19, 2014, following an auction, the court entered an order approving the sale of Fisker's assets to Wanxiang America Corp., whose final bid was valued at approximately $149 million — nearly three times greater than the value of Hybrid's initial bid. While reserving its rights with regard to the allocation of sale proceeds as well as other issues, Hybrid declared after the auction that it would no longer challenge the bankruptcy court's decision to cap its credit bid, and therefore, this decision will stand.

Closing the Gap

In bankruptcy asset sales under or outside of a Chapter 11 plan, a secured creditor's right to credit bid its allowed claim is a critical protection. The right to credit bid is embodied in Section 363(k) of the Bankruptcy Code, which provides that in an asset sale under Section 363, "unless the court for cause orders otherwise, the holder of [an allowed claim secured by a lien on the property to be sold] may bid at such sale, and, if the holder purchases such property, such holder may offset such claim against the purchase price of such property."

In In re SubMicron Systems Corp., 432 F.3d 448 (3d Cir. 2006), the Third Circuit firmly established that a secured creditor's credit bid is not limited to the value of its collateral; instead, it may bid the face amount of its claim, unless its liens are subject to bona fide dispute. Credit bidding allows an undersecured creditor — i.e., one whose claim exceeds the current value of its collateral — to avoid a sale of its collateral at a depressed price by purchasing its own collateral with the debtor's indebtedness to the creditor (rather than cash).

Credit bidding may be particularly important where the secured creditor is a syndicate of lenders, whose individual members may have limited authorization to put up more cash, i.e., "good money after bad,"

or where asset values are decreased in the short term.

In May 2012, the U.S. Supreme Court, in RadLAX Gateway Hotel LLC v. Amalgamated Bank, 132 S.Ct. 2065 (2012), reinforced the credit bid right, holding that a debtor may not deprive a secured creditor of its credit bid right in a sale under a Chapter 11 plan by cashing the creditor out at the value of its collateral under Section 1129(b)(2)(A)(iii) — the so-called "indubitable equivalent" prong.

RadLAX substantively overruled the Third Circuit's 2010 decision in In re Philadelphia Newspapers LLC, 599 F.3d 298, (3d Cir. 2010), effectively silencing the shock waves that the Third Circuit decision released into the market for secured loans.

The RadLAX decision, however, did not address one threat left open by Philadelphia Newspapers. In dicta, the Third Circuit observed in Philadelphia Newspapers that the right to credit bid is "not absolute," and that the express "for cause" exception in Section 363(k) of the Bankruptcy Code authorizes a court to deny a creditor the right to credit bid "in the interest of any policy advanced by the [Bankruptcy] Code, such as to ensure the success of the reorganization or to foster a competitive bidding environment." In Fisker, the U.S. Bankruptcy Court for the District of Delaware addressed the gap that RADLax left open.

Widening the Gap

In Fisker, the debtor proposed to sell substantially all of its assets to Hybrid in a private sale outside a plan. Prior to Fisker's Nov. 22, 2013, bankruptcy filing, Hybrid had purchased the U.S. Department of Energy's roughly $168 million claim against Fisker in an auction for $25 million (i.e., 15 cents on the dollar).

Hybrid, having succeeded to the position of Fisker's senior secured lender, entered into an asset purchase agreement with the debtor under which it would acquire the debtor's assets for consideration that included $75 million in the form of a credit bid, and the debtor moved for approval of the sale.

Following its appointment in December 2013, the Official Committee of Unsecured Creditors objected to the proposed private sale to Hybrid and moved for an alternative sale process with Wanxiang America Corp. as stalking horse bidder, asserting that Wanxiang's offer would result in a 40 percent recovery to unsecured creditors, while the Hybrid offer would produce an extremely small dividend, at best, to unsecured creditors.

Wanxiang made clear that if Hybrid was permitted to credit bid more than $25 million, it would not participate in any auction. Notably, Wanxiag had previously purchased from bankrupt A123 Systems the lithium ion batteries integral to Fisker's electric cars, and so was viewed by Gross as having a "vested interest" in purchasing Fisker's assets.

