FOWLER BELL PLLC

CREDIT BIDDING – SECURED CREDITORS BEWARE!

By Taft A. McKinstry
Fowler Bell PLLC
Lexington, Ky.
tmckinstry@fowlerlaw.com

I. Credit Bidding Under 11 U.S.C. 363(k).

When a debtor proposes to sell a secured creditor's collateral outside of a chapter 11 plan, Bankruptcy Code section 363(k) allows the secured creditor to credit bid its allowed secured claim *unless* the court orders otherwise *for cause:*

> 11 U.S.C. 363(b)(1) The trustee, after notice and a hearing, may use, sell or lease, other than in the ordinary course of business, property of the estate, . . .
>
> 11 U.S.C. 363(k) 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 the property.

II. Credit Bidding Under a Plan.

If a debtor proposes to sell a secured creditor's collateral pursuant to a chapter 11 plan (whether through an auction, a private sale or otherwise), the secured creditor generally must consent to its treatment under the plan or be unimpaired. 11 U.S.C. 1129(a)(8).

If these requirements are not satisfied, a debtor can still sell a secured creditor's collateral free and clear of the secured creditor's lien under a non-consensual "cram down" plan under Bankruptcy Code section 1129(b)(1):

> (b)(1) . . . the court, on request of the plan proponent, shall confirm the plan . . . if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan.
>
> (2) For the purposes of this subsection, the condition that a plan be fair and equitable with respect to a class includes the following requirements:
>
> (A) With respect to a class of secured claims, the plan provides -
>
> (i)(I) that the holders of such claims retain the liens securing such claims, whether the property subject to such liens is retained by the debtor or transferred to another entity, to the extent of the allowed amount of such claims; and
>
> (II) that each holder of a claim of such class receive on account of such claim deferred cash payments totaling at least the allowed amount of such claim, of a value, as of the effective date of the plan, of at least the value of such holder's interest in such property;
>
> (ii) for the sale, subject to section 363(k) of this title, of any property that is subject to the liens securing such claims, free and clear of such liens, with such liens to attach to the proceeds of such sale, and the treatment of such liens on proceeds under clause (i) or (iii) of this subparagraph; or

(iii) for the realization by such holders of the indubitable equivalent of such claims.

A. The Fifth Circuit and the Third Circuit interpreted the three prongs of section 1129(b)(2)(A) as disjunctive alternatives and held that it does not provide a secured creditor an absolute right to credit bid in a sale effectuated through a "cram down" plan.

1. *In re Pacific Lumber*, 584 F.3d 229 (5th Cir. 2009).[1]

In *Pacific Lumber,* a group of undersecured noteholders (with a claim against the estates of approximately $740 million) opposed a plan that provided for a private sale of the collateral securing their notes and payment in cash to the noteholders on the secured portion of their claim. The plan sponsors funded the plan with $580 million in cash and proposed to pay the noteholders the value of their collateral, as determined by the Bankruptcy Court at a valuation hearing. At the valuation hearing, the Bankruptcy Court concluded that the noteholders' secured claim was valued at $513.6 million. The noteholders argued that the plan could not be confirmed over their objection because section 1129(b)(2)(A)(ii) required that the noteholders be given the right to credit bid when the property on which they held a lien was transferred. The Bankruptcy Court subsequently confirmed the plan over the noteholders' objection, finding that the noteholders would receive the "indubitable equivalent" of their claim under the plan and thus did not have a right to credit bid.

The Fifth Circuit affirmed on direct appeal, holding that the payment to the noteholders of the valued amount of their secured claim satisfied the fair and equitable requirement because it constituted the "indubitable equitable" of their claim. The Court found that the three prongs of section 1129(b)(2)(A), which are joined by the disjunctive "or" are alternatives. The Fifth

---

[1] Case summaries of *In re Pacific Lumber, In re Philadelphia Newspapers, LLC* and *In re River Road Hotel Partners, LLC* courtesy of Prof. Kenneth N. Klee, Professor UCLA School of Law and founding member of Klee, Tuchin, Bogdanoff & Stern LLP, Los Angeles, CA from Outline of 6th Circuit Conference Bankruptcy Breakout Session, Lexington, Ky., April 25, 2012.

