CAUSE FOR CREDIT BIDDING: UTILIZING SECURED DEBT TO OBTAIN PROPERTY DURING A BANKRUPTCY AUCTION

Comment

ABSTRACT

Section 363 of the Bankruptcy Code permits distressed companies to sell all or substantially all of their assets during bankruptcy as a means of generating liquidity. As a result, debtors may dispose of rapidly depreciating assets and obtain the cash needed to operate their business during bankruptcy proceedings. While the ability of debtors to sell property during bankruptcy is an important feature of our Bankruptcy Code, the Bankruptcy Code aims also to protect creditor interests and not place senior creditors at a disadvantage when compared to junior creditor interests.

Section 363(k) is the Bankruptcy Code's solution to protecting senior secured creditors' interests when a distressed company invokes Section 363. Section 363(k) empowers secured creditors to use up to the full face value of the debt owed to them by the debtor as currency when they bid in bankruptcy auctions on the collateral against which they hold claims. Historically, this power has been treated as virtually an absolute right, even though Congress amended Section 363(k) in 1984 to add a "for cause" limitation to credit bidding. However, recent court decisions have created uncertainty about the practice of using the face value of secured debt to bid on property.

This comment examines under what circumstances a court is likely to restrict credit bidding for cause. Part II of this comment discusses Section 363 and its legislative history. Part III of this comment discusses credit bidding, its legislative history, and the policies in support of credit bidding. Part IV of this comment examines court decisions that discuss for cause limitations to credit bidding. Part V of this comment discusses how secured creditors can prevent having their ability to credit bid reduced for cause. This comment concludes by summarizing the discussion of Section 363 of the Bankruptcy Code, credit bidding, and for cause limitations to credit bidding.

I. INTRODUCTION

Up, down, sideways, and in circles, market volatility rocked Wall Street in 2015.[1] From Greek debt, to the Chinese economic slowdown, to fears of a United States Federal Reserve System interest rate hike, the average investor had a tough time finding positive returns for stocks and bonds.[2] The Dow Jones closed down 2.2% and the S&P 500 ended the year down 0.7%.[3] While a majority of U.S. stocks ticked downward, one sector was by far hit the hardest.[4] As a whole, the energy industry experienced approximately a 20% dip in market value,[5] with major energy providers Chesapeake Energy, CONSOL Energy, and Southwestern Energy experiencing stock declines of roughly 75%.[6] Faced with a global surplus and OPEC member nations refusing to reduce production levels, oil prices hit a seven-year low, dropping to below $35 per barrel.[7] "[Acceptable returns] can only be achieved if prices exceed $75 [per barrel] . . . or more than double their current levels, which, barring a major supply disruption, is highly unlikely, in our view," industry analysts noted.[8]

As ordinary investors moved out of the energy sector, Wall Street's savviest bargain hunters moved in.[9] Hedge fund managers at Blackstone Group and Apollo Global Management, LLC raised money to purchase embattled energy sector stocks and bonds.[10] Traditional investment firms Western Asset Management Co. and Seix Investment Advisors LLC opened endowments dedicated to helping their larger institutional clients place bets on the energy industry.[11] Bonds from 111 energy sector companies traded below eighty cents on the dollar in 2015, compared with only six in mid-2014, and ninety-one U.S.-based energy companies with market

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1. Patrick Gillespie, *Dow closes worst year since 2008*, CNN MONEY (Dec. 31, 2015, 4:46 PM), http://money.cnn.com/2015/12/31/investing/stocks-market-end-of-2015/.

2. *Id.*

3. *Id.*

4. *Id.*

5. Bob Bryan, *2015 was brutal for oil stocks, and one industry guru thinks 2016 might be even worse*, BUS. INSIDER (Jan. 6, 2016, 4:48 PM), http://www.businessinsider.com/2015-putrid-year-for-energy-2016-worse-2016-1.

6. Gillespie, *supra* note 1.

7. *Id.*

8. Bryan, *supra* note 5 (quoting Oppenheimer analysts Fadel Gheit and Luis Amadeo).

9. Matt Wirz, *Energy Sector Draws Investors in Distressed Securities*, WALL STREET J. (Feb. 12, 2015, 10:50 PM), https://www.wsj.com/articles/energy-sector-draws-investors-in-distressed-securities-1423789494.

