Hastings Business Law Journal

Volume 12
Number 2 *Winter 2016*

Article 4

Winter 2016

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Austin Harms

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As auctions have become more prominent in Chapter 11 proceedings, credit bidding has bolstered the multi-decade trend of secured creditor dominance, which the Supreme Court sustained in 2012. Since this 2012 decision, bankruptcy courts have attempted to level the playing field by progressively expanding the interpretation of Section 363(k) of the Bankruptcy Code, which permits courts to limit secured creditors' ability to credit bid "for cause." The conflict between the Supreme Court's 2012 decision and the bankruptcy courts' recent interpretation of Section 363(k) created an uncertainty that currently plagues the market for secured claims of distressed companies. This Note reviews the current state of the law surrounding credit bidding, examines the most recent developments likely to impact its future, and provides interpretive recommendations for bankruptcy practitioners and the judiciary.

I. INTRODUCTION

Many modern Chapter 11 cases now center on realizing a sale of a substantial portion of the debtor's business. As a result, it is no surprise that secured creditors' rights to credit bid in sales of their collateral under the Bankruptcy Code have become such important points of contention. Credit bidding involves a secured creditor bidding for its collateral in a bankruptcy auction using outstanding debt obligations as currency. This Note reviews the current landscape of the law surrounding credit bidding, canvases the developments likely to be seen in the near future, and proposes a palatable interpretive solution for the judiciary.

* J.D. Candidate, UC Hastings College of the Law; B.A., Government, Harvard University. Thank you first to Jared Ellias for his inspiration and invaluable guidance throughout the writing process and beyond; to the Editorial Board of the *Hastings Business Law Journal* for their hard work; and to my friends and family for their unwavering support.

Although the Chapter 11 process is frequently referred to as a system of reorganization,[1] many of the largest Chapter 11 cases in recent history cannot properly be labeled as such. In fact, nearly fifty-six percent of these debtors engage in a sale of substantially all of those assets.[2] Many of the largest bankruptcies of the twentieth century were of railroad companies whose largest assets were railroad tracks, which were too valuable collectively to be sold piecemeal and too expensive for any one buyer to purchase alone.[3] Today, even in cases of extremely leveraged capital structures, funding resources such as lending syndicates enable arm's length buyers to purchase entire firms.

As a result of this paradigmatic shift toward asset sales, modern bankruptcy judges often serve as auctioneers in many high-stakes cases. This evolution of duties begs the question of how bankruptcy judges should structure the auctions over which they preside. In deciding this matter, judges must keep in mind bankruptcy policy of maximizing recoveries to the debtor's claimants.[4]

From its enactment in 1978 until a circuit split began on September 29, 2009, it was understood that the Bankruptcy Code absolutely protected secured creditors' right to credit bid at a debtor's sale of their collateral. Within this scheme, most bankruptcy sales took place under section 363(b) of the Bankruptcy Code, which dictates that a court can only deny secured creditors their right to credit bid under the seldom utilized section 363(k) "for cause" exception.[5] In cases where the sale was to occur pursuant to the confirmation plan, section 1129(b)(2)(A)(ii) required courts to preserve secured creditors' right to credit bid. Until early 2014, the value associated with credit bidding was certain, as the bankruptcy courts rarely utilized section 363(k) and thus had little authority to limit the practice.[6]

Then, in early 2014, Judge Kevin Gross decided In re *Fisker Automotive Holdings, Inc.*,[7] in which he used section 363(k) to limit the right of secured creditors to credit bid in an auction of their collateral.

1. *See* Nevin M. Gewertz, Comment, *Act or Asset? Multiplicitous Indictments Under the Bankruptcy Fraud Statute, 18 USC § 152*, 76 U. CHI. L. REV. 909, 929 (2009).

2. Douglas G. Baird & Robert K. Rasmussen, Reply, *Chapter 11 at Twilight*, 56 STAN. L. REV. 673, 675–76 (2003) (finding that of Chapter 11 proceedings concluded in 2002, fifty-six percent of them involved sales of assets).

3. *Id.* at 699.

4. *See* Toibb v. Radloff, 501 U.S. 157, 163 (1991) (affirming the "general Code policy of maximizing value of the bankruptcy estate").

5. DONALD S. BERNSTEIN ET AL., *The Logic and Limits of Credit Bidding by Secured Creditors Under the Bankruptcy Code*, *in* LAWRENCE P. KING AND CHARLES SELIGSON WORKSHOP ON BANKRUPTCY AND BUSINESS REORGANIZATION 2011, http://ssrn.com/abstract=1975932.

6. *See In re* 222 Liberty Ass'n., 108 B.R. 971, 978 (Bankr. E.D. Pa. 1990) (noting that the Bankruptcy Code contemplates that the creditor is protected up to the full amount of its claim through its right to credit bid at the sale of the property).

7. *See In re* Fisker Auto. Holdings, Inc., 510 B.R. 55 (Bankr. D. Del. 2014).

Later in 2014, In re *Free Lance-Star Publishing Company*[8] was decided, which utilized the same "for cause" provision as *Fisker* to limit a secured creditor's right to credit bid in a similar auction of its collateral.[9] These decisions ignited the restructuring community, with some observers arguing that *Fisker* and *Free Lance-Star* redefined the "for cause" standard under which the right to credit bid may be constrained.[10] Supporters of this position assert that the secured creditors' conduct in *Fisker* and *Free Lance-Star*, which was deemed improper by the courts, was not uncommon practice for creditors in similar contexts. In contrast, those arguing for restrictions on credit bidding cite secured creditors' unfair advantage over cash bidders, which chills bidding procedures, constrains the price attainable by the debtor, and reduces the value of the estate. Still others argue that the facts of *Fisker* and *Free Lance-Star* were unusually offensive and these bankruptcy judges simply applied a long-established rule to unfavorable facts.[11] Considering the large amount of recent activity in the credit bidding arena, some observers contend that the Supreme Court will soon grant certiorari in another credit bidding case.[12]

To help explain the controversy surrounding these decisions and to provide direction as to the future use of the section 363(k) "for cause" exception, this Note first explores security interests and their role in bankruptcy. Then, it reviews relevant case law and examines the *Fisker*, *Free Lance-Star*, *RML*, and *Charles Street* decisions. Finally, it analyzes the arguments surrounding the section 363(k) "for cause" exception and proposes a reasoned interpretation.

II. OVERVIEW OF SECURITY INTERESTS IN BANKRUPTCY

Security interests are the backbone of many corporate loan transactions. They allow a creditor to extend credit to a debtor while protecting his investment. Article 9 of the Uniform Commercial Code ("UCC") governs security interests in personal property, while statutory law and case law govern security interests in real property. Under Article 9, a security interest is "an interest in personal property or fixtures, which secures payment or performance of an obligation."[13] To install a security

8. *In re* Free Lance-Star Publishing Co., 512 B.R. 798, 804-05 (Bankr. E.D. Va. 2014).
9. *Id.* at 801.
10. David Griffiths, *Bankruptcy and Restructuring Annual Review*, WEIL BANKR. BLOG (Dec. 22, 2014, 10:00 AM), http://business-finance-restructuring.weil.com/case-overviews/2014-bankruptcy-and-restructuring-annual-review-2/print/.
11. *Id.*
12. *Id.*
13. U.C.C. § 1-201(35) (2015).

interest in real property, a slight majority of states utilize a deed of trust while the rest utilize the mortgage.

Under Article 9 of the UCC, creditors may attempt to enforce their security interests after default using three primary methods: (i) collection and enforcement of the debt through a judicial process,[14] (ii) repossession and sale of the collateral without intervention of a court,[15] and (iii) acceptance of the collateral as full or partial satisfaction of the debt.[16] Each of these methods provides the creditor with a means by which to obtain possession of the collateral.

In a typical securitized loan transaction, the debtor will grant the creditor a security interest in one or more assets through a security agreement. This agreement effectuates the debtor's ownership interest in the collateral in exchange for the security holder's obligation to pay the agreed upon value to the debtor.

Security interests are primarily used in loan transactions to secure the payment of a debt. They provide the secured creditor with certain preferential rights in any disposition of collateral by the debtor.[17] These rights vary among different secured interests, but most often if the debtor defaults on a payment, the secured creditor is vested with a right to seize and liquidate the property in order to receive the proceeds of the parties' agreement. Secured creditors' ability to collect proceeds from the sale of their collateral in order to fulfill an outstanding obligation underpins the rationale of credit bidding.

A security interest, once attached, is immediately enforceable against the collateral. Attachment of personal property requires three things: (i) that the debtor have rights in the collateral or the power to convey such rights; (ii) that value be given; and, (iii) in most cases, that the debtor have agreed to a security agreement that sufficiently describes the collateral.[18] The statutory law and case law of individual jurisdictions govern

14. U.C.C. § 9-601 (2015) ("After default, a secured party . . . may reduce a claim to judgment, foreclose, or otherwise enforce the claim, security interest, or agricultural lien by any available judicial procedure.").

15. U.C.C. § 9-609(a), (b) (2015) ("After default, a secured party . . . may take possession of the collateral" either "pursuant to judicial process . . . [or] without judicial process, if it proceeds without breach of the peace."); U.C.C. § 9-610(a) (2015) ("After default, a secured party may sell, lease, license, or otherwise dispose of any or all of the collateral in its present condition or following any commercially reasonable preparation or processing."); U.C.C. § 9-610(b) (2015) ("Every aspect of a disposition of collateral, including the method, manner, time, place, and other terms, must be commercially reasonable.").

16. U.C.C. § 9-620 (2015) (providing that if the debtor consents and other conditions are met, "a secured party may accept collateral in full or partial satisfaction of the obligation it secures").

17. U.C.C. § 9-315(a) (2015).

18. *See* U.C.C. § 9-203 (2015).

attachment of real property. However, attachment alone does not ensure that the secured party's interest will trump that of other lienholders.

Creditors take security interests in collateral to enforce their rights in that collateral in the event the debtor defaults on their obligation. A security interest enables the creditor to take possession of the collateral to satisfy the underlying obligation. This enables the creditor to liquidate the collateral or repurpose it in a profitable manner. If the proceeds from a sale of the collateral exceed the amount of the underlying obligation, the debtor is entitled to the excess. However, if the proceeds do not satisfy the entire obligation, the creditor receives an unsecured deficiency judgment on which he may act in bankruptcy proceedings. In this way, security interests protect creditors from downside in lending.

Proponents of security interests argue that they lower the risk for the lender and the lender in turn passes those savings on to the borrower, thereby lowering its cost of capital. Detractors contend that secured creditors can hold up reorganization of companies in financial distress. The creditors' incentives, they argue, often are to foreclose early on the collateral, repossessing key assets and forcing the company into bankruptcy.[19]

The most cited criticism of secured lending, however, is that if secured creditors are permitted to foreclose on key company assets, the debtor loses the ability to sell the business as a going concern and may be forced to liquidate the business for a lesser price. This is inconsistent with the overarching bankruptcy policy of maximizing the value of the estate. Chapter 11 of the Bankruptcy Code resolves this potential for hold up by restricting creditors' rights to enforce their security interests.

III. CREDIT BIDDING: OVERVIEW, HISTORY, AND POLICY

A. CREDIT BIDDING OVERVIEW

True to its name, credit bidding involves a secured creditor bidding for its collateral in a bankruptcy auction. In this situation, the debtor owes the creditor a specified sum of money under an obligation and the creditor seeks to extinguish that debt by bidding on its collateral.[20] Normally, secured creditors are not entitled to recover more in bankruptcy than the amount of their allowed claim. So, by making a credit bid, a secured

19. SING. INSOLVENCY LAW REVIEW COMMITTEE, FINAL REPORT (2013), https://www.mlaw.gov.sg/content/dam/minlaw/corp/News/Revised%20Report%20of%20the%20Insolvency%20Law%20Reviw%20Committee.pdf.

