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Case Notes on Fisker Automotive and Free Lance-Star Decisions

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FREE LANCE-STAR

In re Free Lance-Star Publishing Co., 512 B.R. 798 (Bankr. E.D. Va. 2014) is the latest in a line of cases, including *In re Philadelphia Newspapers, LLC*, 599 F.3d 298 (3d Cir. 2010) and, more recently, *In re Fisker Automotive Holdings, Inc.*, No. 13-13087, 2014 Bankr. LEXIS 230 (Bankr. D. Del. Jan. 17, 2014), that implicate limitations on credit bidding. Secured creditors may generally “credit bid” the amount of their claim at a sale of their collateral, essentially allowing it to bid for its collateral by offsetting the purchase price with the debt it is still owed. As *Free Lance-Star* illustrates, however, the right to credit bid is not absolute.

Free Lance-Star involved the chapter 11 cases of joint debtors that owned and operated publishing and printing businesses and four radio stations. Prior to their chapter 11 cases, the debtors pursued diversification and expansion of their commercial printing business by constructing an updated, state of the art commercial printing facility. To do so, they borrowed \$50 million, secured by certain real and personal property. The loan was not secured, however, by what later became known as the “Tower Assets”—certain real estate parcels, improvements, and equipment thereon used mainly for radio broadcasting, together with radio licenses, contracts, and other related assets.

Recession-related economic factors eventually caused the debtors to fall behind on their payments, and multiple attempts to obtain refinancing failed. Their lender sold the secured loan to DSP Acquisition, LLC. DSP’s motives were apparent: it had purchased the loan with the exclusive intention of acquiring the debtors’ businesses. According to the court, DSP’s strategy in acquiring and administering the loan exemplified “a classic loan-to-own scenario.” DSP insisted that the debtors proceed with an expedited chapter 11 case to enable its expedient acquisition of their assets and businesses at a § 363 sale. However, DSP soon encountered a major obstacle: the Tower Assets had not been pledged as security for the loan, and the debtors were unwilling to grant liens on the Tower Assets.

DSP then deployed an aggressive, heavy-handed strategy designed specifically to secure liens on the Tower Assets—a strategy that would ultimately result in a limitation on their right to credit bid. For example, DSP filed UCC-1 financing statements to perfect security interests in the Tower Assets, despite having full knowledge that no such liens existed. After commencement of the debtor’s chapter 11 cases, DSP withheld its unilateral UCC filings from the bankruptcy court. It then pressured the debtors to borrow a new, postpetition DIP loan from DSP—a loan secured by the Tower Assets. The debtors rejected DSP’s offer, relying on their own cash flow projections that suggested DIP financing was unnecessary. Later in the case, despite the fact that the debtors had already offered replacement liens and adequate protection payments, DSP filed a motion requesting new liens on the Tower Assets as additional adequate protection. The court denied the motion, disapproving of DSP’s nondisclosure of its UCC filings and citing DSP’s filing of a “false and misleading” declaration with its motion.

DSP also sought to acquire the debtors at a low price by stifling a competitive auction. It strongly opposed the debtors’ retention of a highly-regarded restructuring firm as financial advisors and discouraged the debtors from marketing their assets. Still, the debtors proceeded towards an asset sale, prompting DSP to insist on an abbreviated marketing in period, and for the placement in the marketing materials of a bold, front-page declaration of DSP’s right to a \$39

million credit bid. Testimony in the bankruptcy case confirmed that DSP's conduct, including DSP's surreptitious fixture filings, created "genuine confusion" among potential buyers about the extent of DSP's liens and precisely which of the debtors' assets were encumbered.

DSP initiated an adversary proceeding in which it sought a declaration that it held valid liens on all the debtors' assets, including the Tower Assets. The debtors and DSP filed cross-motions for summary judgment, prompting the court to consider DSP's security interests and its right to credit bid at a § 363 sale. The court observed that although § 363 authorizes credit bidding, § 363(k) permits courts to "for cause order otherwise"—for example, to promote the success of a reorganization, or to encourage a competitive bidding climate.