10. *Id.*

11. *Id.*

capitalizations exceeding $100 million lost more than half of their stock market value.[12] Despite these dire statistics, distressed debt investors—investors that purchase the stocks and bonds of troubled companies cheap and seek profits through either rebounds in fortune or by placing their troubled company into bankruptcy—saw opportunity.[13]

Houston-based oil exploration, development, and production company Shoreline Energy (Shoreline) was one of those troubled companies.[14] Strapped for cash, Shoreline negotiated 30% discounts with its drilling and well completion service partners.[15] Shoreline possessed assets and debts of $100 to $500 million, and creditors numbering upwards of 10,000.[16] On November 2, 2016, Shoreline, along with seven affiliated companies, voluntarily filed for reorganization under Chapter 11 of the Bankruptcy Code in the United States Bankruptcy Court for the Southern District of Texas.[17] As part of its bankruptcy filing, Shoreline (1) continued as possessor of its property and manager of its business as debtor-in-possession; (2) obtained a DIP lender; [18] and (3) petitioned the court to establish a sales procedure for its assets and to approve an asset sale agreement.[19]

CRG Financial LLC (CRG), a distressed debt investor that purchases debt from creditors of troubled companies, was one of Shoreline's creditors.[20] CRG purchased a prepetition secured and properly perfected claim from Eagle Energy Services, one of Shoreline's service providers and creditors.[21] As part of Shoreline's

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12. *Id.*

13. *Id.*

14. Joshua Mann, *Houston energy co. files Chapter 11 bankruptcy*, HOUS. BUS. J. (Nov. 9, 2016, 2:45 PM), http://www.bizjournals.com/houston/news/2016/11/09/houston-energy-co-files-chapter-11-bankruptcy.html.

15. *See* Billy Gunn, *Louisiana oil and gas industry grappling with $49-a-barrel oil: 'The only certainty is uncertainty'*, ACADANIA ADVOC. (Mar. 13, 2015, 8:57 AM), http://www.theadvocate.com/acadiana/news/article_901a0c02-0609-52a7-b922-937909d52d35.html.

16. Mann, *supra* note 14.

17. *See id.*

18. DIP stands for Debtor-in-Possession. A DIP lender provides financing during restructuring to companies in financial distress so they can continue operating during bankruptcy. *See* Marshall S. Huebner, *Debtor-in-Possession Financing* RMA J., Apr. 2005, at 30, 30 https://www.davispolk.com/files/files/Publication/48334111-be66-424d-917b-368894b495cf/Preview/PublicationAttachment/acd1d2f6-4351-4874-bd30-3d2f4d2b5056/huebner.dip.article.2005.revised.pdf.

19. CRG Financial LLC's Limited Objection to Debtors' Motion (Relates to Doc No. 100) at 1–4, *In re* Shoreline Energy LLC, No. 16-35571 (Bankr. S.D. Tex. Dec. 12, 2016), 2016 WL 8118413, ECF No. 155 [hereinafter CRG Objection Motion].

20. *About CRG Financial*, CRG FINANCIAL, https://www.crgfinancial.com/about-crg/ (last visited Nov. 7, 2018).

21. CRG Objection Motion, *supra* note 19, at 3.

asset sale agreement, the DIP lender, Morgan Stanley Energy Capital Inc.,[22] would have been able to credit bid an amount equal to its DIP obligation in connection with the sale of any or all of the debtor's assets or properties, without limitation.[23]

CRG filed an objection to Shoreline's petition, asserting that *cause* existed to limit the DIP lender's ability to credit bid on all or substantially all of the debtor's assets.[24] The court agreed with CRG, finding that the DIP lender could only credit bid if it provided assurances that its claim was valid and would be prohibited from credit bidding the full face value of its claim if it was subsequently determined the validity, rank, or priority of its lien was incorrect.[25]

Once viewed as an absolute right for creditors,[26] the court decisions in *In re Fisker* and *In re Free Lance-Star* that placed limits on credit bidding like *Shoreline* have created uncertainty around the practice of credit bidding.[27] This comment examines credit bidding and when a court will likely restrict for cause a secured creditor's right to credit bid during a bankruptcy auction proceeding. Part II of this comment discusses Section 363 of the Bankruptcy Code, and the legislative history and procedures behind bankruptcy asset sales. Part III of this comment discusses the legislative history of credit bidding, the structure of credit bidding, and the policies in favor of granting secured creditors the right to credit bid. Part IV of this comment examines for cause limitations to credit bidding before *In re Fisker* and *In re Free Lance-Star*, these two decisions, and limitations on credit bidding for cause after they were decided. Part V of this comment discusses how a secured creditor can prevent having its ability to credit bid reduced for cause. This comment concludes by summarizing the discussion of Section 363, credit bidding, and for cause limitations to credit bidding.