20. Vincent S. J. Buccola & Ashley C. Keller, *Credit Bidding and the Design of Bankruptcy Auctions*, 18 GEO. MASON L. REV. 99, 102 (2010).

creditor can protect himself "in situations where [his] collateral is proposed to be sold at a price that the secured creditor believes to be inadequate or below market, whether because of the expedited timing of the sale, an inadequate marketing process, or other factors."[21] For example, suppose that Company B, a creditor of Company A, holds a security interest in substantially all of Company A's assets. Suppose further that Company B's outstanding obligation totals $5 million and that Company B expects its collateral to sell for $3 million in a bankruptcy auction. If Company B values the collateral at $4.5 million, it can credit bid up to $5 million in a bankruptcy auction in order to protect itself from a depressed sale price of its collateral.

Most often, the secured creditor is permitted to credit bid up to the full amount of his secured claim as consideration for the debtor's obligation. This process allows secured creditors to compete with cash bids from third parties. If no other adequate offers are made, secured creditors receive possession of their collateral in lieu of the proceeds of a sale.[22]

B. Policies Behind Credit Bidding

Credit bidding is a favored tool for maximizing the value of a bankruptcy estate for three primary reasons. First, credit bidding increases the frequently small pool of bidders that are familiar enough with the debtor's assets to purchase them on a condensed timetable.[23] Financial, business, and legal due diligence require considerable effort and monetary expenditure that third parties often decide is insurmountable in light of the potential credit bid. Secured creditors' familiarity with the debtor's assets preempts the need for such extensive due diligence, enabling them to participate in the auction on a condensed timetable.

Second, credit bidding reduces debtors' incentives to favor "white knight"[24] buyers who may not pay the highest price for the assets.[25] White knights may, for example, promise to use the debtor's assets for the benefit of the debtor's own management at the cost of the shareholders.[26] This situation gives rise to a typical agency problem: shareholders want to use the assets in a manner that yields the highest value whereas the debtor's management want to ensure their personal compensation and longevity.

21. *See* Beal Bank, S.S.B. v. Waters Edge Ltd. Partnership, 248 B.R. 668, 679 (D. Mass. 2000) (quoting 7 Collier on Bankruptcy ¶ 1129.05[2][b], at 1129–34 (15th ed. rev. 1998)).

22. *See* U.C.C. § 9-601 (2015).

23. Buccola & Keller, *supra* note 20, at 100.

24. "White Knight" buyers are those that acquire a company, typically in financial distress or undergoing a hostile takeover, on terms favorable to the company or its management.

25. Buccola & Keller, *supra* note 20, at 100.

26. *Id.* at 106.

Sales within bankruptcy pose an especially difficult conundrum because the liquidation of assets, which may maximize the value of the debtor's estate, necessarily spells out unemployment for the management.[27] Credit bidding solves this problem by enabling secured creditors to compete with white knights' cash bids, thus bringing more competitive bids to the auction and reducing the debtor's incentive to favor white knight bidders.

Third, credit bidding avoids unnecessary transaction costs associated with preparing and financing a cash bid.[28] It also eliminates liquidity constraints that might otherwise prevent the secured creditor from bidding and inhibit him from establishing an upset price.[29] In theory, a secured creditor should be able to purchase its collateral entirely with a credit bid if it values the collateral at the same amount or less than the secured claim. This is logically sound because the creditor's security interest in the debtor's collateral assures either that the debtor will pay the full amount of its obligation or the creditor may foreclose on the collateral and retain the proceeds of a sale up to the full amount of his claim.[30]

The benefits of credit bidding extend beyond protecting secured creditors to providing value to the debtor's estate. Bankruptcy policy seeks to maximize the value of the collateral so as to reduce the deficiency claims against the estate and ultimately maximize the value of the estate. Credit bidding works to this end by enlarging the usually small pool of realistic bidders at the auction, which often leads to higher and more competitive bids, eliminating the debtor management's incentive to favor white knight buyers who may not offer the highest and best price, and reducing transaction costs associated with submitting a bid.

Although the Bankruptcy Code sometimes precludes creditors from exerting some of their property rights,[31] it does not actually inhibit the creditors' ownership of the property.[32] Credit bidding can therefore be viewed as a rational acknowledgment of creditors' property interests. The ability to credit bid up to the face value of his claim in a bankruptcy sale ensures that a secured creditor will not "pay himself cash for his own property."[33]

27. Buccola & Keller, *supra* note 20, at 106.

28. *Id.* at 100.

29. BERNSTEIN, *supra* note 5.

30. *In re* Phila. Newspapers, LLC, 599 F.3d 298, 331 (3d Cir. 2010) (Ambro, J., dissenting).

31. For instance, the automatic stay prevents the creditor from repossessing his collateral. *See* 11 U.S.C. § 362 (2010).

32. *See* Bruce H. White & William L. Medford, *A Secured Creditor's Rights to Intellectual Property Licensed by a Debtor in Bankruptcy*, 20-MAY AM. BANKR. INST. J. 24, 24 (May, 2001) (stating that a security interest is equal to a property interest and the termination of an automatic stay does not eradicate this property interest).

33. Buccola & Keller, *supra* note 20, at 102.

In practice, credit bidding allows secured creditors to bid the value of the debtor's outstanding obligation plus any residual amount in cash. Proponents of credit bidding contend that "all of a debtor's claimants, in all states of the world, should be indifferent among receiving their share of the sale proceeds from an outside bidder, from the creditor class as a whole, or from the credit bidding [creditor]."[34] Credit bidding provides an opportunity for the secured creditor to realize what it believes to be the full value of the collateral it bargained for, insulates the secured creditor from being forced to cash out when the value of the debtor's assets are depressed, and protects the secured creditor from the risk of "bankruptcy discount."[35]

However, arguments stand to suggest that credit bidding detracts from the goal of maximizing the value of the bankruptcy estate. These critics, often junior creditors, argue that secured creditors' ability to overbid with currency (the creditors' deficiency claims) "chills" bidding by noncreditor third parties.[36] The idea is that secured creditors' bids deter third parties, who have to incur transaction costs conducting financial, business, and legal diligence and raising cash bids, from making competitive offers. This is especially true if there is a question as to whether the assets are worth the face amount of the secured debt, which is frequently the case with distressed companies. As a result, fewer potential buyers participate in the bankruptcy auction, often times yielding a lower purchase price and depressed estate values.

Fundamentally, permitting secured creditors to credit bid does not harm the bankruptcy estate unless there is a viable bidder willing to pay more than the value of the secured claim and the credit bid somehow deters this higher bid. A common way this occurs is by chilling the bidding and discouraging realistic buyers from participating in an auction. For example, a prospective bidder may conduct a cursory valuation and decide that the assets are worth more than the potential credit bid, in which case he is left in a position of needing to bid more than the credit bid after fronting resources for due diligence, often all on a truncated timetable. Thus, as a result of a secured creditor's right to credit bid, a prospective bidder may realistically elect to not participate in the auction.

34. Buccola & Keller, *supra* note 20, at 104.

35. Academics argue that economic theory shows that debtors can suffer price discounts in bankruptcy sales due to prospective buyers' fears of lacking undisclosed information about the financial condition of the seller. *See* George A. Akerlof, *The Market for "Lemons": Quality Uncertainty and the Market Mechanism*, 84 Q.J. OF ECON. 488 (1970).

36. BERSTEIN, *supra* note 5, at 2.

C. Recent Trends in Credit Bidding

Although secured creditors traditionally have taken credit bidding as a given right, recent case law puts that assumption in question.[37] In the past, clever parties took advantage of their practically infallible credit bidding rights by acquiring secured claims, wielding a credit bid, and negotiating for a discounted asset sale or equity in the reorganized debtor.

Two trends created this opportunity.[38] First, a significant increase in second- and third-lien financing has created several echelons of secured debt on the balance sheet of many companies.[39] For example, by one measure, the total value of second-lien loans increased from roughly $430 million in 2002 to $17.6 billion in 2005.[40] Second, a large magnitude of nontraditional lenders emerged in recent years.[41] These lenders include private equity funds, hedge funds, and other distressed debt investment funds that have higher tolerances for debts of financially distressed companies.[42] Significantly, these higher risk tolerances enable the lenders to engage in "loan to own" strategies wherein they enter into a loan agreement with an eye towards taking control of the borrower.[43]

These trends have created an environment where investors are more likely to purchase the secured debt of financially distressed companies, strategically wield their credit bid, and eventually bid on their collateral in bankruptcy auctions. Because Bankruptcy Code section 363(k) empowers the court to restrict a secured creditor's ability to credit bid "for cause," bankruptcy courts will likely continue to come up against challenges to credit bids.

D. Credit Bidding Under Pre-Code State Law

Although credit bidding is hotly contested within bankruptcy proceedings, the right to credit bid in foreclosure proceedings is well-recognized under applicable nonbankruptcy law.[44] Although much of the

37. *See generally Fisker*, 510 B.R. at 55.

38. *See* Daniel P. Winikka & Debra K. Simpson, *Will Bankruptcy Courts Limit the Right to Credit Bid?*, 17 J. Bankr. L. & Prac. 6, Art. 6 (2008).

39. *Id.*

40. Rob Graver, *The Benefits of Second Lien Loans*, CapitalEyes (Bank of America), (Nov./Dec. 2006), available online at: http://corp.bankofamerica.com/public/public.portal?_pd_page_label=products/abf/capeyes/archive_index&dcCapEyes=indCE&id=339.

41. Winikka & Simpson, *supra* note 38.

42. *Id.*

43. *Id.*

44. *See*, *e.g.*, Broadmoor Realty, Inc. v. First Nationwide Bank, 568 So.2d 779, 781 (Ala. 1990) ("The underlying purpose of a foreclosure sale is to sell property at public outcry in order to generate funds to pay the affected creditors. . . . To require [a] 'cash bid' here would be to elevate form over

pertinent case law does not directly touch on credit bidding, these cases generally presuppose that creditors possess the right to credit bid.[45]

The most significant nonbankruptcy law case on the topic is *Louisville Joint Stock Land Bank v. Radford*.[46] Here, Justice Brandeis struck down section 75 of the First Frazier-Lemke Act, holding that it took "from the Bank [mortgagee] without compensation, and given to Radford, rights in specific property which are of substantial value . . . without just compensation," which violated the Fifth Amendment.[47] In his opinion, Justice Brandeis considered the foundation of secured creditors' right to bid for their collateral in bankruptcy auctions.[48] He explained how the conceptual understanding of a "mortgage" in U.S. law developed from a "conditional conveyance theory," under which defaulting borrowers automatically forfeited their property to the creditor under strict foreclosure, to a "lien theory," under which the mortgagor was entitled to the protection of a public sale.[49]

Justice Brandeis concluded that a mortgagee's right to bid at the trustee's auction and subsequently seize the collateral amounted to an indispensable property right.[50] The effect of this holding was to categorize the state law right of a secured creditor to bid at a foreclosure sale as a property right, which may entitle it to constitutional protection.[51] The continued validity of this decision is the subject of some debate.[52] Although the *Louisville Joint Stock* opinion does not directly discuss credit bidding, the logic behind Justice Brandeis' opinion — that in lieu of seizing the collateral the mortgagee has a property right to bid at a foreclosure sale — embraced a state law right to credit bid on par with the right to make a cash bid.

Although the Bankruptcy Act did not include a provision specifically governing credit bidding, it did recognize secured creditors' right to credit

substance.").

