Is Selling the New Reorganizing?

J. Christian Champ
THL Credit Senior Loan Strategies LLC; Chicago

Hon. Arthur J. Gonzalez (Ret.)
New York University School of Law; New York

Jason W. Harbour
Hunton & Williams LLP; Richmond, Va.

Richard Morgner
Jefferies LLC; New York

Anup Sathy
Kirkland & Ellis LLP; Chicago

Hon. Christopher S. Sontchi
U.S. Bankruptcy Court (D. Del.); Wilmington

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Is Selling the New Reorganizing? – Credit Bidding and Free and Clear Issues

November 12, 2014

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Part 1. Credit Bidding After Fisker and Free Lance-Star

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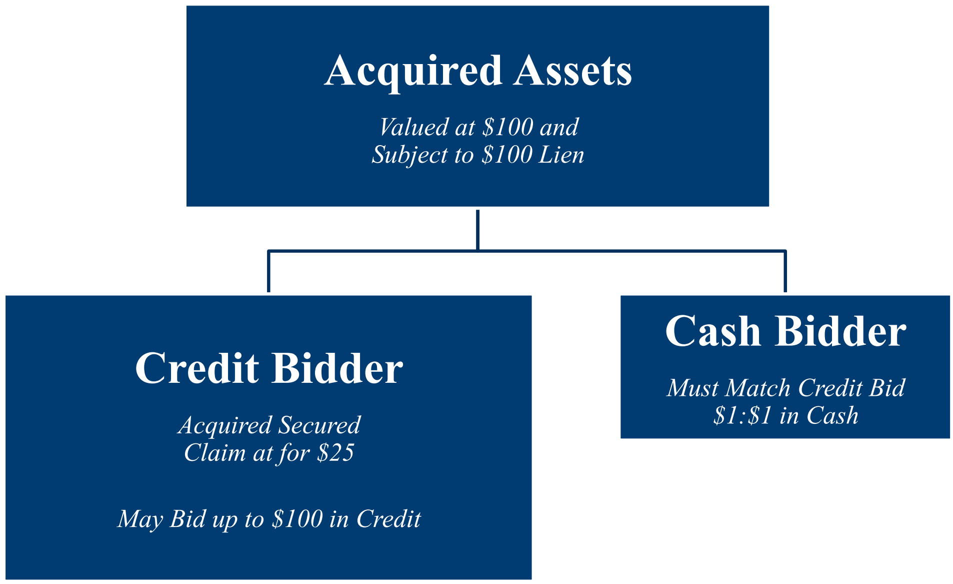
Credit Bidding: The Power of a Credit Bid



3

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Credit Bidding: Overview

- It is very common for secured lenders to “credit bid” acquired debt to purchase assets pursuant to section 363(b) of the Bankruptcy Code or under a chapter 11 plan.
  - Indeed, “loan to own” investors often purchase debt for the express purpose of seeking to credit bid at a bankruptcy auction.
  - Although a significant event in a chapter 11 case, the decision to credit bid at an auction does not resolve certain other material issues, such as the allocation of sale proceeds and whether the secured creditor’s liens are valid and enforceable.
- This right may be limited “for cause,” and two recent bankruptcy court decisions remind us that the landscape for credit bid transactions in chapter 11 is not without risks.
  - Specifically, in In re Fisker Automotive Holdings, Inc., No. 13-13087 (KG) (Bankr. D. Del.), and In re Free Lance-Star Publishing Co., No. 14-30315 (KRH) (Bankr. E.D. Va.), bankruptcy courts limited credit bidding “for cause,” preventing creditors from credit bidding the full value of their claims.
- Much has been said and written about whether these decisions changed the landscape as to whether credit bidding is still an effective strategy.

4

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Credit Bidding: Overview

- Under section 363(b) of the Bankruptcy Code, a debtor is allowed to sell, lease, or use assets outside of the ordinary course of business with prior bankruptcy court approval.
- Section 363(k) of the Bankruptcy Code provides that, in any sale under section 363(b) "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."
- Well-established law provides that a buyer can only credit bid for assets subject to the buyer's perfected liens.
- "Cause" for limiting credit bids is typically found where:
  - liens are **subject to challenge or bona fide dispute**;
  - credit bidding was intended to cover a mix of assets subject to their perfected or unperfected liens (i.e., "**mixed collateral**"); or
  - the credit bidder acted in **bad faith**.
- Significantly, the Third Circuit suggested in dicta in In re Philadelphia Newspapers, LLC (3d Cir. 2010) that credit bidding could also be limited for "cause" to "**foster a competitive bidding environment**."

5

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Fisker: Key Facts

- In late 2013, the Department of Energy (the "DOE") sold its interest in a loan to Fisker—which loan had a principal amount of approximately $170 million and was at least nominally secured by substantially all of Fisker's assets—to Hybrid Tech Holdings, LLC ("Hybrid") for $25 million.
- Hybrid negotiated a deal with Fisker to purchase substantially all of Fisker's assets for consideration that included an $8 million self-priming DIP facility, a $75 million credit bid, waiver of Hybrid's DIP facility claims, and $1 million in cash to wind down the estates.
- Hybrid's deal required a late-November bankruptcy filing, a January 3 sale, and no marketing efforts.
- Hybrid's deal also included assumption of certain substantial liabilities related to, among other things, a shuttered 3.2 million square-foot production facility in Wilmington, Delaware; however, days before the sale hearing, Hybrid announced that it would **not** assume those facility liabilities.
  - Prominent Delaware politicians and various municipal and state taxing bodies subsequently publicly opposed the sale with both public statements and filings in the bankruptcy court.
- An alternative bidder, Wanxiang America Corp. ("Wanxiang"), emerged but conditioned participation in an auction on Hybrid's credit bid being limited.

6

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Fisker: Bankruptcy Court Opinion Capping Credit Bid

- After extensive oral argument, the bankruptcy court ordered Fisker to conduct an auction for its assets and capped Hybrid's credit bid at $25 million; Hybrid would need to pay any additional consideration in cash.
- The bankruptcy court cited disputes regarding whether Hybrid could credit bid for "mixed collateral" over which it might not hold valid liens.
- The court, which had also signaled support for an auction during prior hearings, stated that Hybrid's ability to credit bid $168 million and Hybrid's "hurried" proposed sale timetable would "freeze" competitive bidding.
- Significantly, the ruling did **not** limit Hybrid's secured claim or address creditor recoveries or allocations.

7

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Fisker: Appellate Ruling

- Hybrid subsequently sought certification to immediately appeal the credit bid ruling by motion to the U.S. District Court for the District of Delaware (the intermediate appellate court immediately above the bankruptcy court).
- In applying the standard applicable to such procedural requests, the District Court held that there was **no** "substantial room for a difference of opinion" as to whether a credit bid could be limited to facilitate an auction.

8

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Fisker: Fisker Auction

- Following entry of a bidding procedures order, no additional bidders emerged, and Fisker proceeded with an auction with the two stalking horse bidders—Wanxiang and Hybrid.
- Over the course of a three-day auction commencing February 12, 2014, and that included 19 rounds of bidding, the value of the highest or otherwise best bid rose approximately $90 million before Wanxiang submitted the successful bid for the acquired assets.
- Fisker and the creditors' committee jointly valued Wanxiang's successful bid at approximately $149.2 million, which included:
  - $126.2 million in cash;
  - $8 million of assumed liabilities arising from certain administrative and priority claims against Fisker's estates; and
  - Wanxiang's contribution of 20% common equity interest in a Wanxiang affiliate designated to acquire Fisker's assets.