The debtors advanced several arguments for the limitation of DSP's right to credit bid, emphasizing DSP's inequitable conduct, which had depressed the sales price of the debtors' assets, and fact that limiting the credit bid would positively influence the case by helping to restore a competitive auction. The court was persuaded, specifically stating that it was "troubled" by DSP's inequitable conduct, such as filing UCC-1 filings on certain assets despite lacking any security interests, frustrating a competitive bidding atmosphere.

"Loan-to-own" strategies, the court noted, are particularly susceptible to abuse of credit bidding rights. Ideally, credit bidding protects secured lenders against the devaluation of its collateral at an asset sale. But when the secured creditor intends to acquire the debtor entirely, then credit bidding may be used to depress market value rather than enhance it, discourage any pre-auction bidding, or dissuade otherwise willing bidders from participating at an auction. Such was the case with DSP's conduct. These undesirable results led the court to conclude that cause existed for it to "order otherwise" under to § 363(k) and limit DSP's right to credit bid to approximately \$14 million rather than its original \$39 million debt.

FISKER AUTOMOTIVE

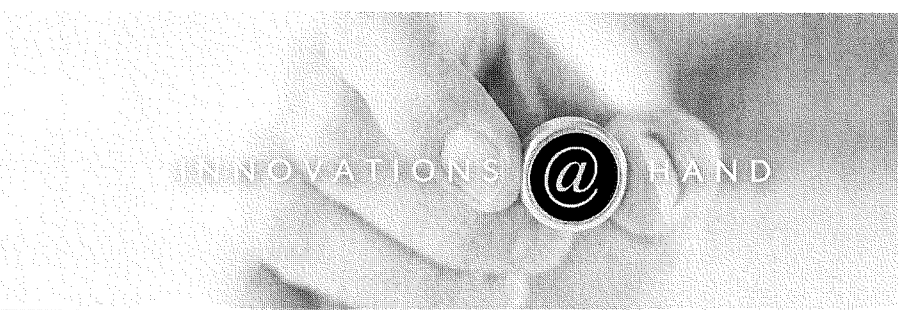
In re Fisker Auto. Holdings, Inc., No. 13-13087, 2014 Bankr. LEXIS 230 (Bankr. D. Del. Jan. 17, 2014) involved the chapter 11 cases of a hybrid vehicle manufacturer, which were expressly filed to facilitate the sale of substantially all of the Debtors' assets to a buyer, Hybrid Tech Holdings, LLC ("Hybrid"). The Debtors had been financed in part by a \$169 million loan from the Department of Energy. After the Debtors became financially distressed, Hybrid was able to purchase the outstanding debt (now in the principal amount of \$168.5 million) from the Department of Energy for just \$25 million. As a result, Hybrid succeeded to the position of senior secured lender with approximately \$168.5 million in secured claims. The Debtors and Hybrid agreed to Hybrid's acquisition of the Debtors' assets through a credit bid of part of the debt, in the amount of \$75 million, and filed a Sale Motion in the bankruptcy case seeking the court's authorization.

However, the unsecured creditors' committee opposed the Sale Motion, specifically, Hybrid's right to credit bid. Instead, the committee sought an auction, and had already identified a buyer ("Wangxiang") with an "extremely attractive" proposed offer. The parties agreed by stipulation that if, as the committee hoped, Hybrid's right to credit bid were either denied or capped at \$25 million (its purchase price for the loan), then a "competitive bidding environment" would result, with a "strong likelihood" of an auction "creating material value for the estate over and above" Hybrid's \$75 million credit bid. On the other hand, they also agreed that if Hybrid were permitted to credit bid, the committee would not oppose the Sale Motion and no auction would occur.

The committee argued that "cause" existed under 11 U.S.C. § 363(k) for the court to deny or limit Hybrid's right to credit bid. Section 363(k) provides that a secured creditor may credit bid "unless the court for cause orders otherwise." The court also cited the Third Circuit Court of Appeals' opinion in *In re Philadelphia Newspapers, LLC*, 599 F.3d 298 (3d Cir. 2010) for the proposition that "the right to credit bid is not absolute" under § 363(k) and that "courts have denied secured lenders the right to bid their credit" for a variety of reasons.