45. *See e.g.*, Alliance Mortgage Co. v. Rothwell, 900 P.2d 601, 616 (Cal. 1995) (concluding that the secured creditor's "full credit bid" did not preclude (as a matter of law) its fraud claims against certain defendants); Mogilka v. Jeka, 389 N.W.2d 359, 364 (Wis. Ct. App. 1986) (holding that under a plain reading of the statute at issue, junior lienholders who purchase an asset at foreclosure may only credit their lien against the purchase price after senior lienholders have been paid in full).

46. Louisville Joint Stock Land Bank v. Radford, 295 U.S. 555 (1935).

47. *Id.* at 601–02.

48. *Id.* at 578–79.

49. *Id.*

50. *Id.* at 601–02.

51. *Id.* at 594.

52. *See* James Steven Rogers, *The Impairment of Secured Creditors' Rights in Reorganization: A Study of the Relationship Between the Fifth Amendment and the Bankruptcy Clause*, 96 HARV. L. REV. 973 (1983).

bid. This was primarily illustrated by a handful of court decisions under the Act assuming that secured creditors possessed the right to credit bid.[53]

E. Credit Bidding Under the Bankruptcy Code

1. Section 363 Sales

Debtors who wish to limit credit bidding in a sale of their assets may utilize one of two provisions of the Bankruptcy Code: section 363 and section 1129. Recently, debtors have progressively elected to use section 363 of the Code to carry out asset sales within Chapter 11.[54]

Section 363(b) empowers a trustee, or more frequently a debtor-in-possession, to "use, sell, or lease, other than in the ordinary course of business, property of the estate."[55] This provision permits the debtor to sell its assets free and clear of encumbrances.[56] Typically, a debtor will file a Chapter 11 petition, avail itself of the Code provisions that can protect it, and then sell its assets through an auction under section 363.

However, section 363 also ensures that the interests of secured creditors are preserved in "free and clear" sales. For example, section 363(e) affords secured creditors the right to adequate protection of their interest,[57] which typically means that the secured creditors' liens attach to the proceeds of the sale. Secured creditors also invoke section 363(k),[58] which generally assures the right to credit bid, unless the court orders otherwise "for cause." When valuing collateral, courts predominantly favor holding public auctions and construe section 363 to permit secured creditors to credit bid the whole face value of their claims.[59]

2. Sales Pursuant to a Debtor's Chapter 11 Plan

In the past, debtors had a viable avenue to avoid credit bids through section 1129(b)(2)(A) of the Code. The requirements of section 363 did not necessarily apply to plans of reorganization under section 1129 and debtors would try to convince judges to approve their plans that prohibited

53. *See*, *e.g.*, *In re* Renne, 55 F. Supp. 868, 871–72 (D. Neb. 1944); Hous. Inv. Corp. v. Todman, 15 V.I. 300, 302 (V.I. Terr. Ct. 1978).

54. *See e.g.*, Contrarian Funds LLC v. Aretex LLC (*In re* Westpoint Stevens, Inc.), 600 F.3d 231, 236–37 (2d Cir. 2010); Cohen v. KB Mezzanine Fund II, LP (*In re* SubMicron Sys. Corp.), 432 F.3d 448, 453 (3d Cir. 2006); United Food & Commercial Workers Union, Local 211 v. Family Snacks, Inc. (*In re* Family Snacks, Inc.), 257 B.R. 884, 887 (B.A.P. 8th Cir. 2001).

55. 11 U.S.C. § 363(b)(1) (2010).

56. *See* 11 U.S.C. § 363(f) (2010).

57. 11 U.S.C. § 363(e) (2010).

58. 11 U.S.C. § 363(k) (2010).

59. *See, e.g.*, *Cohen*, 432 F.3d at 459.

credit bidding.[60] However, the Supreme Court in *RadLAX Gateway Hotel, LLC v. Amalgamated Bank*[61] ended this practice.

If a debtor seeks to conduct a sale pursuant to a Chapter 11 plan without the approval of secured creditors, the debtor must convince the court that the plan is "fair and equitable" in its treatment of dissenting classes.[62] Section 1129(b)(2)(A) describes the three options debtors have when attempting to meet the "fair and equitable" test. First, and most commonly utilized, whoever holds the secured claims may keep their liens on collateral in place and receive deferred payments equal to the present value of their collateral.[63] Second, the debtor must sell the collateral free and clear of any liens, with the liens attaching to the proceeds of any sale.[64] Under this second scheme, the secured creditor must be permitted to credit bid. Finally, the plan of reorganization must ensure that the secured creditors receive the "indubitable equivalent" of their secured claims.[65] This ambiguous term has generally come to mean the value that the secured creditor was contractually assured of receiving. Proceedings typically become controversial when plan proponents attempt to "cramdown" a plan that includes an auction, but bans credit bidding.[66]

3. Restricting Credit Bidding "For Cause" Under Section 363(k)

Despite the Code's grant of entitlement, secured creditors' right to credit bid is not absolute. The Code acknowledges that secured creditors with liens on assets that the debtor is trying to sell may credit bid for such assets up to the value of the obligation "unless the court for cause orders otherwise."[67] This judicial power applies both to sales outside of a Chapter 11 plan of reorganization and pursuant to a cramdown plan. Section 363(k) of the Code provides:

> 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

60. Buccola & Keller, *supra* note 20, at 107.
61. RadLAX Gateway Hotel, LLC v. Amalgamated Bank, 132 S. Ct. 2065 (2012).
62. 11 U.S.C. § 1129(b)(1) (2010).
63. 11 U.S.C. § 1129(b)(2)(A)(i) (2010).
64. 11 U.S.C. § 1129(b)(2)(A)(ii) (2010).
65. 11 U.S.C. § 1129(b)(2)(A)(iii) (2010).
66. Buccola & Keller, *supra* note 20, at 108.
67. 11 U.S.C. § 363(k) (2010).

> property, *such holder may offset such claim against the purchase price of such property*.[68]

Junior creditors and competing bidders often utilize this provision to challenge the secured creditors' right to credit bid. Specifically, they argue that permitting the secured creditor to credit bid, especially on a protracted timeline, will discourage other prospective bidders from investing the resources necessary to conduct due diligence, thereby inhibiting the estate's ability to garner the highest price for the assets. Since *RadLAX*, these arguments have gained traction.[69]

Courts' use of the "for cause" exception is still rare, but it is possible that in response to the Supreme Court's decision in *RadLAX*, the bankruptcy courts will increasingly construe this language expansively so as to prevent holders of secured debt from reducing the value of bankruptcy estates. In the few recent cases where courts have restricted credit bidding "for cause," the facts of the cases included at least one of a number of commonalities. For example, courts limited credit bidding when there was bad faith by the secured creditor or collusion with the debtor or trustee,[70] when the secured creditor's lien on the collateral was subject to a bona fide dispute regarding its validity or priority,[71] and when severe injustice to other lienholders would have occurred.[72]

Even in the limited cases where a moratorium on credit bidding may be appropriate, modern courts remain cautious of imposing blanket prohibitions and instead opt for protective conditions on the credit bid.[73] Still left unresolved is the issue of whether a party can establish cause under section 363(k) to restrict credit bidding based only on the potential injury it could have on the price gathered in the auction. Parties have previously argued that credit bidding would chill the auction,[74] but nobody

68. 11 U.S.C. § 363(k) (2010) (emphasis added)

69. *See Fisker*, 510 B.R. at 57-60; *Free-Lance Star*, 512 B.R. at 805.

70. *See*, *e.g.*, *In re* Aloha Airlines, Inc., No. 08-00337, 2009 Bankr. LEXIS 4588, at 25–26 (Bankr. D. Haw. 2009) (holding that cause existed under section 363(k) where the creditor was contractually bound after the purchase of intellectual property to license it to a company that had allegedly contributed to the failure of the debtor's business).

71. *In re* Akard Street Fuels, L.P., 2001 WL 1568332 (Bankr. N.D. Tex. 2001) (holding that "a bona fide dispute as to a creditor's liens satisfies § 363(k)'s requirement of 'for cause' in disallowing a secured creditor to credit bid at a sale").

72. *See, e.g.*, *In re* Takeout Taxi Holdings, Inc., 307 B.R. 525, 536 (Bankr. E.D. Va. 2004) (reasoning that cause may be found to deny a secured creditor the right to credit bid if there are other secured creditors with liens of equal priority, and there are no cash proceeds from the sale available for distribution to them).

73. *See*, *e.g.*, *In re* Octagon Roofing, 123 B.R. 583, 588 (Bankr. N.D. Ill. 1991) (requiring the credit bidding bank to deliver an irrevocable letter of credit to the trustee to secure the portion of the bid based on a mortgage that was the subject of a pending adversary proceeding).

74. *See In re* Morgan House Gen. Pshp., 1997 WL 50419 (E.D. Pa. Feb. 7, 1997).

has yet attempted using that argument alone to establish cause. Although "for cause" is still a largely undefined concept and has previously been treated as a limited exception,[75] it remains a strong weapon that debtors, junior creditors, and prospective buyers wield to constrain credit bidding.

IV. RECENT DECISIONS IN THE CREDIT BIDDING ARENA

For many years, there were few, if any, noteworthy decisions that examined secured creditors' right to credit bid. Historically, credit bidding was considered non-controversial. But, in 2009, a string of cases began that created a circuit split. At issue in these cases was whether debtors in Chapter 11 proceedings could restrict a secured creditor's right to credit bid in a cramdown. Ultimately, the Supreme Court settled the issue in *RadLAX Gateway Hotel, LLC v. Amalgamated Bank*,[76] in which it struck down debtors' ability to pass cramdown plans restricting secured creditors' right to credit bid.

At the time, the implications of the following decisions sent shockwaves through the minds of bankruptcy practitioners and firms investing in financially distressed companies.[77] Long considered an inviolable right upon which secured creditors relied, the ability to credit bidding suddenly came into question.

A. RECENT CASES APPLYING § 1129(B)(2)

1. In re Pacific Lumber Company

In re Pacific Lumber was the first case to protect debtors' ability to restrict secured creditors' right to credit bid through the use of cramdown. *Pacific Lumber* concerned the two primary debtors in a group of six, Pacific Lumber Company ("Palco") and Scotia Pacific LLC ("Scopac"). These two debtors grew, harvested, and processed timber under an exclusive contract.[78] After a year of lackluster progress toward a plan of reorganization, the bankruptcy court terminated the debtors' exclusivity period and permitted the filing of five competing plans of reorganization. The court only considered two of these plans for confirmation. The first

75. *See In re* Theroux, 169 B.R. 498 (Bankr. D. R.I. 1994); *In re* Diebart Bancroft, 1993 WL 21423 (E.D. La. 1993).

76. *RadLAX Gateway Hotel*, 132 S. Ct. at 2073 (Justice Kennedy took no part in the decision).