Circuit went even further, finding that the three subsections of section 1129(b)(2)(A) constitute a *non-exhaustive* list of means for satisfying the "fair and equitable" requirement since the introduction to section 1129(b)(2) states that the "condition that a plan be fair and equitable *includes* the following requirements. . . ." *Id*. at 245 (emphasis in original). Having concluded the list was non-exhaustive, the Court also concluded it would be inconsistent to require adherence to section 1129(b)(2)(A)(ii), and an opportunity for a secured creditor to credit bid, as the only means to accomplish a sale free and clear in the cramdown context. The Fifth Circuit rejected the contention that a secured creditor is not given an "indubitable equivalent" by a plan that, by not allowing credit bidding, thereby "forfeit[s] the possibility of later increases in the collateral's value" being realized by such creditor. *Id*. at 247. In addressing the argument that allowing a sale without credit bid protections would render section 1129(b)(2)(A)(ii) superfluous, the Court held that "[a]lthough a credit bid option might render Clause (ii) imperative in some cases, it is unnecessary here because the plan offered a cash payment to the Noteholders." *Id*. at 246.

2. *In re Philadelphia Newspapers, LLC*, 599 F. 3d 298 (3d Cir. 2010), J. Ambro dissenting.

After acknowledging that a secured creditor may credit bid at an auction sale up to the full amount of its loan, *Id*. at 311, the majority opinion in *Philadelphia Newspapers* took the position that the adequacy of the plan's protection of a secured creditor should be determined not by an auction but before the auction in a proceeding in which the bankruptcy judge makes an "indubitable equivalent" finding by considering "other forms of compensation" for the secured creditor's collateral, rather than by the auction. *Id*. at 312. The majority opinion made its premise unmistakably clear by stating: "In other words, it is the plan of reorganization, and not the auction itself, that must generate the 'indubitable equivalent.'" *Id*. It thus held that a plan providing for the sale of collateral without allowing credit bidding could nevertheless be found to provide an indubitable equivalent, and rejected the contention that a secured creditor is denied an indubitable equivalent because it is not allowed to credit bid. The Court, however, did not offer any explanation of how, without credit bidding, the secured creditor would be assured of getting full payment of the debt or at least the property.

Judge Ambro dissented from the *Philadelphia Newspapers* majority opinion and argued that section 1129(b)(2)(A)(ii), with its explicit right of

credit bidding, should be controlling where a sale of assets free and clear of liens is proposed under a non-consensual chapter 11 plan. Judge Ambro also argued that the majority's view of subsection (iii) would render subsection (ii) superfluous, and the specific statute (subsection (ii)) should prevail over the general statute (subsection (iii)). Finally, he argued that the majority's opinion was inconsistent with Bankruptcy Code sections 363(k) and 1111(b).[2]

B. The Seventh Circuit declined to follow the Fifth and Third Circuits and, thus, created a split among the Circuits. The Seventh Circuit held that the application of the credit bid right in section 1129(b)(2)(A)(ii) is mandatory if a sale of property subject to a secured creditor's lien is proposed in the context of a "cram down" plan.

***River Road Hotel Partners, LLC v. Amalgamated Bank*, 651 F. 3d 642 (7th Cir. 2011), aff'd sub nom *RadLAX Gateway Hotel, LLC v. Amalgamated Bank*, 132 S.Ct. 2065, 182 L.Ed.2d 967 (U.S. 2012).**

The debtors in *River Road Hotel Partners LLC* had built the InterContinental Chicago O'Hare Hotel with approximately $155.5 million in construction financing. The debtors in *RadLAX Gateway Hotel LLC* had purchased the Radisson Hotel at Los Angeles International Airport with the intention of renovating it and building an adjacent parking structure for which they had obtained a $142 million construction loan.

Both debtors proposed plans under section 1129(b)(2)(A)(iii) or alternatively under section 1129(b)(2)(ii) providing for the sale of substantially all of their assets. The *River Road* debtors proposed a stalking horse bidder (which included a group of insiders) of $42 million subject to higher and better

---

[2] Bankruptcy Code section 1111(b)(1)(A) provides:

A claim secured by a lien on property of the estate shall be allowed or disallowed under section 502 of this title the same as if the holder of such claim had recourse against the debtor on account of such claim, whether or not such holder has such recourse, unless

(i) the class of which such claim is a part elects, by at least two-thirds in amount and more than half in number of allowed claims of such class, application of paragraph (2) of this subsection; or

(ii) such holder does not have such recourse and such property is sold under section 363 of this title or is to be sold under the plan.