Here, the court agreed with the committee that cause existed to limit the amount of Hybrid's credit bid. The court held that "the 'for cause' basis upon which the Court is limiting Hybrid's credit bid is that bidding will not only be chilled without the cap; bidding will be frozen." The court noted that, pursuant to the parties' agreement, there would be "no bidding—not just the chilling of bidding—if the court does not limit the credit bid." Meanwhile, the existence of an attractive, capable and highly motivated bidder all but guaranteed a competitive auction. Moreover, Wanxiang had a "vested interest" in acquiring the Debtors and was willing to increase its offer at auction, since it had recently purchased a core component of the Debtors' electric cars. The court also observed that Hybrid and the Debtors had arranged for roughly six weeks, covering the holiday season between Thanksgiving and the New Year, to elapse between the November 22, 2013 petition date and the purported January 3, 2014 "drop date" for a hearing on the Sale Motion and confirmation. Courts may be less inclined to find "cause" to cap a credit bid the way the *Fisker* court did, absent such a disparity in the outcomes of its decision—here, there was guaranteed to be either a high likelihood of competitive bidding, or no auction at all.

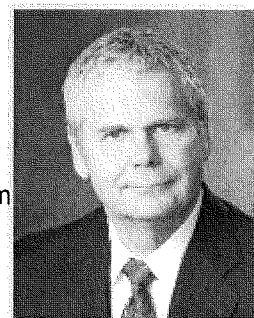
Moreover, the court appeared to premise its holding not just on the “freezing” effect that the credit bid would have on competitive bidding, but also on the fact that the amount of Hybrid’s secured claim was still uncertain—though it did not explicitly include this reasoning in stating its holding. Specifically, the court noted that there is “no doubt that the holder of a lien the validity of which has not been determined, as here, may not bid its lien,” and observed that here, “no one knows how much of the claim Hybrid purchased from DOE will be allowed as a secured claim.”

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Walter J. Greenhalgh practices in the areas of commercial litigation and bankruptcy law, insolvency law and chapter 11 corporate and commercial reorganization. He is the managing partner of Duane Morris' Newark office and a member of the firm's national governing Partners Board.

A past chair of the executive committee of the Bankruptcy Law Section of the New Jersey State Bar Association, he has been an officer of the Section for more than ten years. He is a founding master of the Bankruptcy Inn of Court, established in memory of Judges Vincent J. Commisa, D. Joseph DeVito and Daniel J. Moore and one of two Inns of Court dedicated to bankruptcy practice in the United States. He is board certified as a Business Bankruptcy Law specialist by the American Board of Certification.

A member of the American Bankruptcy Institute, Mr. Greenhalgh is also a member of the American and Hudson County bar associations and the Debtor-Creditor Section of the Essex County Bar Association. He has lectured extensively on the federal bankruptcy law in bar association and continuing legal education programs. In 2009, 2010, 2011, 2012, 2013 and 2014 *Chambers USA: America's Leading Lawyers for Business* included Mr. Greenhalgh in its listing of leading bankruptcy lawyers in New Jersey.

Mr. Greenhalgh is a 1974 graduate of the Seton Hall University School of Law and a 1971 graduate of St. Peter's College.

Areas of Practice

- Commercial Litigation
- Bankruptcy Law
- Insolvency Law
- Chapter 11 Corporate and Commercial Reorganization