9

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Fisker: Global Settlement

- Following the appellate rulings and the auction, the parties focused on the ultimate allocation of the sale proceeds.
- Following months of discussions among Fisker, Hybrid, and the unsecured creditors' committee, the parties negotiated a global settlement that cleared the way for consummation of Fisker's chapter 11 plan.
- The global settlement resolved, among other things:
  - the competing claims to the proceeds arising from Fisker's sale to Wanxiang, including with respect to the allocation of value among physical assets, intellectual property registered in the U.S., and foreign intellectual property;
  - the claims and causes of action asserted against, among others, Hybrid, its principals, and various current and former directors and officers by the creditors' committee;
  - the allowance and resolution of Hybrid's senior secured claim and and the validity, perfection, and priority of the liens securing Hybrid's senior secured claim; and
  - the administration of certain post-confirmation matters by a liquidating trustee.

10

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Free Lance-Star: Key Facts

- Free Lance-Star Publishing Co. ("FLS") is a newspaper, radio, and communications company located in Fredericksburg, Virginia.
- In 2007, FLS borrowed approximately $50.8 million from Branch Banking and Trust ("BB&T") to finance the construction of a commercial printing plant.
  - The BB&T collateral package specifically excluded FLS's so-called "Tower Assets," which consisted of real property employed in FLS's radio broadcasting operations.
  - BB&T did not record financing statements or file mortgages to perfect liens on the Tower Assets.
- In June 2013, BB&T transferred its interest in the FLS loan to DSP Acquisition, LLC ("DSP"), an entity affiliated with Sandton Capital Partners.
- In July 2013, DSP informed FLS that it wanted the company to file for chapter 11 and to sell substantially all of its assets to DSP pursuant to section 363 of the Bankruptcy Code.
  - During restructuring discussions, DSP unilaterally recorded mortgages on various Tower Assets without either authority from or notice to FLS.
  - These discussions collapsed and in January 2014, FLS filed for chapter 11 and sought both a sale process and avoidance of certain of DSP's asserted liens.

11

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Free Lance-Star: Credit Bid Capped

- In March 2014, the bankruptcy court ruled that DSP did not have a valid perfected lien in certain assets, and limited DSP's credit bid to $13.9 million (from $38 million) due to the inclusion of mixed collateral in its proposed credit bid.
- The Free Lance-Star opinion, however, is also notable because, unlike in Fisker, the bankruptcy court considered the creditor's pre- and post-petition conduct.
- Specifically, the Free Lance-Star court held that DSP had actively "engaged in inequitable conduct" by:
  - **failing to disclose** to the court its subsequent attempts to encumber FLS's assets during a cash-collateral hearing;
  - **pressuring FLS to seek an expedited sale hearing** six weeks after filing for bankruptcy; and
  - engaging in an "**overly zealous loan-to-own strategy**."

12

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Free Lance-Star: Credit Bid Capped

- DSP subsequently filed a notice of appeal with the bankruptcy court.
- On May 7, 2014, the district court denied the appeal on largely the same grounds as the Fisker bankruptcy court. The district court reasoned that:
  - DSP would not face irreparable harm under Fed. R. Bankr. P. 8011(d) if the issues were resolved after the auction;
  - the bankruptcy court's decisions were interlocutory because the decisions did not dispose of the adversary proceeding or the contested matter, and the issues of who had the liens, the amounts of the liens, the extent of the liens, and other issues remained undetermined; and
  - an interlocutory appeal would not be granted under 28 USC § 1292 because:
    - there was no controlling question of law, which the district court indicated would be a narrow question of pure law whose resolution would be dispositive,
    - without a controlling question of law there could not be a substantial grounds for difference of opinion as to a controlling question of law, and
    - an immediate appeal would neither materially advance the termination of the litigation nor save estate or judicial resources because the auction could proceed and DSP could seek reimbursement from the sale proceeds.

13

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Free Lance-Star: Credit Bid Capped

- On May 15, 2014, nine bidders (including DSP) participated in a live auction for Free Lance-Star's assets.
  - Following multiple rounds of bidding, DSP submitted the highest bid.
  - Specifically, DSP submitted a $30.2 million bid that included a $13.9 million and $16.3 million in cash that was ultimately determined to be the highest or otherwise best bid for the assets.
  - DSP's bid was deemed to be the highest or otherwise best bid submitted at the auction based on its credit bid and cash components. However, DSP and the creditors' committee subsequently contested certain lien perfection issues.
  - The parties subsequently negotiated a global resolution that was incorporated into Free Lance-Star's chapter 11 plan.

14

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Credit Bidding: Takeaways from Fisker and Free Lance-Star

Limiting Credit Bidding to Foster "Competitive" Bidding

- Citing Philadelphia Newspapers (as well as Fisker and Free Lance-Star), creditors' committees and other parties in interest likely will seek to limit credit bidding to promote a competitive bidding environment.
- However, both Fisker and Free Lance-Star suggest that something in addition to the need to promote competitive bidding is required to cap credit bidding "for cause."
  - For example, Fisker and FLS also involved mixed-collateral disputes (discussed in detail below).
- Fisker and Free Lance-Star are also limited to their respective facts.

15

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Credit Bidding: Takeaways from Fisker and Free Lance-Star

Mixed Collateral

- As noted above, competition problems, coupled with mixed-collateral disputes (i.e., where assets may be subject to disputes regarding the perfection and validity of a creditor's liens), may lead a bankruptcy court to cap credit bidding for cause.
  - For example, a bankruptcy court recently capped a distressed investor's ability to credit bid where there was a dispute regarding the extent of its secured claim. See In re RML Dev. Inc., No. 13-29244 (Bankr. W.D. Tenn. July 10, 2014) (DSK).
- A debtor has tremendous flexibility to craft bid procedures designed to promote a more competitive bidding environment.
- However, the mixed-collateral issues often present greater challenges.
  - There are few "easy fixes" for mixed-collateral disputes, which are often settled in chapter 11 plans. See, e.g., Hawker Beechcraft, Rural/Metro, Cengage Learning, and Sbarro.
  - Mixed collateral may comprise certain of a debtor's most valuable assets.

16

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Credit Bidding: Takeaways from Fisker and Free Lance-Star

Executing Credit Bids After Fisker and Lance-Star

- Credit bidding is alive and well; however, a successful credit bid strategy requires a potential bidder to properly execute its credit bid strategy.
- Specifically, buyers that seek to credit bid should focus on:
  1. carefully **identifying** and **valuing** assets where there may be **unperfected or questionable liens**;
  2. **sponsoring a chapter 11 plan** that seeks to **equitize debt**, thereby:
     - appearing as a "white hat" that deserves protection against undervaluation of collateral, rather than a "loan-to-own" buyer;
     - addressing valuation issues at plan confirmation; and
     - providing for a transaction that addresses both sources and uses, rather than only sources, of value available for distribution to creditors.
  3. crafting auction procedures to permit bidding on the asset pools in question within the overall auction (e.g., permitting bidders to separately bid on foreign intellectual property);
  4. developing **reasonable sale and restructuring timelines**;
  5. considering local **political dynamics** related to potentially sensitive acquired assets;
  6. obtaining **third-party valuation**; and
  7. seeking a **section 506(c) and marshaling waivers** to protect recourse to unencumbered collateral.