77. Buccola & Keller, *supra* note 20, at 101.

78. *In re* Pacific Lumber Co., 584 F.3d 229, 236 (5th Cir. 2009) (The appeal specifically concerned two of the debtors: Pacific Lumber Company (Palco) and Scotia Pacific LLC (Scopac)).

was proposed by the secured notes indenture trustee, which covered only Scopac. The second plan was proposed by Marathon and MRC.[79]

After examination, the Bankruptcy Court for the Southern District of Texas approved the Marathon/MRC plan,[80] but disapproved the indenture trustee's plan.[81] The Marathon/MRC plan dictated that the debtors' assets, including the "Timberlands" and assets of the sawmill would be conveyed to two new entities, Townco and Newco.[82]

In order for the court to confirm the Marathon/MRC plan over the dissent of the secured noteholders, the proponents needed to utilize the cramdown provision of section 1129(b)(2)(A) of the Code.[83] As part of the confirmation proceedings, the court heard testimony on the valuation of the debtors' assets. It concluded that the Timberlands were valued at "not more than $510 million"[84] and, therefore, $510 million was the "indubitable equivalent"[85] of the noteholders' secured note claim. This $510 million figure was far less than the value of the noteholders' original claim, which totaled approximately $740 million.[86] Primarily due to this disparity in valuation, the indenture trustee and several secured noteholders moved for a stay of confirmation of the plan pending appeal.[87] The court denied their motion and the appeal was certified directly to the Fifth Circuit.[88]

On appeal in front of a Fifth Circuit panel, the indenture trustee and secured noteholders argued that the Timberlands were sold without providing the secured noteholders an opportunity to credit bid and therefore, under section 1129(b)(1) of the Code, the plan was not "fair and equitable."[89] However, in a feat of statutory interpretation, the Fifth Circuit disagreed with the indenture trustee and secured noteholders. Rather, the court reasoned that "[t]he non-exhaustive nature of the three subsections is inconsistent with treating them as compartmentalized alternatives."[90] In other words, section 1129(b)(2)(A)(ii) does not apply to the exclusion of sections 1129(b)(2)(A)(i) and (iii). On the contrary, section 1129(b)(2)(A) should be read disjunctively and understood to guarantee secured creditors the right to credit bid only where subsection 1129(b)(2)(A)(ii) is the only

79. *Pacific Lumber Co.*, 584 F.3d at 237.
80. *Id.*
81. *Id.*
82. *Id.*
83. *Id.* at 238.
84. *Pacific Lumber Co.*, 584 F.3d at 238.
85. *See* 11 U.S.C. § 1129(b)(2)(a)(iii) (2012).
86. *Pacific Lumber*, 584 F.3d at 237.
87. *Id.* at 239.
88. *Id.*
89. *Id.*
90. *Id.* at 245–46.

applicable provision of section 1129(b)(2)(A). The court emphasized that, with respect to whether the plan furnished the secured noteholders with the "indubitable equivalent" of their claims, section 1129(b)(2)(A)(iii) referenced "such claims," which meant that under section 506 of the Code, the noteholders' "allowed secured claims" should be considered.[91]

The secured noteholders continued to protest the claim, arguing that by denying them the right to credit bid and foreclose on the Timberlands, the plan "failed to afford them the indubitable equivalent because they forfeited the possibility of later increases in the collateral's value."[92] In response, the Fifth Circuit underscored that the Bankruptcy Code "does not protect a secured creditor's upside potential; it protects the 'allowed secured claim.'"[93] The court also indicated that the valuation process it conducted ensured that the plan, "insofar as it paid the noteholders the allowed amount of their secured claim, did not violate the absolute priority rule."[94] A mild surprise was that the court's decision did not address the policy contradiction between section 1111(b) of the Code, which Congress designed to protect secured creditors against judicial undervaluation of their collateral, and the Fifth Circuit's conclusion that secured creditors' "upside potential" is not protected by the Bankruptcy Code.[95]

2. In re Philadelphia Newspapers, LLC

Soon after the Fifth Circuit's decision in *In re Pacific Lumber*, the Third Circuit followed suit in *In re Philadelphia Newspapers*, affirming a district court ruling that approved bid procedures restricting secured creditors' right to credit bid at an auction of the debtor's assets.[96] However, this decision was not without criticism. Judge Thomas L. Ambro wrote a notable dissent to the majority's decision.[97] His primary contention was that the majority's decision would upset "three decades of secured creditors' expectations, thus increasing the cost of credit."[98]

The plan proposed to the Bankruptcy Court in *Philadelphia Newspapers* provided that substantially all of the debtor's assets would be sold at a public auction, free and clear of liens.[99] The substantial proceeds

91. *Pacific Lumber*, 584 F.3d at246.
92. *Id.* at 247.
93. *Id.*
94. *Id.* at 249.
95. *See* Jason S. Brookner, *Pacific Lumber and Philadelphia Newspapers: The Eradication of a Carefully Constructed Statutory Regime Through Misinterpretation of Section 1129(b)(2)(A) of the Bankruptcy Code*, 85 AM. BANKR. L.J. 127, 152 (2011).
96. *In re* Phila. Newspapers, LLC, 599 F.3d 298, 301 (3d Cir. 2010).
97. *Id.* at 319.
98. *Id.* at 338.
99. *Phila. Newspapers*, 599 F.3d at 301.

of such sale would be used to pay expenses and be distributed to creditors.[100] Importantly, the debtors structured the reorganization plan to block credit bidding by secured creditors.[101] In addressing this issue, the bankruptcy court applied the canon of statutory construction of *lex generalis*, stating that specific laws prevail over general ones,[102] to section 1129(b)(2)(A). The court reasoned that the disjunctive "or" phrasing of section 1129(b)(2)(A) "operates to provide alternatives."[103] This is consistent with the definition of "or" provided by the Bankruptcy Code, which states that "or" is not exclusive.[104] In support of its proposition, the bankruptcy court cited *In re Pacific Lumber* for the proposition that "because the three subsections of § 1129(b)(2)(A) are joined by the disjunctive 'or,' they are alternatives."[105] Thus, the court reasoned, a debtor may avail itself to either subsection (i), (ii), or (iii) and is free from satisfying more than one subsection.[106]

On appeal, the District Court for the Eastern District of Pennsylvania reversed the decision of the bankruptcy court, holding that section 1129(b)(2)(A) barred the lenders from credit bidding in the auction.[107] In analyzing the issue, the district court took a much more textualist approach than the bankruptcy court.[108] The district court looked to the Fifth Circuit's *In re Pacific Lumber*[109] decision and reasoned that since the debtor's plan seemingly met the "indubitable equivalent" standard of section 1129(b)(2)(A)(iii), the plan's denial of credit bidding was permitted.[110]

The Third Circuit predominantly agreed with the district court, concluding that it "simply cannot look past the statutory text, which plainly supports the conclusion that § 1129(b)(2)(A) does not require credit bidding in plan sales of collateral free of liens." Like its peer, the Third Circuit availed its reasoning of the disjunctive nature of the word "or" in

100. *Phila. Newspapers*, 599 F.3d at 301–02 (noting "[u]nder the Plan, the purchase will generate approximately $37 million in cash for the Lenders. Additionally, the Lenders will receive the Debtors' Philadelphia headquarters which the Debtors have valued at $ 29.5 million, subject to a two-year rent free lease for the entity that will operate the newspapers. The Lenders would receive any cash that is generated by a higher bid at the public auction.").

101. *Id.* at 302.

102. *See Lex specialis-Principle*, TRANS-LEX.ORG LAW RESEARCH, http://www.trans-lex.org/910 000 (last visited Jan. 23, 2016).

103. *Phila. Newspapers*, 599 F.3 at 305.

104. 11 U.S.C. § 102(5) (2012).

105. *Pacific Lumber*, 584 F.3d at 245.

106. *Phila. Newspapers*, 599 F.3d at 305.

107. *In re* Phila. Newspapers, LLC, 418 B.R. 548, 552 (E.D.Pa. 2009).

108. *Id.* at 566–67 (explaining "any alleged unscrupulous conduct engaged in the by the respective parties . . . is irrelevant to the Court's analysis. Rather, the discrete issue . . . is the correctness of the Bankruptcy Court's holding that the Bankruptcy Code does not allow the Debtors' to deny the Senior Lenders the right to credit bid under the text of the relevant statutory provisions.").

109. *Pacific Lumber*, 584 F.3d at 229.

110. *Phila. Newspapers*, 418 B.R. at 566–67.

section 1129(b)(2)(A) and its correlated definition in section 102(5).[111] The court concluded that "satisfaction of any of the three subsections is sufficient to meet the fair and equitable test of § 1129(b)(2)(A)."[112]

While the majority's holding controlled, Judge Ambro's lengthy dissent is certainly notable for its arguments against restricting credit bidding. Citing Congress' intent to protect secured creditors both in sales of their collateral free of liens and from undervaluations of their secured assets, Judge Ambro argued that section 1129(b)(2)(A)(ii) is "exclusively applicable to the proposed plan sale in this case, and with it comes a presumptive right to credit bid by the secured lenders."[113] Further, he noted that under this scheme, the debtors are free to argue that credit bidding should be restricted "for cause" under section 363(k) of the Code.[114] Subsequent arguments against restricting credit bidding have cited Judge Ambro's dissent.[115]

3. River Road Hotel Partners, LLC v. Amalgamated Bank

Anxious secured lenders received some reprieve when the Seventh Circuit in *In re River Road Hotel Partners*[116] parted with the Third and Fifth Circuits and upheld secured creditors' right to credit bid in connection with a sale of their collateral in a bankruptcy auction. In *River Road*, the reorganization plan dictated that the debtors would sell substantially all of their assets, which were primarily hotel properties, and that no credit bidding would be permitted.[117]

Soon after the plan was filed, the secured lenders filed an objection, arguing that the debtor's plan could not satisfy section 1129(b)(2)(A)'s requirements because it "sought to sell encumbered assets free and clear of liens without allowing the lenders to bid their credit at the asset auctions, in violation of 11 U.S.C. § 1129(b)(2)(A)(ii)'s requirement that secured creditors be given credit-bidding rights."[118] The debtors responded that in fact the plan was confirmable because it satisfied the "indubitable equivalent" standard of section 1129(b)(2)(A)(iii).[119] However, the Bankruptcy Court ruled in favor of the secured creditors, holding that the

111. *Phila. Newspapers*, 599 F.3d at 319.
112. *Id.*
113. *Id.* at 338.
114. *Id.*
115. *See* River Rd. Hotel Partners, LLC v. Amalgamated Bank, 651 F.3d 642, 653 (7th Cir. 2011).
116. *Id.* at 643.
117. *Id.* at 645.
118. *Id.*
119. *Id.*

debtors' plan could not be confirmed under section 1129(b)(2)(A)(iii).[120] The debtors filed notices of appeal and both their appeals were certified directly to the Seventh Circuit.[121]

On appeal, the debtors unwaveringly focused on the plain language of section 1129(b)(2)(A). They argued that this language does not give courts discretion; instead, they are compelled to approve any cramdown plan that satisfies section 1129(b)(2)(A)(iii)'s "indubitable equivalent" requirement.[122] Further, they contend that the statute's language "unambiguously indicates that a plan that provides a secured creditor with the proceeds from the sale of an asset at an auction that does not permit credit bidding satisfies the indubitable equivalence requirement."[123]

Unsympathetic to the debtors' pleas, the Seventh Circuit affirmed the decision of the bankruptcy court, holding that "the Code requires that cramdown plans that contemplate selling encumbered assets free and clear of liens at an auction satisfy the requirements set forth in Subsection (ii) of the statute."[124] The court reasoned that canons of statutory construction dictate that it should interpret section 1129(b)(2)(A) in a way to give meaning to every part of the statute.[125] On that logic, permitting a plan of reorganization to sell encumbered assets as described in section 1129(b)(2)(A)(ii) without meeting the requirements of that subsection would make subsection (ii) superfluous. The court reasoned that the much more plausible interpretation of section 1129(b)(2)(A) "would read each subsection as stating the requirements for a particular type of sale" with each subsection "conclusively governing" the event it regulates.[126]

In taking up the debtors' second argument, the Seventh Circuit rejected the idea that a plan providing the secured creditors with the proceeds of a sale of their collateral but not permitting them to credit bid automatically fulfills the "indubitable equivalence" standard.[127] The court indicated that auctions restricting credit bidding run the risk of undervaluation, which creates a further risk that "the winning bids in these auctions would not provide the Lenders with the current market value of the encumbered assets."[128] In this way, the Seventh Circuit departed from *In re Pacific Lumber* and *In re Philadelphia Newspapers*, in which the circuit courts did not address the issue of whether the proposed treatment of

120. *River Rd. Hotel Partners*, 651 F.3d at 645.
121. *Id.*
122. *Id.* at 649.
123. *Id.*
124. *Id.* at 653.
125. *Id.* at 651 (citing TRW Inc. v. Andrews, 534 U.S. 19, 31 (2001)).
126. *Id.* at 652.
127. *River Rd. Hotel Partners*, 651 F.3d at 650–51.
128. *Id.* at 651.

secured creditors under the reorganization plan would have satisfied the indubitable equivalence standard.