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22. Interim Order Pursuant to 11 U.S.C. §§ 105, 361, 362, 363(c), 363(d), 364, and 507 and Bankruptcy Rules 2002, 4001 and 9014 at 3, *In re* Shoreline Energy LLC, No. 16-35571 (Bankr. S.D. Tex. Nov. 7, 2016) ECF No. 57 [hereinafter Shoreline Interim Order].

23. CRG Objection Motion, *supra* note 19, at 3.

24. Shoreline Interim Order, *supra* note 22, at 3–5.

25. Order (I) Authorizing (A) Sale of Assets Free and Clear of All Liens, Claims, Encumbrances and Interests and (B) The Debtors' Assumption and Assignment of Certain Executory Contracts and Unexpired Leases; and (II) Granting Related Relief at 34–36, *In re* Shoreline Energy, No. 16-35571 (Bankr. S.D. Tex. Feb. 24, 2017), ECF No. 512.

26. *See* RadLAX Gateway Hotel, LLC v. Amalgamated Bank, 566 U.S. 639, 649 (2012).

27. *See In re* Free Lance-Star Publ'g Co., 512 B.R. 798, 807 (Bankr. E.D. Va. 2014); *In re* Fisker Auto. Holdings, Inc., 510 B.R. 55, 61 (Bankr. D. Del. 2014).

II. SECTION 363 OF THE BANKRUPTCY CODE

A. The Legislative History of Pre-Confirmation Asset Sales

In order to understand credit bidding, one must first look at 11 U.S.C. § 363. Section 363 was enacted by Congress in The Bankruptcy Reform Act of 1978 (1978 Act) to promote fairness and equity during reorganization.[28] Congress achieved these goals by permitting bankruptcy estates to conserve value by selling their assets to obtain cash during extended corporate insolvencies.[29] While Section 363 was enacted in 1978,[30] the process permitting bankruptcy judges to authorize the sale of assets during a bankruptcy proceeding existed well before the 1978 Act.[31] Section 25 of the Bankruptcy Act of 1867 (1867 Act) was Congress's first effort to authorize the sale of a debtor's property outside a plan of reorganization.[32] Under Section 25 of the 1867 Act, a court could order the immediate sale of the debtor's property if it was "perishable in nature, or liable to deteriorate in value" prior to the final liquidation of the bankruptcy estate.[33]

In 1898 Congress passed the Bankruptcy Act of 1898 (1898 Act) which established a uniform bankruptcy system and aimed to facilitate the equitable and efficient administration and distribution of a debtor's property to creditors.[34] While the 1898 Act was silent on pre-confirmation sales of a debtor's property,[35] the Supreme Court adopted a provision similar to section 25 of the 1867 Act that permitted courts to order the sale of assets prior to the confirmation of a bankruptcy plan.[36] This provision, General Order No. 18, maintained the 1867 Act's requirement that assets sold by the court must be perishable in nature or liable to deteriorate in value.[37] As a result, from 1898 through 1937, courts approved orders for pre-confirmation sales pursuant to General

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28. *See* Equity Sec. Holders v. Lionel Corp. (*In re* Lionel Corp.), 722 F.2d 1063, 1070 (2d Cir. 1983).

29. *See id.* at 1069–70.

30. *See generally* H.R. REP. NO. 95-595 (1978), *as reprinted in* 1978 U.S.C.C.A.N. 5963, 6301–03.

31. *See In re Lionel Corp.*, 722 F.2d at 1066.

32. Bankruptcy Act of 1867, ch. 176, § 25, 14 Stat. 517, 528–29 (1868).

33. *Id.*

34. Charles Jordan Tabb, *The History of the Bankruptcy Laws in the United States*, 3 AM. BANKR. INST. L. REV. 5, 25–27 (1995).

35. Douglas S. Mintz & Michael A. Stevens, *So You Want to Sell (Or Buy) A Company Under Section 363? Here's How*, BLOOMBERG LAW (Nov. 22, 2012), https://www.bloomberglaw.com/product/blaw/document/X1T6CL1O000000.