17

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Part 2. "Free and Clear" Findings in Section 363 Asset Sales

18

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"Free and Clear" Overview

- Under section 363(f) of the Bankruptcy Code, subject to certain requirements, assets may be sold "***free and clear***" from broad categories of interests, including liens, claims, and encumbrances (including ***successor liability*** claims)
  - As a result, a 363 sale offers a purchaser an opportunity to acquire assets with a clean title that is supported by a bankruptcy court order.
- A free and clear finding in a sale order requires the debtor to satisfy at least one of the following enumerated requirements of 363(f):
  - (1) applicable nonbankruptcy law permits sale of such property free and clear of such interest;
  - (2) such entity consents;
  - (3) such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of all liens on such property;
  - (4) such interest is in bona fide dispute; ***or***
  - (5) such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest.

19

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§ 363(f)(1) Sale Under Applicable Nonbankruptcy Law

- If applicable nonbankruptcy law permits a trustee to sell property of the estate free of the interest, then the trustee may sell the property free and clear of such interest.
- Examples of free and clear sales under section 363(f)(1) include sales of inventory in the ordinary course of business as permitted by U.C.C. § 9-320, and sales when nonbankruptcy law protects a successor in interest to the property from ongoing obligations in connection with the property. See, e.g., UMWA 1992 Benefit Plan v. Leckie Smokeless Coal, Co. (In re Leckie Smokeless Coal Co.), 99 F.3d 573, 578 (3d Cir. 1996), cert denied, 520 U.S. 1118, 117 S. Ct. 1251, 137 L.Ed. 2d 332 (1997).

20

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§ 363(f)(2) Sale With Consent

- If the holder of the interest in the property consents to the sale, then the trustee may sell the property free and clear of such interest.
- Similarly, section 9-315(a) of the Uniform Commercial Code authorizes a free and clear sale when a secured party consents.
- Although section 362(c)(2) requires consent, unanimous consent of lienholders may not be required; majority consent has been held to be adequate. See In re Metaldyne Corp., 409 B.R. 671 (Bankr. S.D.NY. 2009); In re Chrysler LLC, 576 F.3d 108 (2d. Cir.), judgment vacated as moot, 175 L. Ed. 2d 614 (2009), appeal dismissed, 592 F.3d 370 (2d Cir. 2010) (Where a lien is held by a collateral agent on behalf of a group of secured creditors, consent from a majority is adequate for section 363(f)(2)).

21

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§ 363(f)(3) Sale for Price Greater than the Value of the Liens

- If the sale price is greater than the aggregate value of all liens on such property, then the trustee may sell the property free and clear of such liens.
- Courts have disagreed about the interpretation of the phrase "the aggregate value of all liens."
- Many courts have held that the aggregate value of all liens does not mean the face amount of the claims secured by the liens, but instead means the economic value of the liens or the value of the liens as determined under section 506(a). See, e.g., In re Beker Indus. Corp., 63 B.R. 474, 475-76 (Bankr. S.D.N.Y. 1986).
- Other courts, however, have held that section 363(f)(3) only authorizes a free and clear sale if the sale price exceeds the face amount of the claims secured by the liens. See, e.g., Clear Channel Outdoor, Inc. v. Knupfer (In re PW, LLC), 391 B.R. 25 (B.A.P. 9th Cir. 2008).

22

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§ 363(f)(4) Sale When Interest Is in Bona Fide Dispute

- If there is a bona fide dispute as to the interests, then the trustee may sell the property free and clear of such interests.
- The trustee must establish that a bona fide dispute exists, and while the court is not required to resolve the dispute, the court must conclude that a bona fide legal or factual dispute exists prior to authorizing a sale pursuant to section 363(f)(4). See, e.g., Scherer v. Federal Nat'l Mortgage Ass'n (In re Terrace Chalet Apartments, Ltd.), 159 B.R. 821, 828 (N.D. Ill. 1993); In re Gerwer, 898 F.2d 730, 733 (9th Cir. 1990); In re Daufuskie Island Props., LLC, 431 B.R. 626 (Bankr. D.S.C. 2010); In re Collins, 180 B.R. 447, 452 (Bankr. E.D. Va. 1995).

23

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§ 363(f)(5) Sale When the Interest Holder Could Be Compelled to Accept a Monetary Satisfaction of the Interest

- If the holder could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of the interest, then the trustee may sell the property free and clear of such interest.
- Courts have held that pursuant to section 9-315(a) of the Uniform Commercial Code, a trustee may sell assets in the ordinary course of business free and clear, with the security interest attaching to the proceeds of the sale. See, e.g., In re Grand Slam, U.S.A., Inc., 33 C.B.C.2d 834, 838-39, 178 B.R. 460, 462 (E.D. Mich. 1995); WBQ P'ship v. Commonwealth of Virginia Dep't of Medical Assistance Servs. (In re WBQ P'ship), 189 B.R. 97 (Bankr. E.D. Va. 1995).
- Some courts have indicated that section 363(5) may be satisfied if the interest is subject to cramdown under chapter 11. See, e.g., In re Grand Slam, U.S.A., Inc., 33 C.B.C.2d 834, 838-39, 178 B.R. 460, 462 (E.D. Mich. 1995),
- At least one court has indicated that section 363(5) may be satisfied if the interest is subject to valuation and distribution under chapter 7. In re TWA, 322 F.3d 283, 290-91 (3d Cir. 2003).

24

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General Motors – General Background

- In 2009, General Motors Corporation ("Old GM") sought bankruptcy protection. General Motors, LLC ("New GM"), a newly created, government-sponsored entity, was the only viable purchaser.
- The court approved the sale (the "Sale") of Old Gm's assets to New GM free of liens, claims and interests (except for expressly assumed claims) (the "Sale Order").
- New GM assumed certain death and personal injury liabilities of Old GM in connection with the Sale, but the Sale Order provided for a free and clear sale concerning economic damages.
- Various plaintiffs (the "Plaintiffs") have initiated lawsuits against New GM related to defective ignition switches in Old GM vehicles and parts.

25

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General Motors – The Motion to Enforce

- On April 21, 2014, New GM filed the Motion of General Motors LLC Pursuant to 11 U.S.C. §§ 105 and 363 to Enforce the Court's July 5, 2009 Sale Order and Injunction (the "Motion to Enforce") seeking an order from the court directing the Plaintiffs to:
  - cease and desist from further proceedings that are barred by the Sale Order;
  - dismiss with prejudice the claims brought by the Plaintiffs in violation of the Sale Order; and
  - show cause whether they have any claims against New GM not otherwise already barred by the Sale Order.
- In the Motion to Enforce New GM argues that those who purchased vehicles or parts from Old GM before the Sale, whether they were a known or unknown creditor, are subject to the terms of the Sale Order, including the injunction on claims, and are barred from suing New GM on account of Old GM's liabilities.