The Seventh Circuit rounded out its reasoning by taking a holistic look at the Bankruptcy Code. The court reasoned, "the Code has an expressed interest in insuring that secured creditors are properly compensated."[129] Further, the court took up Justice Ambro's reasoning in his *In re Philadelphia Newspapers* dissent, concluding that the Code does not contain any provisions that authorize a public auction where credit bidding is banned as a "legitimate way to dispose of encumbered assets."[130] Under the debtors' plan, secured creditors would not be provided the same types of protections enjoyed under other parts of the Code. Thus, the debtors' interpretation of section 1129(b)(2)(A) is "less plausible than a construction of the statute that reads Subsection (ii), which offers the standard protections to creditors, as providing the only way for plans seeking to sell encumbered assets free and clear of liens to obtain 'fair and equitable' status."[131] The logical corollary is that section 1129(b)(2)(A) should instead be read to provide secured creditors with the standard protections found elsewhere in the Code. The Seventh Circuit ultimately held that the Code requires that the debtors' reorganization plan provide secured creditors the protections afforded under section 1129(b)(2)(A)(ii).[132]

4. RadLAX Gateway Hotel, LLC, et al. v. Amalgamated Bank

On December 12, 2011, the Supreme Court granted certiorari to review *In re River Road Hotel Partners* and resolve the circuit split between the Third, Fifth, and Seventh Circuits. Ultimately, the Supreme Court unanimously held on narrow statutory grounds that under section 1129(b)(2)(A) of the Bankruptcy Code, secured creditors may not be denied the right to credit bid at a sale of their collateral pursuant to a Chapter 11 plan.[133] Justice Scalia, writing for the Court, concluded that a cramdown plan that endeavors to hold a sale of collateral free and clear of encumbrances must satisfy the requirements set forth in section 1129(b)(2)(A)(ii), and cannot be confirmed if it only satisfies the "indubitable equivalent" standard of section 1129(b)(2)(A)(iii).[134] Consequentially, debtors seeking to provide secured creditors with the

129. *River Rd. Hotel Partners*, 651 F.3d at 653.
130. *Id.*
131. *Id.* (quoting *Phila. Newspapers*, 599 F.3d at 331 (Ambro, J., dissenting)).
132. *Id.*
133. *RadLAX Gateway Hotel*, 132 S. Ct. at 2073.
134. *Id.* at 2072.

"indubitable equivalent" of their secured claims must also allow secured creditors to credit bid in a sale of their collateral.

The circuit court decisions in *Pacific Lumber* and *Philadelphia Newspapers*, which suggested that secured creditors may be barred from credit bidding in a sale of their collateral pursuant to a Chapter 11 plan, were the subject of much dispute among commentators. Indeed, many bankruptcy lawyers and commentators advocated for the Seventh Circuit's view as presented in *River Road*, under which a reorganization plan involving the sale of collateral cannot be confirmed unless secured creditors are afforded the right to credit bid in the asset sale.[135]

The Court's analysis of the Bankruptcy Code's section 1129(b)(2)(A) focused predominantly on principles of statutory construction. The Court turned to the canon of statutory construction that "the specific governs the general" to dismiss the debtors' reading of section 1129(b)(2)(A) as "hyperliteral and contrary to common sense."[136] In the eyes of the Court, subsection (ii) was a specific provision setting forth the prerequisites for selling collateral free of liens, while subsection (iii) contained broadly constructed language that does not refer to a sale of collateral.[137] Under the lens of this general/specific canon of statutory interpretation, the general language of subsection (iii) does not apply where the sale is specifically addressed by subsection (ii).[138]

In response to the debtors' principle textual argument that section 1129(b)(2)(A) "unambiguously provides three distinct options for confirming a Chapter 11 plan over the objection of a secured creditor,"[139] the Court asserted that "[t]he question here, is not whether debtors must comply with more than one clause, but rather which one of the three they must satisfy."[140] The debtors went on to argue that "clause (ii) is no more specific than clause (iii), because the former provides a procedural protection to secured creditors (credit-bidding) while the latter provides a substantive protection (indubitable equivalence)."[141] As a result, the debtors argue, subsection (ii) is not "a limiting subset" of subsection (iii), which the general/specific canon requires.[142] The Court responded to this argument by stating that it knew of no authority supporting the idea that the

135. DONALD S. BERNSTEIN ET AL., *Credit Bidding in Chapter 11 after RadLAX*, *in* LAWRENCE P. KING AND CHARLES SELIGSON WORKSHOP ON BANKRUPTCY AND BUSINESS REORGANIZATION 2012, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2243669.

136. *RadLAX Gateway Hotel*, 132 S. Ct. at 2068.

137. *Id.*

138. *Id.*

139. Brief for Petitioners at 15, *RadLAX Gateway Hotel*, 132 S. Ct. at 2065 (No. 11-166).

140. *RadLAX Gateway Hotel*, 132 S. Ct. at 2072.

141. *Id.*

142. *Id.*

canon "is confined to situations in which the entirety of the specific provision is a 'subset' of the general one."[143]

In any case, the Court concluded that subsection (ii) is entirely a subset of subsection (iii). Subsection (iii) applies to all cramdown plans, which includes all situations that the narrower subsection (ii) applies.[144] The Court observed that the scope, not the "nature of the provisions' prescriptions," is consequential when applying the general/specific canon.[145]

Bearing in mind that its narrow statutory interpretation may not always be absolute, the Court pointed out that "the general/specific canon is not an absolute rule, but is merely a strong indication of statutory meaning that can be overcome by textual indications that point in the other direction."[146] It followed this tempering by noting that the present debtors "point to no such indication here."[147] The Court provided an example of this situation, which is a "statutory scheme in which the specific provision embraced within a general one is not superfluous, because it creates a so-called safe harbor." The Court rejected the debtors' assertion that this was the case here; that "clause (iii) ('indubitable equivalent') being the general rule, and clauses (i) and (ii) setting forth procedures that will always, ipso facto, establish an "indubitable equivalent," with no need for judicial evaluation."[148]

B. Expanding the Section 363(k) "For Cause" Exception

In the wake of the Supreme Court's momentous *RadLAX* decision, secured lenders are well advised to be mindful of section 363(k)'s power to restrict credit bidding.[149] Traditionally, courts have rarely utilized the "for cause" exception borne out in section 363(k), generally only invoking it when there was a bona fide dispute over the extent or validity of a secured claim[150] or some sort of misconduct by a creditor.[151] Since *RadLAX*, however, bankruptcy courts have shown more willingness to resort to

143. *RadLAX Gateway Hotel*, 132 S. Ct. at 2072.
144. *Id.* at 2072–73.
145. *Id.* at 2073.
146. *RadLax Gateway Hotel*, 132 S. Ct. at 2072.
147. *Id.*
148. *Id.*
149. *See* 11 U.S.C. § 363(k) (1984) (restricting credit bidding "for cause").
150. *See, e.g.*, *In re* L.L. Murphrey, No. 12-03837-8-JRL, 2013 WL 2451368 (Bankr. E.D.N.C. June 6, 2013) (limiting the right to credit bid because of a dispute over the validity of liens).
151. *See, e.g.*, *In re* Aloha Airlines, Case No. 08-00337, 2009 Bankr. LEXIS 4588 (Bankr. D. Haw. May 14, 2009) (restricting a secured creditor's right to credit bid as a consequence of misconduct, which included selling confidential information to a competitor).

section 363(k) to constrain credit bidding.[152] In *In re Fisker Automotive Holdings, Inc.*[153] and *In re Free Lance-Star Publishing Company*,[154] two different bankruptcy courts suggested that merely furthering bankruptcy goals, such as enhancing the competition of an auction, could amount to a "cause" sufficient to restrict credit bidding.

1. In re Fisker Automotive Holdings, Inc.

In *In re Fisker Automotive Holdings, Inc.*, Judge Kevin Gross of the prominent United States Bankruptcy Court for the District of Delaware provided some guidance as to the meaning of "for cause" in the context of section 363(k). Fisker Automotive ("Fisker") was founded in 2007. Its primary business was the design and production of hybrid electric cars.[155] Three years later, Fisker received a loan from the United States Department of Energy to assist it in development and production of its products.[156] Fisker faced challenges that prevented it from operating as planned including safety recalls, loss of substantial inventory in Hurricane Sandy, and the loss of their Department of Energy lending facility.[157]

On October 11, 2013, Hybrid Tech Holdings, LLC ("Hybrid") purchased Fisker's outstanding loan facility debt due to the Department of Energy.[158] Although this debt totaled $168.5 million, Hybrid purchased it at the auction for $25 million, which equates to roughly fifteen cents on the dollar.[159] Fisker eventually filed for Chapter 11 relief and originally attempted to sell its assets to Hybrid through an asset purchase agreement under which Hybrid would acquire "substantially all of the assets of Debtors for consideration which includes $75 million in the form of a credit bid" of the debt purchased from the Department of Energy.[160]

The Official Committee of Unsecured Creditors preferred an auction to a private sale and thus opposed Fisker's yet-to-be consummated deal with Hybrid.[161] Specifically, the creditors endeavored to restrict Hybrid's ability to credit bid the debt it purchased from the Department of Energy.[162] Instead, the creditors proposed an auction with Wanxiang America

152. *See Fisker*, 510 B.R. at 55; *Free Lance*, 512 B.R. at 798.
153. *Fisker*, 510 B.R. at 55.
154. *Free Lance*, 512 B.R. at 798.
155. *Fisker*, 510 B.R. at 56.
156. *Id.*
157. *Id.*
158. *Id.* at 57.
159. *Id.*
160. *Id.*
161. *Fisker*, 510 B.R. at 57.
162. *Id.*

Corporation ("Wanxiang").[163] Wanxiang was a particularly attractive buyer because it had recently purchased at an auction assets of bankrupt A123 Systems, LLC for almost $300 million.[164] Included in these assets was the lithium ion battery, which was the primary component of Fisker's hybrid electric cars.[165] Thus, Wanxiang had skin in the game. However, Wanxiang recognized the power of Hybrid's credit bid and refused to participate in an auction unless Hybrid's ability to credit bid was restricted to $25 million.[166]

At a hearing on January 10, 2014, Fisker and its unsecured creditors announced to the court that they agreed to narrow the scope of the dispute. Both parties stipulated that (1) restricting Hybrid's right to credit bid would likely generate an auction with a material chance of creating significant value for the estate in an amount greater than Hybrid's present credit bid;[167] (2) if Hybrid's credit bid is not regulated, there is no realistic chance of an auction;[168] (3) restricting Hybrid's ability to credit bid "would likely foster and facilitate a competitive bidding environment";[169] and, lastly, (4) the assets offered for sale include properly perfected collateral, assets not subject to properly perfected liens in Hybrid's favor, and assets where there is "no dispute as to whether Hybrid has a properly perfected lien."[170]

The question for the court was first whether Hybrid is entitled to a credit bid and, if so, could the court limit Hybrid's ability to credit bid.[171] It was clear that if the answer to the second question was no, there would be no auction and Hybrid would acquire Fisker's assets at bargain prices, leaving little for the creditors.[172] The court immediately acknowledged secured creditors' longstanding right to credit bid, citing Bankruptcy Code section 363(k), *RadLAX*, and *Philadelphia Newspapers*.[173] However, the court promptly noted that "[t]he law is equally clear . . . that the Court may 'for cause order otherwise.'"[174]

In an initial effort to determine what "cause" means for purposes of restricting credit bidding, the court engaged the Third Circuit's ruling in *In re Philadelphia Newspapers, LLC*.[175] In the referenced block of the Third

163. *Fisker*, 510 B.R. at 57.
164. *Id.* at 60.
165. *Id.*
166. *Id.* at 59.
167. *Fisker*, 510 B.R. at 57–58.
168. *Id.* at 58.
169. *Id.*
170. *Id.*
171. *Id.* at 59.
172. *Id.*
173. *Fisker*, 510 B.R. at 59.
174. *Id.* at 59.
175. *See Phila. Newspaper*, 599 F. 3d at 298.