* * *

(2) If such election is made, then notwithstanding section 506(a) of this title, such claim is a secured claim to the extent that such claim is allowed.

offers. The *RadLAX* debtors proposed a stalking horse with an initial bid of $47.5 million. Both debtors sought to prohibit their secured creditor from bidding its secured debt under section 1129(b)(2)(A)(iii). The debtors also filed motions to prohibit the secured creditors from credit bidding their secured debt for cause under section 1129(b)(2)(A)(ii) and 363(k). The *River Road* debtors argued that the lenders' failure to advance additional funds to complete the hotel caused the debtors to fail, that allowing credit bidding would chill the bidding process, and that there were $10 million in mechanics lien claims that had priority over the secured lender's mortgage.

The Bankruptcy Court was not persuaded by the 363(k) arguments and held that it could condition the secured creditor's right to credit bid by requiring it to place cash in escrow, to pay a portion of its bid in cash or post an irrevocable letter of credit for the amount of the alleged senior mechanics liens.

The debtors nevertheless argued that the plans were confirmable because the lenders would receive the "indubitable equivalent" under 1129(b)(2)(A)(iii). The Bankruptcy Court disagreed and certified the debtors' appeal[3] to the Seventh Circuit.[4]

Splitting from the Fifth Circuit in *Pacific Lumber* and the Third Circuit in *Philadelphia Newspapers*, the Seventh Circuit unanimously held that a plan under which the secured creditor's collateral is to be auctioned does not provide the "indubitable equivalent" of its claim "without allowing credit bidding." The Seventh Circuit emphasized that credit bidding was built into both section 363(k) and 1129(b)(2)(A) to ensure that the secured creditor's lien is not extinguished for less than the true value of its collateral:

> . . . By granting secured parties this ability [to credit bid], the Code provides lenders with means to protect themselves from the risk that the winning auction bid will not capture the asset's actual value. If a secured lender feels that the bids that have been submitted in an auction do not accurately reflect the true value of the asset and that a sale at the highest bid price would leave them

[3] The debtors did not appeal the Bankruptcy Court's finding that cause did not exist under 363(k).
[4] Just over a week after the Seventh Circuit opinion, the *River Road* lenders confirmed their own reorganization plan mooting any further appeal by those debtors.

> undercompensated, then they may use their credit to trump the existing bids and take possession of the asset. In essence, by granting secured creditors the right to credit bid, the Code promises lenders that their liens will not be extinguished for less than face value without their consent. This protection is important since there are a number of factors that create a substantial risk that assets sold in bankruptcy auctions will be undervalued. *Id.*, at 650.

The Seventh Circuit found it dubious that a plan based on a "free and clear" asset sale that did not provide the lenders the right to credit bid could ever be considered "fair and equitable." The Court noted that the term "indubitable equivalent" is not defined in the Bankruptcy Code and its definition depends in each case on the amount of the creditor's lien and the current value of the asset in question. Finding bankruptcy sales inherently unreliable, the Court was skeptical that a winning bid at a bankruptcy auction could serve as an effective determinate of market value. Rather, it was the lender's right to credit bid that served as the "crucial check against undervaluation." *Id.*, at 651.

In reaching its decision, the Court found that, even considered in isolation, subsection (iii) did not unambiguously indicate that it was applicable to a plan involving an auction or sale. The Seventh Circuit looked to the same canon of statutory construction utilized by Judge Ambro to resolve this ambiguity, finding that the statute should be interpreted in a way that gives meaning to each part while taking care not to render any section superfluous and that interpreting subsection (iii) to confirm plans proposing to sell encumbered assets that nevertheless failed to satisfy subsections (i) or (ii) would render those sections superfluous. Instead, the Seventh Circuit found that the "infinitely more plausible interpretation" of section 1129(b)(2)(A) was to read each of the subsections as conclusively governing the category of proceedings it addresses. *Id.*, at 652.

The Seventh Circuit opinion was rendered in June, 2011; the debtors filed their petition for certiorari on August 5, 2011, the U.S. Supreme Court granted the petition in December, 2011, heard oral argument in April, 2012 and rendered a unanimous opinion on May 29, 2012 affirming the Seventh Circuit.