26

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General Motors – The Objection

- On April 22, 2014, some of the Plaintiffs filed the Objection to Motion of General Motors LLC Pursuant to 11 U.S.C. §§ 105 and 363 to Enforce the Court's July 5, 2009 Sale Order and Injunction (the "Objection"). In the Objection, the Plaintiffs argue that:
  - Old GM had evidence of the defective ignition switches as early as 2001 and committed fraud on the court by failing to disclose this information.
  - The Plaintiffs should be granted relief from the relevant releases and injunctions in the Sale Order and should be granted the opportunity to assert successor liability claims against New GM.
  - Because Old GM knew of the ignition switch defect prior to the bankruptcy filing, the Plaintiffs are known creditors who should have received actual notice of the bankruptcy; the claims bar date; the proposed sale procedures; the Sale; and the chapter 11 plan, and that as a result, the Plaintiffs are not bound by the Sale Order or the Confirmation Order – or the releases therein – because their due process rights were violated by not receiving actual notice.

27

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General Motors – The Threshold Issues

- The parties have agreed that the following "Threshold Issues" could be resolved with little discovery or based on stipulated facts:
  - (1) whether the Plaintiff's due process rights were violated by the entry of the Sale Order;
  - (2) if so, what remedies could be fashioned;
  - (3) should the remedies be against Old GM or New GM; and
  - (4) if against Old GM, the applicability of the doctrine of equitable mootness and related arguments.
- The parties also have agreed to brief their views on the legal standards that must be met to establish whether Old GM committed fraud on the court.

28

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General Motors – The Briefing Schedule

- On August 22, 2014, the Court approved the following briefing schedule:
  - by November 5, 2014, New GM must file its opening brief regarding the Due Process Threshold Issue, the Remedies Threshold Issue, the Old GM Claim Threshold Issue, and the Fraud on the Court Standard Briefing; and the Unitholders and the GUC Trust must file their opening brief on the Equitable Mootness Threshold Issue;
  - by December 16, 2014, Designated Counsel and the Gorman Plaintiffs, collectively, and the GUC Trust and the Unitholders, collectively, must file their responses to the New GM Opening Brief; and Designated Counsel and the Gorman Plaintiffs, collectively, and New GM must file their response to the Unitholder/GUC Trust Opening Brief;
  - by January 16, 2015, New GM must file its reply brief in support of its Opening Brief and the Unitholders and the GUC Trust, collectively, must file their reply in support of their Opening Brief; and
  - the court will hold a hearing on a date set by the court after January 26, 2015.

29

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General Motors – Questions and Observations

- Courts have indicated that due process requires notice reasonably calculated, under all circumstances, to apprise interested parties of the pendency of the action and to afford them an opportunity to present their objections.
  - What is necessary for notice to be reasonably calculated to apprise unknown claimants?
  - What is required for someone to be a known claimant?
  - What is necessary for notice to be reasonably calculated to apprise known claimants?
  - What are the potential implications for future manufacturing debtors or debtors in industries where the use of hazardous materials may create potentially vast pools of potential creditors?

30

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Ormet – Successor Liability for Pension Plan Liability

- The Debtors sought to sell a Smelter and related assets free and clear of any successor liability claim of the Steelworkers Pension Trust.
- The Trust objected to the free and clear sale based on the Trust's successor liability claim for underfunding the pension plan under ERISA (the Employee Retirement Income Security Act of 1974) and MPPAA (the Multiemployer Pension Plan Amendment Act of 1980).
- The court concluded that TWA was controlling, supported by Leckie, and that the successor liability claims of the Trust could be extinguished by the section 363 sale. In re Ormet Corporation, 2014 WL 3542133 (Bankr. D. Delaware); see In re Transworld Airlines, Inc., 322 F.3d 283 (3d Cir. 2003) (affirming sale under section 363 free and clear of successor liability claims for employment and sex discrimination); In re Leckie Smokeless Coal Co., 99 F.3d 573 (4th Cir. 1996) (authorizing sale free and clear of claims for future medical benefits under the Coal Industry and Retiree Health Benefit Act).

31

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Ormet – Successor Liability for Pension Plan Liability

- The court recognized the strong policy considerations in favor of protecting multi-employer pension plans, preventing sex and employment discrimination, protecting the medical benefits of coal workers and creating successor liability for those claims.
- The court, however, held that section 363 trumps those policy interest.
- The court noted that the proposed exceptions to free and clear sales would depress the prices that parties would bid for a debtor's assets and the important policy of the Bankruptcy Code to maximize the value of the debtor's assets for distribution to creditors consistent with the priority scheme of the Bankruptcy Code.

32

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Energytec – Covenants That Run With the Land

- The Debtor sought to sell a gas pipeline system free and clear of liens, claims and encumbrances.
- Newco Energy objected to the sale and argued that its interest in certain transportation fees in connection with the pipeline system and its right to consent to any assignment ran with the land and could not be stripped by the bankruptcy sale.
- The bankruptcy court ruled that the transportation fee was not a covenant running with the land and that the sale was free and clear of Newco's interest; the bankruptcy court did not address Newco's right to consent to assignment of the pipeline.
- The district court affirmed the bankruptcy court.
- The Debtor also argued that Newco could be compelled to accept a money satisfaction of its interests pursuant to section 365(f)(5); however, the bankruptcy court and the district court did not address section 365(f)(5) because they determined that the Newco's interests were not covenants that ran with the land.

33

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Energytec – Covenants That Run With the Land

- The Fifth Circuit stated that under applicable Texas law a covenant runs with the land when it:
  - touches and concerns the land;
  - relates to a thing in existence or specifically binds the parties and their assigns;
  - is intended by the original parties to run with the land; and
  - when the successor to the burden has notice. In addition, privity of estate between the parties when the covenant was made is required.
- The Fifth Circuit concluded these requirements were met and that Newco's rights to transportation fees and to consent to assignment are covenants that run with the land. In re Energytec, Inc., 739 F.3d 215 (5th Cir. 2013)
- The Fifth Circuit also concluded that the bankruptcy court and the district court erred in determining that the sale of the pipeline system could be free and clear of Newco's interest.
- The Fifth Circuit remanded the issues of whether Newco could be compelled to accept money satisfaction for its interests under section 365(f)(5).

34

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Ormet and Energytec – Questions and Observations

- How should the policy considerations be balanced between protecting multi-employer pension plans, preventing sex and employment discrimination, and creating successor liability for medical benefits, on the one hand, and the Bankruptcy Code's policy of maximizing value for all creditors and distributing the proceeds according to the Bankruptcy Code, on the other?
- Would potential purchasers abandon bidding for assets in bankruptcy cases if they could not be sold free and clear of such claims or would buyers of distressed assets simply reduce prices to take into account the decreased value of the assets based on these liabilities?
- In Energytec the issue of whether the sale was free and clear of certain claims was left unresolved at the time of the sale, is this an anomaly or does it indicate a willingness on the part of asset buyers to accept the risk that a sale might not be free and clear of certain claims?

35

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Feature

By Tyler P. Brown, Jason W. Harbour and Justin F. Paget

Secured Lender's Credit-Bid Capped in *Free Lance-Star*

Tyler P. Brown
Hunton & Williams LLP; Richmond, Va.

Jason W. Harbour
Hunton & Williams LLP; Richmond, Va.

Justin F. Paget
Hunton & Williams LLP; Richmond, Va.

Tyler Brown and Jason Harbour are partners, and Justin Paget is an associate, in the Bankruptcy, Restructuring and Creditors' Rights Practice of Hunton & Williams LLP in Richmond, Va.