Circuit's opinion, the court noted that "[i]n a variety of cases where a debtor seeks to sell assets pursuant to § 363(b), courts have denied secured lenders the right to bid their credit."[176] Subsequently, in a footnote, the Third Circuit did away with the creditors' argument that the court's ability to restrict credit bidding "for cause" is limited to situations in which a "secured creditor has engaged in inequitable conduct."[177] Rather, according to the court, "[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."[178]

The court's first rub was with the debtors' truncated timeline and uncompromising attitude.[179] The debtors filed these cases on November 22, 2013, which was three days before Thanksgiving.[180] They then insisted that the sale motion and confirmation hearings occur no later than January 3, 2014, two days after New Years Day.[181] This timeline only provided parties twenty-four days to challenge the sale motion, and less time for the committee of unsecured creditors, which was not appointed until December 5, 2013.[182] When the court prompted the debtors and Hybrid for justifications for such a contracted timeline, neither presented a satisfactory reason.[183] In the end, the court focused on the third parties harmed by the downfall of Fisker, concluding that "[i]t is the Court's view that Hybrid's rush to purchase and to persist in such effort is inconsistent with the notions of fairness in the bankruptcy process."[184]

Next, the bankruptcy court took up the credit bid's tendency to chill bidding in the bankruptcy auction. The court reasoned that according to the stipulations set forth by both parties, there would be no bidding whatsoever if the court did not restrict Hybrid's ability to credit bid.[185] The court recognized that Wanxiang was a highly attractive prospective buyer, already having purchased assets consisting of the primary component of Fisker's electric cars.[186] Stressing that the parties' stipulations posited that there would be *no* bidding, rather than just chilled bidding, the court concluded that "the 'for cause' basis upon which the Court is limiting

176. *Phila. Newspaper*, 599 F. 3d at 315–16.
177. *Id.* at 315–16, n. 14.
178. *Id.*
179. *Fisker*, 510 B.R. at 60.
180. *Id.*
181. *Id.*
182. *Id.*
183. *Id.*
184. *Id.* at 60–61.
185. *Fisker*, 510 B.R. at 60.
186. *Id.*

Hybrid's credit bid is that bidding will not only be chilled without the cap; bidding will be frozen."[187]

Further drawing on the parties' stipulations, the court addressed the unsecured creditors' argument that the amount of Hybrid's secured claim is uncertain. Hybrid cited *In re Submicron Systems Corp.*,[188] arguing that case law in the Third Circuit entitled it to credit bid its entire claim. However, the bankruptcy court distinguished the present case from *Submicron Systems* by reasoning that in the present case, it is the *validity* of the lien that is in dispute, not the *value* of the lien.[189] The court thus justified limiting Hybrid's ability to credit bid a claim secured by a lien of an undetermined amount, concluding that no party knew what portion of Hybrid's claim would eventually be recognized as a secured claim.[190]

Based on the above reasoning, the court allowed Hybrid to credit bid. But, it limited the extent to which Hybrid could do so to the $25 million it paid for the distressed debt. Of note, the court did not explain why it selected the $25 million figure as the amount of the restriction. Hybrid immediately sought emergency leave to appeal to both the district court and directly to the Third Circuit. The district court denied both requests.[191]

After the Bankruptcy Court limited Hybrid's ability to credit bid, a competitive auction between Wanxiang and Hybrid ensued. In the end, Wanxiang was awarded the assets for a bid of $149.2 million.[192] Here, the ultimate sale price far exceeded the amount the estate would have received had the court not restricted Hybrid's ability to credit bid.

Fisker provides initial clarity as to what can constitute "cause" under section 363(k) of the Bankruptcy Code. Although many distressed debt investors are squirming nervously in their seats, *Fisker* far from set the standard of how courts will interpret and employ section 363(k). The chief takeaway in this regard is that although the court limited Hybrid's ability to credit bid, it is unclear why the court selected $25 million, which was the price Hybrid paid for the distressed debt, as the appropriate ceiling. It is possible that the court derived the $25 million figure from the parties' stipulations, meaning it is unrelated to the purchase price of the debt.

187. *Fisker*, 510 B.R. at 60.

188. *See Submicron Systems*, 432 F.3d at 448.

189. *Fisker*, 510 B.R. at 61.

190. *Id.*

191. *See* Hybrid Tech Holdings, LLC v. Official Comm. of Unsecured Creditors of Fisker Auto. Holdings, Inc. (*In re* Fisker Auto Holdings, Inc.), 2014 U.S. Dist. LEXIS 15497 (D. Del. Feb. 7, 2014); Hybrid Tech Holdings, LLC v. Official Comm. of Unsecured Creditors of Fisker Auto Holdings, Inc. (*In re* Fisker Auto Holdings, Inc.), 2014 U.S. Dist. LEXIS 17689, 1 (D. Del. Feb 12, 2014).

192. Ben Rosenblum, *Delaware Court Finds "Cause" to Limit Credit-Bid to Facilitate Bankruptcy Auction,* JONES DAY PUBLICATION (Mar. 27, 2014), http://www.jonesday.com/files/Publication/28c33426-1cfc-47e8-90d5-59d78a8a7d97/Presentation/PublicationAttachment/8513386c-a3da-450b-9fab-e05aae1625a/Fisker%20Credit%20Bidding%20363_k_%20BRR%20Mar_Apr%202014.pdf.

However, more likely is that the court sought to protect the interests of the unsecured creditors and capping credit bidding at the purchase price was comfortably justifiable on these grounds.

Regardless of why it chose the $25 million cap, the court's focus was squarely on whether it could restrict secured creditors' ability to credit bid. Judge Gross clearly answered that query in the affirmative. Given the significant role that credit bidding plays in distressed acquisitions, distressed debt purchasers are wise to study how subsequent courts interpret and apply *Fisker*.

2. In re Free Lance-Star Publishing Company

A few months after *Fisker* was decided, a second court followed suit in *In re Free Lance-Star Publishing Company*.[193] The court largely adopted *Fisker's* reasoning in limiting the secured creditor's ability to credit bid.[194] Here, Free Lance-Star Publishing Company entered Chapter 11 intending to sell substantially all of its assets in a section 363 sale.[195] The debtor urged the court to limit the rights of its secured creditor, DSP Acquisition, to credit bid.[196] It asserted that cause existed under section 363(k) for three reasons.[197] First, DSP did not have a lien on all of the debtors' property being sold.[198] Second, the debtors allege that DSP engaged in "inequitable conduct that has damped interest in the auction and depressed the potential sales price the Debtors' otherwise might have realized from the sale of the business."[199] Lastly, the debtors asserted that restricting DSP's ability to credit bid would foster a competitive bidding process by encouraging potential buyers to participate.[200]

Free Lance-Star's first two reasons are consistent with historic standards under which courts have limited secured creditors' rights to credit bid. However, with their third reason, that limiting the ability to credit bid would foster a competitive bidding process, the debtors adopted *Fisker*'s expansion of what constitutes "cause" for purposes of section 363(k).

In the end, the Bankruptcy Court limited DSP's ability to credit bid. It justified this restriction on a finding of a "perfect storm, requiring the

193. *Free Lance-Star*, 512 B.R. at 798.
194. *Id.* at 807.
195. *Id.* at 801.
196. *Id.* at 805.
197. *Id.*
198. *Id.*
199. *Free Lance-Star*, 512 B.R. at 805.
200. *Id.*

curtailment of DSP's credit bidding rights."[201] The contributors to this perfect storm included "(i) DSP's less than fully-secured lien status; (ii) DSP's overly zealous loan-to-own strategy; and (iii) the negative impact of DSP's misconduct."[202] Addressing DSP's misconduct, the court cited the pressure DSP exerted over the debtor to cultivate a "speedy bankruptcy filing," DSP's strong objection to the debtor's hiring of a financial consultant, insistence that the marketing materials "contain on the front page, in bold font, a statement that DSP had a right to a $39 million credit bid," and that DSP had unilaterally recorded financing statements in an attempt to perfect a security interest in some of the debtors' assets, which DSP did not have a lien on.[203]

Although DSP engaged in inequitable conduct, the court did not extinguish the entirety of its right to credit bid.[204] Rather, the court determined that "in order to foster a robust and competitive bidding environment," sufficient cause existed to limit DSP's credit bid to a total of $13.9 million.[205] Hybrid filed an emergency motion seeking leave to appeal the ruling, which the Delaware's District Court denied.[206]

Like *Fisker*, it is not clear how Judge Huennekens arrived at that figure. It is clear that he relied on Suzanne Roski, the debtors' expert witness from its financial consultant who testified regarding the proposed bidding procedures and auction process.[207] The court noted that "[t]he methodology Roski employed eliminated the unencumbered assets of the Debtors from the potential credit bid and applied a market analysis to develop an appropriate cap for a credit bid that would foster a competitive auction process."[208] Ultimately, DSP submitted the winning bid in the auction, in which it paid a total of about $30 million — $16.3 million in cash and a credit bid of $14 million.[209]

3. In re RML Development, Inc.

Soon after *Free Lance-Star*, the United States Bankruptcy Court for the Western District of Tennessee handed down a decision that

201. *Free Lance-Star*, 512 B.R. at 807.
202. *Id.*
203. *Id.* at 803.
204. *Id.* at 808.
205. *Free Lance-Star*, 512 B.R. at 808.
206. *In re* Fisker Auto. Holdings, Inc., No. 14-CV-99 (GMS), 2014 WL 576370, at *1 (D. Del. Feb. 12, 2014).
207. *Free Lance-Star*, 512 B.R. at 807.
208. *Id.*
209. *See* Maria Chutchian, *Free Lance-Star Newspaper Co. Gets Go-Ahead For $30M Sale*, LAW360 (May 28, 2014, 6:26 PM), http://www.law360.com/articles/542270/free-lance-star-newspaper-co-gets-go-ahead-for-30m-sale.

commentators argue cuts against the grain of *Fisker* and *Free Lance-Star*. After careful study, however, these arguments appear misguided.

In *In re RML Development, Inc.*,[210] the debtor sought to sell two residential apartment complexes outside the ordinary course of business under section 363. Subsequently, one of the creditors, SPCP Group III CNI 1, LLC ("Silverpoint") asserted that it held a valid first mortgage interest in both apartment complexes that the debtor sought to sell.[211] It thus filed a motion seeking permission to credit bid the full amount of its secured claim at the bankruptcy auction.[212] Silverpoint's senior liens secured its obligations in the amount of approximately $2.5 million.[213]

Unlike *Fisker* and Free *Lance-Star*, there were no allegations of inequitable conduct on the part of the secured creditors. Rather, the debtor admitted that Silverpoint's claim totaled approximately $2.3 million and only raised objections regarding the last $200,000.[214] Ultimately, the court permitted Silverpoint to credit bid up to the undisputed value of its claim but required any bid over the $2.3 million figure to be bid in cash to be held in escrow until RML's objection to Silverpoint's claim was resolved.[215] The court noted that it should only restrict secured creditors' ability to credit bid "when equitable concerns give it cause."[216] It went on to conclude, "such a modification or denial of credit bid rights should be the extraordinary exception and not the norm."[217] This clearly worded statement appears to suggest that "cause" under section 363(k) should be narrowly construed, thus limiting judicial authority to restrict credit bids and cutting against *Fisker* and *Free Lance-Star*. However, after further analysis, this is not the case.