C. The U. S. Supreme Court unanimously affirmed the Seventh Circuit and held that section 1129(b)(2)(ii) and (iii) are independent provisions and that (ii) is not subsumed in (iii).

***RadLAX Gateway Hotel LLC, et al v. Amalgamated Bank*, 132 S. Ct. 2065 (2012).**

In a 10-page decision by Justice Scalia, the Supreme Court concluded that debtors cannot sell property under a chapter 11 plan without allowing lienholders the right to credit bid at the sale. The opinion succinctly and firmly held that the provisions of section 1129(b)(2)(A) operate very simply:

> . . . [T]he structure of the statute . . . suggests that clause (i) is the rule for plans under which the creditor's lien remains on the property, (ii) is the rule for plans under which the property is sold free and clear of the creditor's lien and (iii) is a residual provision covering dispositions under all other plans – for example, one under which the creditor receives the property itself, the 'indubitable equivalent' of its secured claim. *Id.*, at 2072.

The Court rested its holding on the "general/specific" canon of statutory interpretation: Where two statutory authorizations exist side by side, one specific and one general, the specific provision should be given effect to preserve the effect of the entire statute and avoid superfluity. The Court found that the specific requirement of subsection (ii) always applies to a proposed plan sale of collateral. Subsection (iii) may give the debtor the right to come up with other methods for providing the secured lender with the indubitable equivalent of its claim, but it does not provide an alternative method of collateral sale.

III. Denial of Credit Bidding Under Section 363(k).

The Supreme Court in *RadLAX* did not address the ability of a court to restrict the right to credit bid "for cause" under Bankruptcy Code sections 1129(b)(2)(A)(ii) or 363(k). Since the Supreme Court's decision, there have been several cases that

have found "cause" and restricted an asserted secured creditor's right to bid its claim for credit.

A. *In re Fisker Automotive Holdings, Inc.*, Case No. 13-13087 (KG), 2014 WL 210593 (Bankr. D. Del. Jan. 17, 2014).

Established in 2007 to design and manufacture premium plug-in hybrid electric vehicles, Fisker Automotive Holdings, Inc. and Fisker Automotive, Inc. (collectively, "Fisker") obtained, in April 2010, a loan from the US Department of Energy for $530 million to be secured by liens on substantially all of the debtors' assets to fund the development, production, sale and marketing of two models. Due to a variety of problems, including safety recalls related to battery packs purchased from a third party and loss of a material portion of its unsold inventory due to Hurricane Sandy in October 2012, Fisker defaulted on the DOE loan. Fisker retained an investment banker to explore strategic alternatives and a potential sale, which were unsuccessful.

The DOE decided to sell the loan on the secondary market and hired a nationally recognized financial advisor to conduct an auction. Five bids were submitted including by Wanxiang America Corp. and by Hybrid Tech Holdings, Inc., a Fisker affiliate. Hybrid was the successful bidder and purchased the loan which was then at $168 million for $25 million.

Fisker filed chapter 11 on November 22, 2013 and immediately sought approval of a private sale of its assets to Hybrid, without further marketing or auction, for 1) $75 million in the form of credit bid, 2) waiver of a portion of Hybrid's DIP loan, 3) assumption by Hybrid of certain liabilities, and 4) certain cash payments, $500,000 of which would be for unsecured creditors. Hybrid conditioned its bid on Bankruptcy Court approval by January 3, 2013, just 45 days (and 24 business days) from the bankruptcy filing.

The Unsecured Creditors Committee was appointed December 5, 2013 and immediately objected to the private sale and proposed an auction based on a competing bid of Wanxiang of $25.725 million plus a 20% interest in the acquiring entity. Wanxiang's bid was expressly conditioned on Hybrid's credit bid being limited to $25 million. The Committee noted that Wanxiang had recently purchased for almost $300 million through a bankruptcy auction

certain assets of A123 Systems,[5] a seller of lithium ion batteries, a primary component of Fisker cars, and thus had a genuine interest in being a bidder. The Committee argued that "cause" existed to limit or cap Hybrid's credit bid because 1) doing so would foster a competitive bidding environment, 2) Hybrid had engaged in inequitable conduct, and 3) certain of Hybrid's liens were disputed or unperfected as to assets worth millions of dollars. The Committee also sought standing to commence an adversary proceeding against Hybrid to equitably subordinate its secured claim, asserting that Hybrid, an insider, should be precluded from credit bidding because its principals had engaged in self-dealing and breached their fiduciary duties owed to Fisker (an officer of Fisker had resigned to become an officer of Hybrid the day the Purchase Agreement was signed).