Editor's Note: *For more on the* Fisker Automotive *case, see the cover feature of the April 2014 issue.*

Recent decisions of the Delaware bankruptcy and district courts in *In re Fisker Automotive Holdings Inc.*[1] have made credit-bidding one of the most popular topics of 2014. These decisions have now been followed by rulings of the Eastern District of Virginia bankruptcy and district courts in *In re The Free Lance-Star Publishing Co. of Fredericksburg, Va.*[2] In *Free Lance-Star*, the bankruptcy court determined that cause existed under 11 U.S.C. § 363(k) to cap the amount of a secured lender's credit-bid.[3] As was the case in *Fisker*, the secured lender in *Free Lance-Star* sought an expedited appeal of the bankruptcy court's ruling prior to the auction. Also as in *Fisker*, the district court denied the secured lender's request, determining that the bankruptcy court's orders were not final and that interlocutory review was not appropriate.[4]

Background

The *Free Lance-Star* was a family-owned business involved in publishing, print and radio broadcasting primarily in Fredericksburg, Va.[5] In business for more than 130 years, the company relied intermittently on financing to expand its operations, which initially consisted of newspaper publishing, followed by expansion into radio broadcasting beginning in the 1960s. In 2007, in an attempt to further diversify its business, the company expanded into the commercial printing business.[6] The company, along with a related entity, William Douglas Properties LLC, obtained a loan from BB&T Bank of $50.8 million to finance the design and construction of a state-of-the-art commercial printing facility.[7]

Construction of the new facility coincided with the "great recession." The debtors foresaw that they would fall out of compliance with their loan covenants and sought an agreement with BB&T to restructure the debt or to find a purchaser of the debtors' business.[8] Unable to reach an acceptable resolution with BB&T, the debt was sold to DSP Acquisition LLC, an affiliate of Sandton Capital Partners, in June 2013.[9]

After purchasing the debt, DSP informed the debtors that it wanted them to file bankruptcy and sell substantially all of their assets pursuant to 11 U.S.C. § 363.[10] DSP indicated to the debtors that it wanted to purchase the assets.[11] Around July 25, 2013, DSP requested that the debtors execute deeds of trust that would encumber the debtors' three parcels related to their broadcasting towers (the "tower parcels").[12] DSP circulated a "restructuring timetable" that included recording the deeds of trust and commencing a bankruptcy case in September 2013.[13] The debtors rejected DSP's attempt to obtain liens on additional assets. Unbeknownst to the debtors, DSP recorded fixture filings against the tower parcels in August 2013.[14]

1 *In re Fisker Auto. Holdings Inc.*, No. 13-13087 (KG) 2014 Bankr. LEXIS 230 (Bankr. D. Del. Jan. 17, 2014); *Hybrid Tech Holdings LLC v. Official Committee of Unsecured Creditors of Fisker Auto. Holdings Inc. (In re Fisker Auto. Holdings Inc.)*, No. 14-CV-99 (GMS) 2014 U.S. Dist. LEXIS 17689 (D. Del. Feb. 7, 2014). *See also* Oscar N. Pinkas and Joseph G. Selby, "Is *Fisker Automotive Holdings* a New Limit on Credit-Bidding?," XXXIII *ABI Journal* 4, 14, 84-86, April 2014.
2 *In re The Free Lance-Star Publishing Co. of Fredericksburg, Va.*, No. 14-30315-KRH 2014 Bankr. LEXIS 1611 (April 14, 2014); *DSP Acquisition LLC v. The Free Lance-Star Publishing Co. of Fredericksburg, Va. (In re The Free Lance-Star Publishing Co. of Fredericksburg, Va.)*, Nos. 3:14cv303-HEH, 3:14cv304-HEH 2014 U.S. Dist. LEXIS 63274 (E.D. Va. May 7, 2014). Hunton & Williams LLP represented the official unsecured creditors' committee in *Free Lance-Star*.
3 *Free Lance-Star*, 2014 Bankr. LEXIS 1611, at *26.
4 *Free Lance-Star*, 2014 U.S. Dist. LEXIS 63274, at *9, 10-15.
5 *Free Lance-Star*, 2014 Bankr. LEXIS 1611, at *7.
6 *Id.* at *8.
7 *Id.*
8 *Id.* at *9.
9 *Id.* at *10. The bankruptcy court assumed for the purpose of the opinion that DSP was the holder of the debtors' debt, as there was some uncertainty regarding the noteholder's identity.
10 *Id.*
11 *Id.*
12 *Id.* at *11.
13 *Id.*
14 *Id.*

Subsequently, DSP provided the debtors with a revised forbearance agreement that contained a blanket release, but it did not contain a requirement to execute deeds of trust on the tower parcels because "DSP expected to pick up that collateral in a [debtor-in-possession] post-petition financing order."[15] When the debtors' financial advisor projected that the debtors would not need post-petition financing to continue operations during bankruptcy, the relationship between the parties turned "sour."[16] DSP attacked the financial projections as being too optimistic and insisted that the company needed post-petition financing, pursuant to which DSP would obtain liens on the tower parcels.[17]

On Jan. 11, 2014, DSP alerted the debtors that it no longer supported a bankruptcy filing on the proposed terms.[18] The following week, DSP recorded additional financing statements in various jurisdictions without giving any notice to the debtors.[19]

The debtors filed for bankruptcy on Jan. 23, 2014. To obtain authority to use cash collateral, the debtors filed a cash collateral motion and proposed to provide DSP adequate protection in the following forms: (1) to the extent of any diminution in DSP's cash collateral from the use of cash collateral, a replacement lien on post-petition assets to the same extent as DSP's lien on pre-petition assets; and (2) payments of $70,000 per month. DSP objected to the use of cash collateral and requested liens on the tower parcels as adequate protection.[20] DSP did not disclose to the debtors or the bankruptcy court the financing statements it filed against the tower parcels in August 2013 and January 2014.[21] The bankruptcy court denied DSP's request for the additional liens and found its interest in the cash collateral to be adequately protected by the debtors' proposal.[22]

Concurrent with filing their bankruptcy petitions, the debtors filed a motion to sell their "tower assets," including the tower parcels, and a motion to sell substantially all of the debtors' remaining assets. Although the parties disagreed about a number of issues, including DSP's credit-bid rights, the parties ultimately reached an agreement on a bid procedure orders. The bid procedure orders, among other things, scheduled a hearing to determine DSP's credit-bid rights in advance of the auction.[23] The same day that the court entered the agreed-upon bid procedure orders, DSP filed a complaint seeking a declaratory judgment as to the amount of its claim, the extent, validity and priority of its lien, and its right to fully credit-bid its claim, and that all of the debtors' assets would convert into receivables upon sale and constitute DSP's collateral.[24] DSP then moved for summary judgment in the adversary proceeding. The debtors also moved for a summary judgment in the adversary proceeding, and the debtors, DSP and the committee submitted briefs to the court in both the bankruptcy case and the adversary proceeding concerning the extent of DSP's liens and its credit-bid rights.