Consider that in *RML* there were no allegations of inequitable conduct as there were in *Fisker* and *Free Lance-Star*. So, giving context to the *RML* court's statement that restricting credit bidding should be the extraordinary exception rather than the norm, it is conceivable that this statement was only intended to apply in similar situations where no inequitable conduct was present. Viewed in this light, the statement was intended as a guidepost for cases such as *RML* where no inequitable conduct by a secured creditor was at issue.

210. *See In re* RML Dev., Inc., No. 13–29244, 2014 WL 3378578 (Bankr. W.D. Tenn. July 10, 2014).
211. *Id.* at *1.
212. *Id.* at *1–2.
213. *Id.* at *2–3.
214. *Id.* at *12–13.
215. *Id.* at *13–14.
216. *RML Dev.*, 2014 WL 3378578, at *11.
217. *Id.*

Even more telling is the fact that despite concluding that restricting credit bids should be the extraordinary exception, the court did restrict Silverpoint's credit bidding rights to the value of its undisputed claim.[218] Given its statement requiring an "extraordinary exception," it is surprising that the court appeared to base its limitation on the finding of a "bona fide dispute" over whether the last $200,000 of Silverpoint's claim is proper.[219] For a court so favoring judicial restraint in this regard, Judge David Kennedy implicitly set a low bar for limiting Silverpoint's credit bid absent inequitable conduct.

Yet, in a footnote the court pointed out, "where a creditor holds an uncontested secured claim, it should ordinarily be permitted to bid . . . regardless of its intrinsic impact on other bidding."[220] The court is clear that "mere 'chilling' of third party bids" will not suffice as cause to limit credit bidding rights.[221] This point is potentially in conflict with the *Fisker* and *Free Lance-Star* courts' opinions, in which chilling of the bidding was adjudged to have inhibited a competitive bidding process and thus contributed to "cause" to limit credit bidding.

Thus, the extraordinary exception language used by the *RML* court cuts slightly against prior decisions in some respects, but does not go as far as it initially seems to. In similar cases where no inequitable conduct on the part of secured creditors is alleged, *RML* seems to have set a low bar for restricting secured creditors' right to credit bid in an auction.

4. In re Charles Street African Methodist Episcopal Church

Most recently, in *In re Charles Street African Methodist Episcopal Church*,[222] a bankruptcy court denied in part a debtor's motion to limit credit bidding. In *Charles Street*, Charles Street African Methodist Episcopal Church ("CSAME") owned two contiguous parcels of real property.[223] CSAME moved to sell these parcels free and clear of liens to its stalking horse bidder, Action for Boston Community Development, Inc. ("ABCD"), or to the highest bidder at an auction.[224]

Pursuant to the plan, CSAME was obligated to pay ABCD a $50,000 break-up fee if ABCD was not ultimately the highest bidder.[225] Two other

218. *RML Dev.*, 2014 WL 3378578, at *12.
219. *Id.*
220. *Id.* at *14, n.11.
221. *Id.*
222. *In re* Charles St. African Methodist Episcopal Church, 510 B.R. 453, 455 (Bankr. D. Mass. 2014).
223. *Id.*
224. *Id.*
225. *Id.*

parties, Horizons for Homeless Children, Inc. and OneUnited showed interest in bidding for the assets.[226] However, the debtor's motion also included a request to prohibit OneUnited from credit bidding for the assets or to at least require the non-stalking horse bidders to submit $210,000 in cash to pay ABCD's break-up fee.[227] CSAME also filed an objection to OneUnited's claim.[228] OneUnited's claims were secured by CSAME's real property.[229]

Picking up on Judge Kennedy's reasoning in *RML*, CSAME argued that its objection showed that OneUnited's claim is subject to a "bona fide" dispute, which created sufficient cause to deny OneUnited's right to credit bid under section 363(k).[230] The bankruptcy court acknowledged that often "the existence of a bona fide dispute as to the secured claim is cause" to restrict credit bidding.[231] However, under these facts, CSAME's "counterclaims do not amount to cause to prohibit credit bidding."[232]

The court explained that it arrived at this conclusion primarily because CSAME's objections do not challenge OneUnited's underlying claims but instead "interpose counterclaims as the basis of a defense of setoff."[233] It went on to explain 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."[234]

The court also quickly disposed of an off-topic credit risk argument posed by CSAME. CSAME's argument, essentially, was that that if OneUnited was permitted to credit bid freely, then the claim that would satisfy CSAME's counterclaim would already have, at least in part, been used up.[235] This effectively rendered any judgment that CSAME may obtain on its counterclaims uncollectible.[236] As a result, credit bidding created an unjust credit risk.[237] The court seemed to see through this veiled attempt at securing prepayment. Reasoning that CSAME had bad intentions in making this credit risk argument, the court concluded that

226. *Charles St. African Methodist*, 510 B.R. at 455.
227. *Id.*
228. *Id.* at 455–56.
229. *Id.* at 456.
230. *Id.* at 457.
231. *Id.* at 458.
232. *Charles St. African Methodist*, 510 B.R. at 458.
233. *Id.*
234. *Id.*
235. *Id.*
236. *Id.*
237. *Id.*

CSAME had attempted to use "a denial of credit bidding as, in essence, a form of prejudgment security."[238]

Next, the court took up CSAME's alternative request for narrowed credit bidding rights. In other words, CSAME requested that any bid not from the stalking-horse ABCD include a mandatory cash sum of $210,000 to pay for the break-up fee due to ABCD.[239] As OneUnited did not oppose this request, the court agreed that the "need to fund the break-up fee [was] cause to limit the right to credit bid."[240] However, the court saw no need to exceed the protection beyond the $50,000 break-up fee. So, the court limited OneUnited's right to credit bid only to the extent that in order to participate in the auction, it must include $50,000 cash in its bid.[241]

It is unclear what role *Charles Street* plays in the ongoing chain of credit bidding case law. CSAME expressly disavowed any reliance on theories used to limit credit bidding in *Fisker* including bid chilling and inequitable conduct by a secured creditor.[242] Although the *Charles Street* court had "no occasion to address *Fisker's* rationale," this case stands to further define the boundaries of cause under section 363(k), specifically that courts will dismiss frivolous attempts by debtors to establish cause.[243]

V. HAVE COURTS SET A NEW STANDARD FOR WHAT CONSTITUTES SUFFICIENT CAUSE?

The natural question, and the one which this Note aims to address, is whether courts have set a new standard for what constitutes cause sufficient to limit secured creditors' right to credit bid under section 363(k) of the Bankruptcy Code. A sufficient answer to this question may only be obtained through thorough analysis of the relevant case law after *RadLAX*.[244] In sum, my evaluation is as follows: section 363(k) of the Code does not set parameters on what constitutes "cause" to limit the right to credit bid. Legal scholars have made convincing arguments that Chapter 11 has become obsolescent in today's legal climate.[245] Gone are the days where secured creditors need such robust protection.

238. *Charles St. African Methodist*, 510 B.R. at 459.
239. *Id*.
240. *Id*. at 459.
241. *Id.*
242. *Id.* at 457.
243. *Id.*
244. The American Bankruptcy Institute recently published a book discussing the issues surrounding credit bidding in bankruptcy sales. *See* PAUL R. HAGE ET AL., CREDIT BIDDING IN BANKRUPTCY SALES: A GUIDE FOR LENDERS, CREDITORS, AND DISTRESSED-DEBT INVESTORS (2015).
245. *See generally* Charles J. Tabb, *Credit Bidding, Security, and the Obsolescence of Chapter 11*, 2013 U. ILL. L. REV. 103 (2013).

In today's system, investors, namely hedge funds and private equity firms, purchase outstanding obligations of distressed firms at steep discounts with the intention of extracting substantial value in bankruptcy. Bankruptcy courts must balance the interests of debtors while protecting secured creditors' from undervaluation of their collateral in a sale. The *RadLAX* decision reduced the ability of bankruptcy courts to ensure these equitable results in the current system by confirming that secured creditors may not be denied the right to credit bid at a sale of their collateral pursuant to a Chapter 11 plan under section 1129(b)(2)(A) of the Bankruptcy Code.[246] The Court decided *RadLAX* on very narrow statutory grounds, not discussing at length the equities associated with the current system of credit bidding. It is plausible to read this restrained opinion as conferring to bankruptcy judges the power to decide on a case-by-case basis whether credit bidding is fair and equitable and, if so, to what degree it should be permitted in a given case.

In an effort to ensure equity since *RadLAX*, bankruptcy courts in *Fisker* and its progeny have struggled to discern what constitutes "cause" under section 363(k) of the Code. Whether section 363(k) will evolve into an oft-used mechanism to ensure equity is unclear. What is clear is that ambiguity abounds and we are likely to soon see appellate review and potentially another Supreme Court review of credit bidding.

A. THE EFFECT OF *FISKER* AND *FREE LANCE-STAR*

The facts of *Fisker* exemplify the current climate of distressed debt investors attempting to extract value in bankruptcy. Hybrid Tech Holdings, LLC purchased Fisker's outstanding loan facility debt due to the Department of Energy at roughly fifteen cents on the dollar.[247] Sensing inequity and undue pressure from Hybrid, Judge Kevin Gross invoked section 363(k) to limit Hybrid's credit bidding ability.[248] The reasons he cited for such action expanded the conventional interpretation of section 363(k). For example, he cited the debtors' truncated timeline and uncompromising attitude, the complete freezing of bidding, and the uncertainty of Hybrid's claim amount. *Fisker* represented the first attempt of bankruptcy judges to combat inequity and so called "loan-to-own" strategies.

The reasoning in *Fisker* gained momentum when the court in *Free Lance-Star* also invoked section 363(k) to limit the secured creditor's right

246. *RadLAX Gateway Hotel*, 132 S. Ct. at 2073.
247. *Fisker*, 510 B.R. at 57.
248. *Id.* at 61.

to credit bid.[249] The *Free Lance-Star* court relied heavily on the concepts originated in *Fisker*, even citing *Fisker* for the proposition that credit bidding can be restricted in order to promote a competitive bidding environment.[250] Further, the court discussed at length what it considered "inequitable" conduct by DSP, focusing on the negative impact of DSP's actions on the credit bid mechanism.[251] Of note, however, is that Judge Kevin Huennekens did not address whether other factors, such as a dispute over the validity of the claim, were sufficient cause to limit credit bidding.[252]

In both *Fisker* and *Free Lance-Star*, the secured creditors pursued loan-to-own strategies and the courts found them to have engaged in "inequitable conduct." In *Fisker*, this meant trying to rush a private sale and in *Free Lance-Star*, this meant trying to stretch its lien on the debtor's assets in bad faith. So, the question remains, how much weight does each factor carry? Should investors purchasing secured debt of distressed firms at discounted prices be concerned or will courts require more than just a loan-to-own strategy to find cause sufficient to limit credit bidding rights? Taken to its logical extreme, *Fisker* stands for the proposition that courts may restrict credit bidding rights even without the presence of inequitable conduct or a dispute as to the validity of a creditor's lien or claim. Unfortunately, any answers set forth at this point in time are merely conjecture. Either uniformity in bankruptcy courts' decisions or appellate guidance is needed to settle the issue.