At the sale hearing on January 10, 2014, the Debtors and the Committee stipulated:

1) If Hybrid's credit bid were capped or denied, there was a strong likelihood that an auction would create substantial value for the estates;

2) If Hybrid's credit bid were not capped or denied, a competitive auction would likely not occur;

3) The highest and best value of the estates would be achieved only through the sale of all of the debtors' assets as an entirety;

4) A material portion of the assets being sold were not subject to perfected lien in favor of Hybrid or were subject to a *bona fide* dispute.

The Bankruptcy Court quoted from *In re Philadelphia Newspapers*, at 315-316, that a "court may deny a lender the right to credit bid in 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." Finding that permitting Hybrid to credit bid $75 million would not just chill the bidding, but "freeze bidding," the Court capped Hybrid's credit bid at $25 million. *In re*

---

[5] *In re B456 Systems, Inc. (f/k/a A123 Systems, Inc.*), Case No. 12-12859 (KJC) (Bankr. D. Del. 2013).

Fisker, at 11. In reaching this amount, the Court appears to have relied on a stipulation between the Debtors and the Committee that $25 million was the limit that would permit a robust auction process.[6] Wanxiang ended up as the successful bidder at the auction with a bid of $149.2 million ($126.2 million cash, $8 million of assumed debt, and a contribution of 20% of the common stock of an affiliate designated by Wanxiang) after 19 rounds of bidding over 3 days.

It is worth noting that the Court appeared to have been also partially motivated by the more traditional factors used to limit credit bidding for cause. The Court noted that Hybrid had "insisted on an unfair [sale] process," and that "the validity of its secured status ha[d] not been determined."[7] Id. at 11. The Court also noted the amount paid by Hybrid for the purchased debt. Irrespective, it appears that the overriding basis of the Court's ruling emphasized the effects of an uncapped credit bid on the auction process – a rationale, standing alone, that has not yet been used by a court to restrict a credit bid.

B. *In re Free Lance-Star Publishing*, Case No. 14-30315-KRH, 2014 Bankr. LEXIS 1611 (Bankr. E.D. Va. April 14, 2014).

In 2006, Free Lance-Star Publishing Company and William Douglas Properties, LLC borrowed approximately $50.8 million from BB&T to expand their commercial printing business. BB&T took liens on Debtors' real and personal property but did not obtain liens on the "Tower Assets", 3 parcels of

[6] The United States District Court for the District of Delaware, in two opinions, declined to consider Hybrid's appeal of this decision and declined to certify a direct appeal to the Third Circuit. *Hybrid Tech. Holdings, LLC v. Official Committee of Unsecured Creditors (In re Fisker Automotive Holdings Inc.)*, Case No. 14-CV-00099 (GMS), 2014 WL 546036 (D. Del. Feb. 7, 2014) and 2014 WL 576370 (D. Del. Feb. 12, 2014). The District Court noted that Hybrid could credit bid its $25 million and continue bidding in cash, thus, effectively, "round-tripping" the cash to the extent of its allowed claim above $25 million.

[7] Hybrid had argued that under the law of the Third Circuit expressed *in Cohen v. KB Mezzanine Fund III, LP (In re SubMicron Systems Corp.)* 432 F.3d 448 (3d Cir. 2006), wherein the Third Circuit had ruled that an undersecured creditor was entitled to credit bid the face amount of its secured claim, that it was entitled to credit bid its entire claim. The Bankruptcy Court distinguished *SubMicron* where the entire secured claim was deemed allowed, whereas the Bankruptcy Court did "not yet know how much of Hybrid's claim is secured."

land and transmittal towers used in Free Lance-Star's radio broadcasting business. In early 2009, Debtors fell out of compliance with their loan covenants and were unsuccessful in obtaining replacement financing. In June 2013, BB&T sold its loan to DSP Acquisition, LLC.