The Bankruptcy Court's Decision

Following combined hearings concerning the motions for summary judgment in the adversary proceeding and the issues identified in the bid procedure orders, the bankruptcy court determined that "cause" existed under § 363(k) to limit DSP's right to credit-bid,[25] finding that

> DSP pressured the Debtors to shorten the Debtors' marketing period for the sale of its business and to put language in the marketing materials conspicuously advertising DSP's credit-bid rights. The Court is equally troubled by DSP's efforts to frustrate the competitive bidding process…. The Court finds that DSP did engage in equitable conduct.[26]

The bankruptcy court also stated that

> DSP's motivation to own the Debtors' business rather than to have the Loan repaid has interfered with the sales process. DSP has tried to depress the sales price of the Debtors' assets, not to maximize the value of those assets. A depressed value would benefit only DSP, and it would do so at the expense of the estate's other creditors. The deployment of DSP's loan-to-own strategy has depressed enthusiasm for the bankruptcy sale in the marketplace.[27]

[T]he decisions ... in *Fisker* and *Free Lance-Star* highlight the potential difficulties in appealing a bankruptcy court's decision to limit credit-bidding for "cause" under § 363(k).

In light of the "uncontroverted evidence" concerning the impact of allowing DSP its full credit-bid, the bankruptcy court found that it was appropriate to limit DSP's credit-bid "to foster a fair and robust sale."[28] In addition, the court expressed concern over DSP's efforts to expand its liens on the debtors' assets.[29] Citing this "confluence" of factors, the bankruptcy court capped DSP's credit-bid on the print and publishing assets at $12.7 million, and its credit-bid on certain of the radio broadcasting assets at $1.2 million.[30]

The District Court's Decision

DSP sought to appeal the bankruptcy court's decisions in both the bankruptcy case and the adversary proceeding by filing a notice of appeal and a motion to certify the bankruptcy court's orders as final pursuant to Federal Rule of Civil Procedure 54(b), made applicable by Bankruptcy Rule 7054, or in the alternative, for leave to pursue an interlocutory appeal.[31] DSP sought expedited consideration of its motion to obtain relief in advance of the auction. The bankruptcy court denied DSP's certification request.[32]

15 *Id.* at *12.
16 *Id.*
17 *Id.* at *13.
18 *Id.* at *14.
19 *Id.*
20 *Id.* at *14-15.
21 *Id.*
22 *Id.* at *15.
23 *In re The Free-Lance Star Publishing Co. of Fredericksburg, Va.*, No. 14-30315-KRH, Docket Nos. 111, 112 (March 10, 2014).
24 *Free Lance-Star*, No. 14-30315-KRH, Adv. Proc. No. 14-3038-KRH (March 10, 2014).
25 The bankruptcy court also determined that DSP's liens did not extend to certain of the debtors' assets, including the tower parcels, motor vehicles, Federal Communications Commission licenses, insurance policies and bank accounts. The court entered an order in the adversary proceeding filed by DSP that denied DSP's motion for summary judgment and granted, in part, the debtor's motion for summary judgment. *Free Lance-Star*, Adv. Proc. No. 14-3038-KRH 2014 Bankr. LEXIS 1644 (April 14, 2014).
26 *Free Lance-Star*, 2014 Bankr. LEXIS 1611, at *20.
27 *Id.* at *22.
28 *Id.* at *24.
29 *Id.* at *12.
30 *Id.* at *26-27
31 *Free Lance-Star*, No. 14-30315-KRH, Docket No. 191 (April 15, 2014).
32 *Free Lance-Star*, No. 14-30315-KRH, Docket No. 2013 (April 18, 2014).

DSP argued that the bankruptcy court's orders were final and appealable because they resolved discrete issues involving the extent and validity of DSP's liens and the extent of DSP's credit-bidding rights. Asserting that the finality of bankruptcy orders is viewed "in a more pragmatic and less technical way" than in other situations, DSP argued that irreparable harm would occur if an appeal were deferred until after the auction when DSP's credit-bidding rights would become moot.[33]

The district court first addressed DSP's irreparable harm argument under Rule 8011(d) and held that there was no risk of irreparable harm if the issues were not resolved before the auction because the bankruptcy court would determine who receives what portion of the sale proceeds after the sale, and so the bankruptcy court could adjust the payment to DSP.[34] The district court then held that the bankruptcy court's decisions were interlocutory, noting that even if there were a risk of irreparable harm to DSP, there is a competing risk to the progression of the bankruptcy case and underlying litigation were the court to consider an interlocutory appeal.[35] Citing *Fisker*, the district court also observed that "general antipathy toward piecemeal appeals still prevails in individual adversary actions … [and] inefficient use of judicial resources is as objectionable in bankruptcy appeals as in other fields."[36] The district court noted striking similarities to the facts in *Fisker*, observing that DSP could still bid at the auction and "could then either receive a cash return of the difference between the full credit entitled, or if a third-party bidder won the auction, [the secured lender] could receive its entitlement out of the cash paid by this party."[37]

The district court held that the bankruptcy court's opinions left open the issues of who has the liens, the amount of the liens and the full extent of DSP's liens.[38] Thus, the district court held that the bankruptcy court's opinions were not final.

The district court then addressed whether to grant interlocutory review. DSP argued that interlocutory review was appropriate because (1) the determination of a secured creditor's right to credit-bid presented a controlling issue of law on appeal; (2) substantial grounds existed for a difference of opinion on the correctness of the bankruptcy court's rulings; and (3) granting an interlocutory appeal would materially advance the chapter 11 cases.[39] The district court held that the 28 U.S.C. § 1292 interlocutory appeal standard was not met and denied DSP's request for an interlocutory appeal.[40]

Although DSP identified seven potential controlling issues of law, the district court summed up DSP's appeal as resting on two issues decided by the bankruptcy court: (1) the extent and validity of DSP's liens, and (2) the cap placed on DSP's credit-bid.[41] The district court found that neither issue presented a controlling issue of law, noting that "the kind of question best adapted for discretionary interlocutory review is a narrow question of pure law whose resolution will be completely dispositive of the litigation, either as a legal or practical matter, whichever way it goes."[42] The district court also observed that the Delaware district court in *Fisker* held that there was no controlling question of law as to which substantial grounds for a difference of opinion existed where the Third Circuit had previously identified that one of the reasons for denying a credit-bid right was "to foster a competitive bidding environment."[43]

The district court noted that without a controlling issue of law, there could not be substantial grounds for a difference of opinion on such legal issue.[44] The court also stated that the continuation of the adversary proceeding following the bankruptcy court's rulings showed that the bankruptcy court's rulings did not fully determine DSP's rights.[45]

With respect to the third interlocutory appeal factor, the district court determined that no material advancement of the case would occur if the interlocutory appeal request were granted. The district court adopted the Delaware district court's material-advancement analysis in *Fisker*, noting that the Delaware district court concluded that there was no evidence that capping the secured lender's credit-bidding was an issue that must be resolved for the sale of the debtor's assets to proceed.[46]

The district court added that DSP had not shown exceptional circumstances to justify the interlocutory appeal and that the record suggested none.[47] Finally, the court noted that it was difficult to imagine a compelling argument for exceptional circumstances given the bankruptcy court's finding that DSP engaged in inequitable conduct and expressly consented to the sales procedures and the timeline.[48] DSP did not appeal the district court's decision.

The Sale

Numerous bidders attended the *Free Lance-Star* auction held on May 15, 2014. DSP ultimately submitted the winning bid on substantially all of the debtor's assets for a total amount of $30.2 million, which consisted of a credit-bid of $13.9 million and cash of $16.3 million. On May 27, 2014, the bankruptcy court entered an order approving the sale to DSP. As of the submission of this article, DSP continued to pursue the adversary proceeding, which is scheduled for trial on July 24-25, 2014.