Even with the lack of decisive resolution, there are important takeaways from both *Fisker* and *Free Lance-Star*. First, and most notably, the holdings can be plausibly interpreted as bankruptcy courts' reactions to what they saw as inequitable loan-to-own strategies by influential investors attempting to exert excessive control over debtors and extract substantial value from the firm. With this in mind, investors who purchase secured claims in distressed firms are well advised to be especially sensitive to how the court perceives their role in the bankruptcy process. Specifically, courts and committees of unsecured creditors will scrutinize investors' influence on the debtor's timeline and on the debtor's ability to secure financial advisors to aid it in obtaining the highest price in an auction.

Second, *Fisker* and *Free Lance-Star* will continue to be relied on by parties in bankruptcy proceedings seeking to limit credit bidding rights. This leverage may be tapered, however, by subsequent case law and by the

249. *Free Lance-Star*, 512 B.R. at 807.
250. *Id.* at 808.
251. *Id.* at 806.
252. It was undisputed that DSP's loan was secured by a lien on some of Free Lance-Star's real and personal property, but not on the assets in question.

relatively sizable discretion that bankruptcy judges wield. Those holding secured claims will be wise to holistically evaluate the judge's perception of their position in light of *Fisker* and *Free Lance-Star* when negotiating with debtors. With the apparent judicial hostility towards loan-to-own strategies, secured claimholders must adapt to the negative impact that surely will follow the uncertainty created by these cases.

B. THE SIGNIFICANCE OF *RML* AND *CHARLES STREET*

RML and *Charles Street* add to the base built by *Fisker* and *Free Lance-Star*. However, *RML* is distinguishable from both *Fisker* and *Free Lance-Star*. In *RML*, there were no allegations or findings of inequitable conduct by secured creditors. The *RML* court focused its analysis on this principal of inequity, noting that credit bidding rights should only be restricted "when equitable concerns give it cause" and that this event should be the "extraordinary exception and not the norm."[253] It eventually limited the contested portion of the claim, finding that a "bona fide" dispute existed as to the extent of the claim.[254]

The *RML* decision potentially departs from *Fisker* and *Free Lance-Star* regarding the weight of credit bidding's "chilling" effect on auctions. The *RML* court plainly holds that "mere 'chilling' of third party bids" will not suffice as cause to limit credit bidding rights.[255] In contrast, the *Fisker* and *Free Lance-Star* courts included bid chilling in their justification for limiting credit bidding. However, of note, the courts did not limit credit bidding solely on the basis of bid chilling. In this regard, *RML* does not directly conflict with *Fisker* and *Free Lance-Star*, but may indicate a departure from their required level of evidence.

Unfortunately, the *RML* court left unclear whether its hostile attitude toward limiting credit bidding rights should apply only under similar situations or whether its logic was also intended to apply to situations in which there was inequitable conduct. Regardless, the opinion is surely influential in cases that do not include allegations or findings of inequitable conduct.

The *Charles Street* reasoning sets forth a more traditional, pre-*Fisker* case. There, the court refused to limit credit bidding except for a pre-determined break-up fee agreed to with the stalking horse bidder. CSAME attempted to take up the *RML* court's logic by arguing that its objection showed that the secured creditor's claim is subject to a "bona fide" dispute,

253. *RML Dev.*, 528 B.R. at 150.
254. *In re* RML Dev., Inc., 2 No. 13-29244, 2014 WL 3378578, at 12 (Bankr. W.D. Tenn. July 10, 2014).
255. *Id.* at 14, n. 11.

which created sufficient cause to deny the secured creditor's right to credit bid.[256] In denying CSAME's attempt to restrict the secured creditor's credit bid, the court observed 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."[257] This suggests that the court saw through CSAME's veiled attempt to stifle credit bidding and, upholding principles of equity, dismissed it as such.

The court in *Charles Street* expressly noted that it was not addressing the "types of 'cause'" at issue in *Fisker*. Thus, *Charles Street* stands to support the proposition that although a dispute over the validity of a claim or lien may constitute cause, veiled attempts to utilize counterclaims that do not challenge the underlying claims as a defense to restrict credit bidding will be struck down.

C. SO, WHERE DO WE STAND?

The question left open by *Fisker* and its progeny still is: How wide of an interpretation will courts use in interpreting cause as sufficient grounds to limit credit bidding? Under what circumstances will a court limit a secured creditor's right to credit bid? For example, could a mere showing of a loan-to-own strategy that would depress the debtor's ability to fetch the highest price at an auction be sufficient?

No one has yet attempted to establish cause under section 363(k) by showing that the secured claimant acquired the debt as part of a strategy to acquire the firm or its assets. This, however, is a logical extension of the case law. As long as it is profitable, secured creditors will continue to make use of credit bidding as part of acquisition strategies. As a result, bankruptcy courts will likely be asked to consider such contentions and set firmer parameters defining what constitutes cause to restrict credit bidding.

If the judiciary continues to limit credit bidding for cause, purchasers of secured claims of distressed companies may lose much of their incentive for acquiring such debt. This alteration of claim purchasers' incentive structure will also impact secured creditors and debtors. Increased risk of bankruptcy courts limiting credit bidding will drive down the price of distressed companies' outstanding claims. The extent to which secured creditors may encounter difficulty selling debt that they own in distressed companies is unclear. Should secured creditors experience increased difficulty divesting their claims, debtors may gain leverage in negotiations

256. *Charles St. African Methodist*, 510 B.R. at 457.
257. *Id.* at 458.

with secured creditors. As a result, secured creditors may face additional pressure to negotiate with the debtor to restructure their debt. These negative effects caused by judicial uncertainty shift the negotiating clout surrounding the bankruptcy process and must be carefully examined.

There is no definitive indication that the judiciary intends to use section 363(k) to reduce secured creditors' ability to acquire debtors' assets at depressed prices or to influence the bankruptcy process by way of credit bidding. Reduced secured creditor clout could increase values of bankruptcy estates, which the judiciary holds as a fundamental goal of bankruptcy law. If the courts intend to find a solution to the issues surrounding credit bidding, they must resolve the uncertainty.

There is no consensus manner to remedy this issue to be found in the dearth of academic literature surrounding credit bidding.[258] However, what these writings do agree on is that *Fisker* and its progeny could have serious implications on future auctions and more generally on the market for secured claims of distressed companies.[259]

Secured creditors seeking to avoid limitations of their ability to credit bid must be aware of the perception they now carry and the potentially associated tradeoffs. The days of pressuring debtors into a hasty, conclusive sale and having unlimited credit bidding power may be over. Instead, secured creditors must be prepared for a world in which judges scrutinize interactions and encourage competitive auction processes conducted on lenient timetables as the dominant method of selling the assets of distressed firms in bankruptcy.

D. A PATH FORWARD

In the vast majority of cases, courts should permit secured creditors to credit bid the full value of their secured claim. However, in limited circumstances, courts may appropriately limit secured creditors' right to credit bit for cause under section 363(k) to the creditors' basis in the secured claim. Such limited circumstances include special situations in which the bankruptcy court either reasonably seeks to avoid inequitable conduct by secured creditors or must act to prevent unreasonable bid chilling. This proposal aims to strike a balance between secured creditors'

258. However, the American Bankruptcy Institute recently published a book. PAUL R. HAGE ET AL., *supra* note 244.

259. *See supra* note 192; Kobi Kastiel, *Two New Cases Cast a Shadow Over Credit Bidding*, HARV. L. SCH. F. ON CORP. GOVERNANCE AND FIN. REG. (July 13, 2014), https://corpgov.law.harvard.edu/2014/07/13/two-new-cases-cast-a-shadow-over-credit-bidding/; Adam C. Harris et al., *Credit Bid Buyers Beware: Delaware Bankruptcy Court Caps Credit Bid*, SCHULTE ROTH & ZABEL LLP, RESOURCES (Jan. 24, 2014), http://www.srz.com/Credit_Bid_Buyers_Beware_Delaware_Bankruptcy_Court_Caps_Credit_Bid/.

right to protect the value of their claim and bankruptcy law's goal of maximizing the value of debtors' estates.

In the limited circumstances where courts appropriately cap credit bidding, the secured creditors' basis in his claim is an appropriate cap. Two primary assertions underpin this principle. First, section 363 seeks to avoid the difficulties and inefficiencies involved in judicial valuation of collateral. Instead, courts prefer deferring to a free market sale to value assets.[260] Implicit in this notion is that a free market sale must be referenced in order to avoid conducting a judicial valuation of collateral. In the context of a secured creditor planning a credit bid, the most recent sale prior to a bankruptcy auction is typically the acquisition of secured claims. The price paid for these secured claims is thus the best representation of value that courts have to reference.

Second, capping the right to credit bid at secured creditors' basis in the claim will, to a large extent, prevent bid chilling and inequitable conduct. If outside market participants do not face a credit bid representing claims exceeding the value of the collateral, they are more likely to invest the time and money to conduct due diligence and potentially submit a bid. Further, capping credit bidding at secured creditors' basis reduces the clout that secured creditors wield in negotiations. If a debtor believes that an auction will yield a third party bid greater than the value of a secured creditor's basis in his claim, it will be less likely to agree to inequitable arrangements with the secured creditor prior to the auction. This mechanism allows debtors to avoid, for example, pressured sales to secured creditors on contracted timelines.

When evaluating proposed credit bidding arrangements, courts' focus should be on equity. Thus, unusual circumstances where equity so demands are appropriate situations in which to limit credit bidding. Blanket prohibitions on secured creditors' right to credit bid are improper. Rather, courts may find limiting credit bids to the claimholder's basis to be a justifiable cap. This cap both protects bankruptcy estates from improper bid chilling and inequitable conduct by secured creditors and assures secured creditors the right to credit bid a reasonable amount of their claims.

To the extent that courts invoke section 363(k) to limit the right to credit bid in order to avoid undue influence, they must draw a boundary indicating a zone of permissible activities for secured creditors to operate within. The legal field of lender liability provides guidance on this issue. In *In re Radnor Holdings Corp.*,[261] the court concluded that the overarching inquiry in a recharacterization of debt to equity is the intent of the parties.

260. *SubMicron Systems*, 432 F.3d at 461.
261. *In re* Radnor Holdings Corp., 353 B.R. 820 (2006).

Although I disagree with this conclusion, the court correctly emphasized that no "mechanistic" approach would suffice and a "*common sense* evaluation of the facts and circumstances surrounding a transaction" must be applied.[262] In the context of assessing undue influence by secured creditors, this evaluation includes consideration of the bargaining positions of each party, availability of outside options, control that the secured creditor maintains over the day-to-day operations of the debtor, the secured creditor's control of the debtor's board of directors, and the economic reality of the surrounding circumstances. In limited circumstances, these factors may suggest that a cap on credit bidding is appropriate.

VI. CONCLUSION

With secured creditors hugely profiting from acquisition strategies utilizing credit bidding, they will expectedly continue to push the boundaries of the law. As a result, bankruptcy courts will likely be increasingly called upon to consider objections to bidding procedures. While the traditional method of challenging the validity or priority of the underlying claim will persist, use of the "for cause" exception embodied in section 363(k) of the Code will continue to garner increased attention. The arguments for what constitutes "cause" will expand and courts will likely be compelled to set parameters. At this time, the extent to which courts will limit credit biding "for cause" remains unclear. Whether or not courts continue to expand the "for cause" exception in the long term, the current climate of uncertainty will continue to produce negative effects in the market for secured claims of distressed companies. As a result of the negative externalities associated with such unfettered uncertainty, we are likely to see forthcoming appellate guidance and potentially Supreme Court review of the issue.

262. *Radnor Holdings*, 353 B.R.at 840.