DSP demanded the Debtors execute deeds of trust on the Tower Parcels and that the Debtors file for relief under chapter 11. When the companies declined to execute the deeds, DSP unilaterally filed UCC fixture filings on those assets. Ninety days later, DSP resumed its pressure for a chapter 11 bankruptcy filing to sell the Debtors' assets, with a DSP credit bid, not more than 6 weeks from filing to closing. DSP also strongly objected to Debtors' engagement of a financial consultant in connection with the bankruptcy, and insisted that marketing material contain on the front page, in bold font, a statement that DSP had a right to a $39 million credit bid. On January 11, 2014, DSP recorded additional financing statements in various jurisdictions without notice to the Debtor.

On January 23, 2014, Debtors filed their chapter 11 petitions. DSP objected to Debtors' motions to use cash collateral and asked the Court to grant it new liens on the Tower Assets, as additional adequate protection to supplement the post-petition replacement liens and adequate protection payments offered by the Debtors. DSP did not disclose its secretly recorded fixture filings and financing statements. The Court denied DSP's request for additional replacement liens.

With their petitions, the Debtors filed two sale motions, one for the sale of their business assets, and one for the sale of the Tower Assets. The Court entered orders approving bidding procedures and the right of DSP to credit bid its claim on which it had valid liens as either (1) agreed to by the Debtors and the Unsecured Creditors Committee, or (2) as determined by the Court.

On March 10, 2014, DSP commenced an adversary proceeding for a determination that it had valid perfected liens on substantially all of the Debtors' assets. Following the conclusion of an evidentiary hearing, the Court ruled that DSP did not have valid, properly perfected liens on the Tower Parcels or improvements thereon, the other Tower Assets, the FCC licenses, the rolling stock, insurance policies or the Debtors' bank accounts, that section 552 prevented DSP from asserting a lien on the proceeds of such assets, and that

DSP could not credit bid a claim against assets on which it lacked a valid lien or security interest.

DSP provided no evidence at the hearing concerning its acquisition of the BB&T loan and there was no evidence in the record that DSP was the holder of the Draw Commercial Note dated September 11, 2007. The Court invited DSP to supplement the record with this information and the amount paid for the loan, but DSP declined to do so. The Court further found that the declaration filed by DSP in support of its Complaint was both false and misleading and that DSP's witness at the hearing was not credible. Further, DSP failed to provide any witness to refute the Debtors' allegations that DSP's conduct was inequitable.

At the hearing, the only testimony provided regarding the bidding procedures was the Debtors' expert witness, Suzanne Roski from the Debtors' financial consultant, Proviti, Inc. Roski testified that many interested parties had executed nondisclosure agreements, that only one party had made a site visit, that numerous parties were awaiting resolution of the credit bid issue before launching advanced due diligence and that there was genuine confusion among potentially interested parties over what assets DSP had a lien and the auction process. Roski eliminated the unencumbered assets from the credit bid and then applied a market analysis to develop an appropriate cap for a credit bid that would foster a competitive auction process.[8]

The Court held that cause existed to limit the amount of DSP's credit bid: "The confluence of (i) DSP's less than fully secured status, (ii) DSP's overly zealous loan-to-own strategy; and (iii) the negative impact DSP's conduct has had on the auction process has created the perfect storm, requiring curtailment of DSP's credit bid rights." *Id.*, at 13. The Court found that DSP had pressured the Debtors for a speedy "bankruptcy filing," objected to the Debtors' hiring of a financial advisor to market the assets, had insisted that its credit bid amount be placed on marketing materials in bold font, and had secretly recorded financing statements with respect to assets over which DSP knew it did not have liens. The Court found that DSP's loan-to-own strategy had depressed enthusiasm for the sale in the marketplace, that potential bidders perceived the sale as a "fait accompli" and were not inclined to participate in

[8] The Court expressed concerns over the sensitive nature of this aspect of Roski's testimony and ordered the courtroom closed to the public and this portion of the record is unavailable.

the auction process, and that limiting DSP's bid would attract renewed interest in the bidding process and serve to increase the value realized for the assets. Thus, the Court ruled that DSP "had engaged in inequitable conduct that, under the circumstances, required the court to limit DSP's credit bid right in order to foster a robust auction." *Id.*, at 3.