Conclusion

On the heels of *Fisker*, do the credit-bid decisions in *Free Lance-Star* reveal a possible trend of limiting credit-bidding for cause pursuant to § 363(k)? It is probably too early to know whether these decisions are the beginning of a trend, especially in light of the fact-intensive inquiries that underlie each of the decisions. Nevertheless, the decisions of the district courts in *Fisker* and *Free Lance-Star* highlight the potential difficulties in appealing a bankruptcy court's decision to limit credit-bidding for "cause" under § 363(k). abi

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33 *Id.*
34 *Free Lance-Star*, 2014 U.S. Dist. LEXIS 63274, at *7-8.
35 *Id.* at *8.
36 *Id.*
37 *Id.* at *9.
38 *Id.* at *10.
39 *Id.* at *11.
40 *Id.* at *15.
41 *Id.* at *11.
42 *Id.* at *11-12.
43 *Id.* at *12.
44 *Id.* at *13-14.
45 *Id.* at *14.
46 *Id.* at *14-15.
47 *Id.*
48 *Id.*

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Loan to Own Is Back—With a Twist

BY HON. CHRISTOPHER S. SONTCHI,
U.S. BANKRUPTCY COURT,
DISTRICT OF DELAWARE

FEATURE

In the years immediately prior to the economic apocalypse of 2008 and 2009, a phenomenon known as "loan to own" spread throughout the insolvency world. In its most basic terms, loan to own involves a nontraditional lender such as a hedge fund making a loan to a potentially insolvent borrower, not with an eye to being paid back its principal plus interest but, rather, to owning the borrower's business in the event of bankruptcy.

Such "loans" were generally made on a junior secured basis, with the lender holding a second- or even third-priority lien in the borrower's collateral. Ideally, from the lender's perspective, its loan would be the fulcrum security, with its junior lien being in the money but undersecured. As such, the lender would be in a position to restructure or to pay off the senior debt (perhaps at a discount) and own the debtor's reorganized business, either under a plan of reorganization or by credit bidding its junior debt in a Section 363 sale of the debtor's assets. In an asset sale situation, the lender would often serve as the stalking horse bidder, providing it with significant control over the sale process.[1]

While couched as a secured loan, a loan to own investment is, for all intents and purposes, an equity investment (and is priced as such) in a potentially insolvent debtor that allows the lender/investor to jump in front of unsecured debt. The loan to own strategy is based on the power of collateral and, to a lesser extent, the control of the process inherent in acting as a stalking horse.

The ultimate success of the investment, however, depends on an increase in the value of the reorganized (or sold) debtor sufficient to pay off the loan to own debt. The collapse of equity values and credit availability in 2008 and 2009 (and after) led to a concomitant collapse of the loan to own strategy, especially the issuance of second or third lien debt.

Wearing Multiple Hats

But, loan to own has returned to the post-apocalypse world, albeit with a twist.

The power of collateral and the advantage of controlling the sale process by serving as a stalking horse bidder are as strong today as they were in 2007. Recently, potential purchasers of insolvent businesses have used that power in adopting a new strategy for buying the assets of an insolvent company. The potential purchaser buys the debt held by an existing secured lender, often at a deep discount. Regardless of the price it actually paid, the buyer has a claim for the full face amount of the debt.

The buyer of the prepetition secured debt (and potential purchaser) then enters into an asset purchase agreement in which it credit bids its debt under Section 363(k) and serves as the stalking horse purchaser. Unlike in the typical loan to own scenario, having purchased the senior debt, the investor/buyer generally provides short-term DIP financing, which (as with a defensive DIP financing referenced in endnote 1) is sufficient to support the debtor through the closing of a Section 363 asset sale but no further. The new senior lender has acquired the company's debt for the sole purpose of buying the company.[2]

Such a lender/buyer wears several hats in the bankruptcy process, and its cumulative power is formidable. At the very least, it may credit bid the full face amount of the debt, regardless of its purchase price. For example, a buyer might pay 20 cents on the dollar for $100 in (undersecured) debt. The buyer may then credit bid the entire $100, regardless of the value of the collateral or the price it paid for the debt. This allows the buyer to capture any value of the collateral between $20 and $100. That creditor can then either hold out until competing bids reach $100, after which the buyer would need to use actual cash in any further bidding or settle for a "strike price" between $20 and $100, making a tidy profit on a short-term loan.

In addition, the buyer may provide DIP financing. Through its role as DIP lender, the buyer can force the debtor into an asset sale scenario structured as the buyer sees fit by dictating the terms of the DIP loan. For example, the buyer may provide financing for a short duration and include sale milestones that must be met for the debtor to avoid defaulting on the DIP loan.

Finally, the buyer may enter into an asset purchase agreement in which it serves as the stalking horse bidder. In that role, the buyer can control the structure of the sale by drafting the form asset purchase agreement that any competing bidders must either follow or justify amending.

In addition, through insisting on a breakup fee and expense reimbursement, usually totaling about 5 percent of the purchase price (including non-cash consideration in the form of a credit bid above the purchase price), the buyer can deter competing bidders by requiring a 5 percent incremental bid that an opposing bidder would have to pay in cash. Moreover, the buyer is certain to receive at least a 5 percent kicker on the price it paid for the debt that served as the basis of its stalking horse bid, which will generally be paid three to six months after the buyer purchased the debt.

Practice Is on the Rise

For some time, existing prepetition secured lenders have used the advantages arising from holding secured debt, acting as a DIP lender, and serving as a stalking horse to control the sale process and to ensure a minimum recovery from or an outright purchase of a debtor's assets. What is new is that potential buyers have caught on to the power of these advantages and are stepping into the shoes of the prepetition secured debt not to get paid on a loan but to buy a debtor's assets—in other words, to loan to own.[3]

The practice appears to be on the rise and gathering steam. Since 2013, at least eight Chapter 11 cases in which a potential buyer has purchased the

continued on page 32

continued from page 31

prepetition secured debt for the purpose of credit bidding its debt and serving as a stalking horse bidder have been filed in the District of Delaware

- *Victor Oolitic Stone Company, d/b/a Indiana Limestone Co.*, Case No. 14-10311 (CSS)
- *Fisker Automotive Holdings, Inc.*, Case No. 13-13087 (KG)
- *Velti, Inc.*, Case No. 13-12878 (PJW)
- *HSS Holding, LLC*, Case No. 13-12740 (BLS)
- *Furniture Brands International, Inc.*, Case No. 13-12329 (CSS)
- *MSD Performance, Inc.*, Case No. 13-12286 (PJW)
- *Landauer Healthcare Holdings, Inc.*, Case No. 13-12098 (CSS)
- *iGPS Company LLC*, Case No. 13-11459 (KG)

Perhaps the best-known instance of the use of this new loan to own strategy in recent memory arose in the case of *In re Fisker Automotive Holdings*.[4] In *Fisker*, the debtors and the U.S. Department of Energy (DOE) were parties to a loan arrangement and reimbursement agreement, dated as of April 22, 2010. On October 11, 2013, Hybrid Tech Holdings LLC purchased DOE's position of outstanding principal of $168.5 million under the senior loan agreement for $25 million (approximately 15 percent of par) and, for all practicable purposes, succeeded to DOE's position as the debtors' senior secured lender.