Representative Matters

- Represented Liberty Healthcare Systems, Inc. (Jersey City Medical Center) in acquisition of Christ Hospital.
- Represented various creditors in Bayonne Medical Center chapter 11 proceeding.
- Represented various creditors in Hudson Healthcare, Inc. (St. Mary's Hospital) chapter 11 proceeding.
- Represented creditors in Beth Israel Hospital Association of Passaic chapter 11 proceeding.
- Represented the Official Unsecured Creditors Committee of Solomon Dwek
- Represented the Official Unsecured Creditors Committee of Able Laboratories, Inc.
- Represented the Official Unsecured Creditor Committee of Jersey City Medical Center, one of the largest public hospitals in the State of New Jersey
- Represented various creditors and equipment lessors in the United Health Care Hospital matter.
- Represented the Equitable Receiver and Liquidating Trustee in New Jersey Car Group Insurance Trust, multiple employer Health Welfare Benefit Plan.
- Acted as Assignee for the Benefit of Creditors in Advanced Community Health Care, a nonprofit visiting nurses organization.
- Represent the chapter 7 Trustee for Kiwi Airlines
- Represent ZETA Consumer Products Corporation AKA Tucker Housewares in chapter 11 proceeding
- Represented the chapter 7 Trustee for Upsala College, New Jersey
- Represented successful proponent of Plan of Reorganization to acquire Emerson Radio Corp., one of the largest volume consumer electronics distributors in the United States, in its chapter 11 proceeding.
- Representing the group that acquired Lana Lobell Farms, Inc., one of the leading standardbred breeding farms in the United States
- Represented a major secured consignment creditor in the Zale bankruptcy proceedings in Dallas, Texas with claims in excess of \$23,000,000
- Representing a group of four lending institutions, whose total mortgage portfolios exceed \$81,000,000, in the case of In Re: Capital Resources Corporation, presently pending
- Representing proponent of plan acquiring Penn Jersey of Pennsylvania, one of the larger automotive retail store chains in the Philadelphia, Delaware area

Admissions

- New Jersey
- U.S. Court of Appeals for the Third Circuit
- U.S. District Court for the District of New Jersey
- Supreme Court of New Jersey

Education

- Seton Hall University School of Law, J.D., 1974

Robert E. Grossman



A graduate of Rider University, Robert E. Grossman earned his J.D. in 1973 from Brooklyn Law School. He began his legal career at the Securities and Exchange Commission in the Division of Enforcement in a group associated with the Division of Corporate Finance. After leaving the SEC, Judge Grossman founded and served as general counsel to a large financial services company that focused on acquiring and operating distressed assets.

Most recently, Judge Grossman practiced in the area of corporate law, business reorganization and litigation at Duane Morris. A significant part of his practice focused on providing advice to troubled or newly restructured companies, and investors, with respect to the financing needs of such companies. Judge Grossman has extensive experience in complex bankruptcy and creditor rights litigation for both individuals and institutions and has represented parties in the restructuring and transfer of assets in the bankruptcy court. Experienced in the intricacies of bankruptcy and restructuring matters across a wide range of industries, including real estate and healthcare, he represented borrowers, secured creditors, landlords and owners across the United States. Prior to joining Duane Morris, Judge Grossman was the chair of the restructuring practice group at Arent Fox, directing almost 20 professionals in matters across the United States and in Europe.

Judge Grossman was appointed as a U.S. Bankruptcy Judge for the Eastern District of New York in April 2008, and currently is also serving as a visiting Judge in the Southern District of New York. Judge Grossman is an adjunct professor at Touro Law School. He is also a past Chair of the International Secured Transactions and Insolvency Committee of the American Bar Association, Section of International Law and is a frequent speaker both in the United States and Europe. In addition, Judge Grossman was the past president of the Brooklyn Law School Alumni Association.

Courtroom Deputy: Madrie Tagle

Law Clerks: Lynn Ryan and Catherine Cozzette

BIOGRAPHY

Kenneth L. Baum is a Member in the Bankruptcy and Corporate Restructuring Department of Cole, Schotz, Meisel, Forman & Leonard, P.A., with offices in New York, NY, Hackensack, NJ, Wilmington, DE, Baltimore, MD, and Dallas and Fort Worth, TX. With more than two decades of experience, Mr. Baum's practice is focused on financial restructuring, creditors' rights, commercial litigation, and developing strategic alternatives. His clients include debtors, secured creditors, private equity funds, trustees, creditors' committees, landlords, asset purchasers, parties in avoidance and nondischargeability actions, former spouses, administrative claimants, and other parties.

Mr. Baum's expertise in insolvency law also includes non-bankruptcy solutions such as workouts, UCC Article 9 sales, assignments for the benefit of creditors, and orderly liquidations. Additionally, Mr. Baum has extensive experience litigating complex commercial disputes, including receivership actions, commercial foreclosures, reclamation actions, and minority shareholder oppression suits.