On Jan. 10, 2014, Gross ruled from the bench that in any asset sale, Hybrid would be permitted to credit bid only $25 million of its roughly $168 million claim. Gross capped the credit bid "for cause," within the meaning of Section 363(k).

In his written memorandum opinion issued on Jan. 17, 2014 (following Hybrid's appeal), Gross made clear that such "cause" was to foster a competitive bidding environment. Relying on dicta from Philadelphia Newspapers, Gross emphasized that the right to credit bid is "not absolute" and can be limited or denied in the name of policies advanced by the Bankruptcy Code. Applying that principle to

the sale at hand, Gross capped Hybrid's credit bid because otherwise competitive bidding would not only be "chilled," but also "frozen."

Although Gross' written opinion made clear that the "cause" for the credit bid cap was to encourage competitive bidding, he was also very focused on the fact (which was the subject of a stipulation between the debtor and the committee) that Hybrid had "undetermined perfected liens on a group of assets."

That is, Hybrid had properly perfected liens on some of the "mixed bag" of assets to be sold, but not all of them. Additionally, the debtor and the committee had agreed that there existed "material assets where there is a dispute as to whether Hybrid has a properly perfected lien."

Because Gross had no evidence regarding the perfection of Hybrid's liens, it appeared that it was the exigencies of the case that led him to cap Hybrid's credit bid. Gross appeared to use the $25 million purchase price that Hybrid paid for the claim of the U.S. Department of Energy as a proxy for the value of the collateral on which Hybrid had a lien. Concluding that issue, Gross repeated a familiar principle: "The law leaves no doubt that the holder of a lien the validity of which has not been determined, as here, may not bid its lien."

In the interim between Gross' ruling from the bench and his written memorandum opinion, Hybrid took an appeal of the credit bid decision to the U.S. District Court for the District of Delaware, which the court dismissed as interlocutory.

Furthermore, on Feb. 14, 2014, Wanxiang prevailed at the bankruptcy auction for Fisker's assets with a bid valued at approximately $149 million, representing $126,200,000 of cash, $8 million of assumed liabilities, and a contribution of common equity in an affiliate designated by Wanxiang. The auction began on Feb. 12, 2014, but concluded on Feb. 14, 2014, after 19 rounds of bidding.

Hybrid's initial bid was valued at $55 million, nearly three times less than the value of Wanxiang's final bid. Therefore, it appears that Gross's decision to cap Hybrid's credit bid, at least in part, was responsible for successfully fostering a competitive bidding environment. The court entered an order approving the sale on Feb. 19, 2014.

Minding the Gap

If Gross' decision to cap Hybrid's credit bid was driven by uncertainty regarding which assets, of a mixed bag to be sold, were subject to properly perfected liens of Hybrid, the decision is not controversial. In SubMicron Systems, while recognizing a secured creditor's right to credit bid the full face amount of its claim, the Third Circuit recognized an exception to that rule where the creditor's liens are "subject to bona fide dispute." At least part of Gross' rationale for capping Hybrid's credit bid was just that: its liens or the proper perfection of them was in dispute.

Insofar as Gross' credit bid decision was driven by a broader concern in favor of a competitive bidding environment, the decision is more noteworthy. Credit bidding is a right sacred to secured lenders, one upon which lenders rely in extending credit and one which can be viewed as appurtenant to a property right protected against takings without just compensation under the Fifth Amendment.

To place a lender's credit bid right within the loose bounds of judicial discretion — vulnerable to being eviscerated in the name of value to the bankruptcy estate — injects uncertainty into a lender's position

that ultimately could affect the cost of credit.

It is possible to understand the credit bid decision in Fisker as driven primarily by facts, rather than legal principles. In his written memorandum decision, sharply focused on recoveries to unsecured creditors, Gross' concern for the taxpayers' loss in the federal government's failed investment in Fisker was evident: "The Fisker failure has damaged too many people, companies and taxpayers."

Time will tell whether Fisker is precedent for stripping a lender of its credit bid right in favor of broad bankruptcy policies, such as maximizing recovery to the bankruptcy estate. What is certain is Fisker's age-old lesson to secured lenders to be scrupulous in properly perfecting their liens, which, without fail, are fire-tested in bankruptcy.

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