After the sale of the senior debt by DOE to Hybrid, the debtors entered into an asset purchase agreement with Hybrid. Pursuant to the agreement, Hybrid was to acquire substantially all of the debtors' assets for consideration, which included $75 million in the form of a partial credit bid of the debt under the senior loan agreement it had just purchased from DOE for $25 million.

The debtors filed bankruptcy on November 22, 2013, and immediately sought authority to sell, under the asset purchase agreement, substantially all of their assets to Hybrid through a private sale. For a number of reasons not relevant to this discussion, the Bankruptcy Court limited, for cause, under Section 363(k), Hybrid's credit bid to $25 million, the amount it had paid for the debt under the senior loan agreement.[5] For purposes of this discussion, the point is simpler—Hybrid purchased the secured debt of DOE for the sole purpose of credit bidding that debt to buy Fisker's assets in a Section 363 sale.

Fisker, however, has been the exception to the rule. The bulk of these transactions have been approved, with the prepetition lender/DIP lender/stalking horse successfully purchasing the debtor's assets in a 363 sale. For example, in *Velti*, debtors entered into a credit agreement with prepetition lenders. As of the petition date, the amount outstanding under the prepetition credit agreement was approximately $57.5 million, exclusive of interest.

On November 1, 2013, three days prior to the commencement of the case, GSO Credit-A Partners LP, GSO Palmetto Opportunistic Investment Partners LP, and GSO Coastline Partners LP purchased the debt under the prepetition credit agreement. Two days after GSO's purchase of the debt, the debtors and GSO entered into an asset purchase agreement. Pursuant to the agreement, GSO was to serve as the stalking horse and purchase the debtors' assets through a combination of a credit bid of the recently purchased debt and cash. GSO further agreed to provide the debtors with $25 million in DIP financing. Debtors filed bankruptcy on November 4, 2013, and on December 20, 2013, the court approved the sale to GSO.

Judicial Scrutiny

Having identified the trend, where does that leave things? Should it matter to the court that the credit-bidder stalking horse purchased its debt prior to the bankruptcy and for a steep discount? The answer is not clear.

One of the problems with a loan to own scenario is that what looks like debt is really acting like equity. The motivations and goals of a buyer or equity investor are very different from those of a lender that is seeking to get repaid on its debt. Has the secured lender seriously considered whether to restructure its debt and continue a relationship with the debtor, but reluctantly determined that a quick sale is the best path forward? Is the lender's only interest to be a buyer in a quick sale with the "downside" being a nice return on a short-term investment? How seriously should the court consider a secured lender's threat to liquidate the debtor if it doesn't receive an 80 percent recovery on its debt when it purchased it for 20 percent? Or is a "lender" that just purchased debt in order to buy the company really going to walk if it doesn't get the relief it has insisted upon?[6]

These are serious questions. However, in all likelihood, the debt will be treated for exactly what it is—senior secured debt—regardless of its owner, the purchase date and price, or the lender's desire to buy the company through a credit bid.

But, that is not the final word. Even when a court is treating the debt irrespective of its ownership history, it is likely, at the very least, that the lender/buyer can expect stricter scrutiny by the bankruptcy judge. While bankruptcy is a collective proceeding, it operates in the context of the adversary system in which judges rely on the parties to identify the important issues, frame conflicts for decision, and suggest appropriate results. Given the myriad issues and motions in a bankruptcy case and the challenges of running a business under court supervision, bankruptcy judges in particular rely on the parties that have an economic stake in the outcome to frame the issues.

When parties in a bankruptcy case wear multiple hats, however, the judge cannot rely as much on the adversary system to assist him or her in reaching the right decision. As such, judges are required to devote more resources and time to determining the appropriate course of action. In some ways, the judge becomes a party to the proceeding.

In a case in which a bidder has purchased debt for the purpose of buying a debtor's assets and is serving as both the stalking horse bidder and DIP lender, the court cannot rely on normal assumptions regarding parties' behavior. At the very least, the parties should expect that the judge will exercise a higher level of scrutiny throughout the case or at least through the sale.

The recent trend of loan to own, in which potential buyers of a debtor's assets buy out the existing secured debt for the purpose of credit bidding that debt in a 363 sale, raises some interesting issues and provides challenges for Bankruptcy Courts. Even if lender/buyers will be treated without regard to when, at what price, and for what purpose they bought the debt, it is likely that courts will apply stricter scrutiny in such cases. How courts will ultimately adapt to the recent trend is unclear. Stay tuned.

- Loan to own lenders generally did not serve as DIP lenders, leaving that role to the senior secured lenders to provide a "defensive" DIP financing package. Such defensive DIP loans were usually short-term loans providing financing sufficient to support the debtor through the closing of a Section 363 asset sale and no further.
- An alternative to buying the prepetition debt prior to the bankruptcy filing is for the potential buyer to agree to provide DIP financing that includes sufficient funds to pay off the prepetition debt. The new DIP lender/buyer is then in a position to serve as a stalking horse by credit bidding its DIP loan. The primary difference between the two approaches is that in the DIP lending scenario the buyer/DIP lender will almost certainly have to pay par to buy the prepetition debt. The net result to the estate, however, is the same.
- "New" is not strictly accurate. Buyers have acquired debt for purposes of acquiring debtors for some time. *See In re The Colad Group, Inc.*, 324 B.R. 208 (Bankr. W.D.N.Y. 2005) (Debtor's DIP financing lender "had recently acquired its secured position, with the stated desire to effect a purchase of assets as a going concern under section 363 of the Bankruptcy Code"). What is "new" is the recent prevalence of the practice.
- *In re Fisker Automotive Holdings, Inc.*, 2014 WL 210593 (Bankr. D. Del. Jan. 17, 2014).
- It is important to note that the court did not limit the credit bid to $25 million based on the fact that Hybrid had purchased the debt for that amount. Rather, based on the stipulation of facts submitted to the court, $25 million was the agreed limit to the credit bid in the event that the court determined (as it did) that allowing the auction to go forward as proposed would not result in a fair price for the assets.
- See, e.g., *Colad*, 324 B.R. at 219 ("At the hearing to consider the debtor's first day motions, the respective attorneys for Colad and Continental responded to the above concerns, by asserting that the proposed lending arrangement represented the best and only terms available to the debtor. In my view, this position seemed disingenuous. Continental had recently acquired its secured position, with the stated desire to effect a purchase of assets as a going concern under section 363 of the Bankruptcy Code. With this objective, Continental would be obviously disinclined to compel a distressed liquidation of its position.")

Christopher S. Sontchi is a U.S. Bankruptcy Court judge for the District of Delaware and a frequent speaker in the U.S. and Canada on issues relating to corporate reorganizations. He is a lecturer at The University of Chicago Law School and an adjunct professor at Widener Law School in Wilmington, Delaware. Sontchi is a member of the Committee on Financial Contracts, Derivatives and Safe Harbors of the ABI's Commission to Study the Reform of Chapter 11 and recently testified on safe harbors for financial contracts before a House Judiciary Committee subcommittee. He holds a bachelor's degree from the University of North Carolina at Chapel Hill and a law degree from The University of Chicago Law School.

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