Mr. Baum is admitted to practice in the states of New York and New Jersey, and before the United States District Courts for the Southern, Eastern, and Northern Districts of New York; the District of New Jersey; and the Northern, Southern, and Eastern Districts of Texas. He is also admitted to practice before the United States Court of Appeals for the Third Circuit Court. Mr. Baum is a member of the American Bankruptcy Institute, the Turnaround Management Association, and the New Jersey State and Bergen County Bar Associations. Mr. Baum is an Editor of the American Bankruptcy Institute's VOLO Circuit Court Reporter.

Mr. Baum has lectured on bankruptcy law for numerous organizations, including the New York and New Jersey State Bar Associations, the New Jersey Institute for Continuing Legal Education, the National Business Institute, and the Bergen County Bar Association. His articles on bankruptcy law, debtor/creditor issues, and commercial disputes have appeared in numerous legal journals, blogs, and other publications.

Mr. Baum received his B.A. from Binghamton University and his J.D. from Benjamin N. Cardozo School of Law, where he was an Editor of the Moot Court Honor Society.



J. Scott Victor
Managing Director

J. Scott Victor is a founding partner and Managing Director of SSG Capital Advisors, LLC, a leading national boutique middle market special situations investment banking firm with offices outside of Philadelphia, PA and in New York, NY. Prior to his transition to investment banking in 2000, he was a partner at Saul Ewing, LLP and a senior member of its Bankruptcy and Reorganization Department.

With 31 years of experience in representing companies in special situations, workouts, restructurings and in Chapter 11 proceedings, Scott is an expert in the restructuring, refinancing and sale of distressed middle-market companies. As a Managing Director of SSG, he provides investment banking services focusing on the sale, capital raises, restructuring and complex valuation of middle-market companies facing operational and/or financial challenges throughout the U.S. and Europe. His clients are public traded, privately held, private equity sponsored and family owned companies in almost every industry.

Scott has completed over 150 sale, refinancing and restructuring assignments for middle-market companies and has testified as an expert in numerous Bankruptcy Courts across the U.S. He has given more than 150 presentations around the U.S. and Europe on bankruptcy and insolvency law, capital markets, mergers and acquisitions and special situation financing issues for organizations such as the National Conference of Bankruptcy Judges, the American College of Bankruptcy, the American Bankruptcy Institute, Turnaround Management Association, Association of Insolvency and Restructuring Advisors, VALCON, Association of Corporate Growth, Association of Corporate Counsel, Wharton School of the University of Pennsylvania, University of Chicago, Villanova University, Pennsylvania Bar Institute, Philadelphia Bar Education Center, Eastern District of Pennsylvania Bankruptcy Conference, Southern District of Florida Bankruptcy Bar Association, New York Business Forum, Strategic Research Institute, The Canadian Institute, Institute for International Research, Financial Research Associates, New York Institute of Credit, New York Capital Roundtable, M&A Advisors, Global M&A Network and many other organizations. He has also written extensively on special situations and the capital markets.

Scott is a Fellow of the American College of Bankruptcy. He received the TMA Outstanding Individual Contribution Award in 2013, was named 2010 and 2011 restructuring investment banker of the year for a boutique firm by the Global M&A Network in its annual Turnaround Atlas Awards and has won several other firm and deal team awards from the TMA, ACG, M&A Advisor and Global M&A Network. Scott is also an active member of the Turnaround Management Association (past President and past Chairman of the Philadelphia Chapter, a current member of the Board of Trustees of TMA Global, previously served as Vice President of Conferences, Vice President of Chapter Relations, a longtime member of the Executive Board and was Co-Chair of the 2013 25th Annual Conference and Co-Chair of the 2012 Distressed Investing Conference), the American Bankruptcy Institute (current member of the Board of Directors, previously served as Co-Chair of the Investment Banking Committee and was Co-Chair of the Complex Financial Restructuring Conference and Co-Chair VALCON Conference), the Eastern District of Pennsylvania Bankruptcy Conference, Association of Insolvency and Restructuring Advisors, Association for Corporate Growth, Philadelphia Bar Association, Pennsylvania Bar Association and American Bar Association. Scott is a former President and a member of the Executive Committee and Board of Directors of the Consumer Bankruptcy Assistance Project, a member of the Board of Trustees of the Cardiovascular Institute of Philadelphia, a member of the Hamilton Circle and former member of the Board of Trustees of the Philadelphia Bar Foundation.