The Court limited DSP's right to credit bid to $1.2 million for assets related to the Debtors' radio business and $12.7 million for assets related to the Debtors' newspaper and printing business on which DSP had valid, properly perfected liens.[9] *Id.*, at 13. At the auction, DSP ultimately purchased the assets for $16.3 million in cash on top of its court allowed credit bid of $13.9 million.

Both the *Fisker* and the *Free Lance-Star* decisions recognized a secured creditor's right to credit bid. In *Fisker*, the Court began its analysis by stating "[i]t is beyond peradventure that a secured creditor is entitled to credit bid its allowed claim." In *Free Lance-Star*, the Court specifically noted "[t]he right to credit bid under section 363(k) of the Bankruptcy Code is an important safeguard that insures against the undervaluation of the secured claim at an asset sale."

On the other hand, both Courts strongly suggested that merely the furtherance of general bankruptcy goals, such as the desire to foster a competitive bidding environment, might constitute "cause" sufficient to limit credit bidding rights. Both Bankruptcy Courts quoted *In re Philadelphia Newspapers, LLC*, 599 F.3d 298, 315-316 that "a court may deny a lender the right to credit bid in 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." In the *Free Lance-Star case*, the Bankruptcy

---

[9] The United States District Court denied DSP's emergency motion for leave to appeal and emergency motion for certification to the Third Circuit. The District Court found "no risk of irreparable harm if the issues are not resolved before the auction because there are no pending issues regarding the assets . . . and the Bankruptcy Court will determine who receives the proceeds (and how much) after the sale." Further, the District Court found that the Bankruptcy Court's opinion was not final because "[w]ho has liens, the amount of those liens, the full extent of DSP's liens, and other issues remain to be determined." In addressing whether it was appropriate to grant leave for an interlocutory appeal, the District Court noted that the Bankruptcy Court's decision did not involve a controlling issue of law for which there was substantial grounds for a difference of opinion, and that if interlocutory appeal were granted, there "would be neither material advancement of the ultimate termination of the litigation nor savings of judicial or estate resources." Nor did the District Court find "exceptional circumstances to justify a departure from the basic policy of postponing appellate review until after the entry of final judgment." *DSP Acquisition, LLC v.Free Lance-Star Pub. Co. of Fredericksburg, VA*, No. 3:14cv303-HEH, 2014 WL 1818175 (E. D. Va. May 7, 2014).

Court quoted from the US Supreme Court in *RadLAX* ("The ability to credit-bid helps protect a creditor against a risk that its collateral will be sold at a depressed price[]" by enabling the secured "creditor to purchase the collateral for what it considers the fair market price (up to the amount of its security interest) without committing additional cash to protect the loan.").

However, both Courts had more historically based "for cause" circumstances. In reaching their decision in each case before the Courts, there was a bona fide dispute regarding the extent and validity of the secured creditor's claim and egregious conduct on the part of the secured creditor. Although neither Court expressly set the limit on the secured creditor's bid based on the price paid for the claim, the Bankruptcy Court in *Fisker* stated that the bankruptcy auction would help determine whether the price paid for the DOE loan was in fact "fair and reasonable and in the best interest of the debtors' estates." Thus, both *Fisker* and *Free Lance-Star* could have serious implications for future auctions and broader implications for the claims trading market for distressed debt. This rationale is of particular importance to strategic buyers who acquire secured debt at a discount with the goal of using that debt as acquisition currency in "loan-to-own" strategies. Such buyers would serve themselves well by first checking out the lien perfection of the "secured" claim.

With both District Courts denying interlocutory appeals, a secured creditor is at risk of the loss or limitation of its credit bid rights. A later appeal of an order approving a sale may be unavailing on account of statutory mootness under Bankruptcy Code section 363(m)[10] and equitable mootness absent a stay of the sale order prior to a closing. The most conservative route would be for a secured creditor to have the validity and amount of its secured claim determined prior to an auction, but the compressed timetable of most bankruptcy auctions may make that impossible. An alternative is for the secured creditor to "round-trip" its cash bid to the extent its claim is later allowed as secured. Another alternative is for a secured lender to offer a

[10] Bankruptcy Code section 363(m) provides:

The reversal or modification on appeal of an authorization under subsection (b) or (c) of this section of a sale or lease of property does not affect the validity of a sale or lease under such authorization to an entity that purchased or leased such property in good faith, whether or not such entity knew of the pendency of the appeal, unless such authorization and such sale or lease were stayed pending appeal.

letter of credit[11] or other assurance to the Bankruptcy Court with respect to liens that are in bona fide dispute to preserve the right to credit bid the full amount of its claim.

C. *In re Charles Street African Methodist Episcopal Church of Boston*, 510 B.R. 453 (Bankr. D. Mass. 2014).

CSAME was the owner of two adjoining lots. Following denial of its first proposed plan of reorganization, CSAME filed a motion requesting (i) authority to sell all of its assets free and clear of all liens to a stalking horse bidder, and (ii) an order either (x) barring its secured creditor, OneUnited, from submitting a credit bid, or (y) to the extent the Court permitted credit bidding, requiring OneUnited to deposit at least $210,000 in cash as required by other bidders. CSAME also filed an objection to OneUnited's secured proof of claim, asserting three setoff counterclaims that, if successful, would have eliminated OneUnited's claim.

CSAME argued that its claim objection[12] evidenced that OneUnited's claim was subject to a *bona fide* dispute creating sufficient cause to deny OneUnited's right to credit bid. While acknowledging that the existence of a *bona fide* dispute often constitutes cause to deny credit bidding, the Court found that the counterclaims asserted did not amount to cause. The Court explained that "CSAME does not dispute the validity of the underlying loan agreements, the validity, perfection or priority of OneUnited's mortgages, the amounts claimed to be due, or anything intrinsic to either of OneUnited's claims. Nor does CSAME allege that the mortgages or loan agreements may be avoided." *Id.*, at 7. Because the Court determined there was no dispute about the "validity or extent of OneUnited's secured claims,"[13] it permitted

---

[11] See, e.g., *In re Octagon Roofing*, 123 B.R. 583 (Bankr. N. D. Ill. 1991) (allowing secured party to credit bid full amount of its claim but requiring irrevocable letter of credit guaranteeing payment of challenged portion of claim if objection succeeds).

[12] CSAME alleged unfair and deceptive loan origination in that OneUnited knowingly structured the Construction Loan to be underfunded, wrongfully refused to fund the tenth draw request under the Construction Loan, and acted in an unfair and deceptive manner when it initiated collection and foreclosure actions with no intent to pursue those actions to completion.

[13] The Court was of the opinion that there was "no risk of distribution on an invalid claim; instead there is risk that an untested counterclaim will go unsatisfied. CSAME would be using a denial of credit bidding as, in essence, a form of prejudgment security," a purpose the Court doubted it was intended to serve. Id., at 7.

OneUnited to credit bid.[14] The Court did determine that the need to fund the break-up fee constituted cause to limit OneUnited's right to credit bid by requiring OneUnited to include $50,000 cash in any bid to pay the break-up fee of the stalking horse bidder.

In its opinion, the Court noted that because CMASE "expressly disavow[ed] any reliance on [*Fisker*] and its rationale," the Court did not need to address the "types of 'cause'" at issue in *Fisker*. *Id.*, at 5.

A secured creditor's right to credit bid its claim when its collateral is sold in a bankruptcy case has been generally viewed as a fundamental right provided by section 363(k) of the Bankruptcy Code. This not only reduces a lender's need for liquidity at the time of the sale, but also ensures that the collateral pledged to the lender is not sold for less than the amount of such lender's secured claim without its consent.

However, these cases should serve as a reminder that the Bankruptcy Code does not provide a secured creditor with an unfettered right to credit bid in a sale of its collateral. At a minimum, these cases indicate that a secured creditor's right to credit bid is safest from attack when the creditor is the original holder of the debt, the claim is secured by a lien on substantially all of the assets being sold, the priority and perfection of the lien is undisputed and the creditor has not engaged in inequitable conduct.

---

[14] Although the issue did not seem to be before the Court, the Court noted in a footnote that "The right in question is only a right to pay a successful bid by offsetting the creditor's claim against the purchase price. The credit bidder does not otherwise enjoy special consideration in the bidding process. If, for example, the final round of bidding is by sealed bids, the creditor may submit a final sealed bid but is not entitled to a special opportunity to top a higher bid than its own." *Id.*, at 6.