36. General Order in Bankruptcy No. XVIII, 89 F. viii (November 28, 1898).

37. *Id.*

Order No. 18 only if the bankruptcy estate's property was perishable.[38] For example, in *In re Pedlow*, the Court of Appeals for the Second Circuit applied General Order No. 18 to approve the sale of a bankrupt company's stock of handkerchiefs because the value of the handkerchiefs was expected to decline substantially if the sale was not executed immediately.[39] Although the Second Circuit recognized that handkerchiefs were not, strictly speaking, as perishable as a cargo of bananas, the court reasoned that by "perishable" General Order No. 18 meant "property which . . . will deteriorate in value" and that it left determining what was perishable "to the discretion of the court."[40]

In 1938, Congress enacted The Bankruptcy Act of 1938 (1938 Act), which was designed to amend the 1898 Act to embody the new socioeconomic conceptualization of reorganization and rehabilitation of the debtor and its business as a going concern, instead of just a liquidation.[41] "Going concern" refers to the assumption that a company can continue operations and make enough money to avoid another bankruptcy if it is properly reorganized.[42] The 1938 Act reworked the bankruptcy laws into "chapters," whereby Chapter X addressed corporate reorganizations and Chapter XI addressed "arrangements."[43] An arrangement is "any plan of a debtor for the settlement, satisfaction, or extension of the time of payment of [its] unsecured debts, upon any terms proposed by the debtor before or after adjudication of the bankruptcy."[44] Section 116(3) of the 1938 Act, which was an immediate predecessor to Section 363, stated that upon approval of a petition, a judge may, upon notice and a showing of cause, authorize a receiver, trustee, or debtor in possession to lease or sell any portion of the debtor's property.[45] Section 116(3) of the 1938 Act applied to Chapter X proceedings;

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38. *See* Equity Sec. Holders v. Lionel Corp. (*In re* Lionel Corp.)., 722 F.2d 1063, 1067 (2d Cir. 1983).

39. *See In re* Pedlow, 209 F. 841, 842 (2d Cir. 1913).

40. *Id.*

41. Herman M. Knoeller, *Reorganization Procedure Under the New Chandler Act*, 24 MARQ. L. REV. 12, 12 (1939).

42. Definition of Going Concern in the Dictionary Section, *What Does 'Going Concern' Mean*, INVESTOPEDIA, https://www.investopedia.com/terms/g/goingconcern.asp (last visited Nov. 7, 2018).

43. Fed. Judicial Ctr., *The Evolution of U.S. Bankruptcy Law: a time line*, U.S. BANKR. CT. DISTRICT OF R.I., http://www.rib.uscourts.gov/newhome/docs/the_evelution_of_bankruptcy_law.pdf (last visited Nov. 8, 2018).

44. JOHN V. TERRY, DICTIONARY FOR BUSINESS & FINANCE 16 (3d ed. 1995) (defining "arrangement").

45. Equity Sec. Holders v. Lionel Corp. (*In re* Lionel Corp.), 722 F.2d 1063, 1067 (2d Cir. 1983); Chandler Act of 1938, ch. 575, § 116(3), 52 Stat. 840, 884–85.

while a similar provision, Section 312(2), applied to Chapter XI cases.[46] Since both of these sections were similar, when the 1978 Act was codified, the power of the court to sell a debtor's property prior to adjudication was extended to cover both reorganizations with a debtor in possession and bankruptcies with a trustee in control of the debtor's property.[47]

While Section 116(3) of the 1938 Act included the clause "upon cause shown" that was initially interpreted to mean perishability,[48] as case law developed this "perishability" requirement for pre-confirmation sales became the exception and not the rule.[49] In 1978, Congress passed the 1978 Act, which aimed to clarify, simplify, and modernize previous law and consolidated Chapter VII (railroad reorganizations), Chapter X, Chapter XI, and Chapter XII (real property arrangements) of the 1938 Act into a single reorganization chapter under Chapter 11.[50] Today, Section 363 is increasingly used by over-levered distressed companies looking for a source of liquidity.[51] While only 13% of all large, public bankruptcies involved asset sales between 1996 and 2000, between 2001 and 2010 that figure rose sharply to nearly 30% and peaked in 2015 with 47% of all large public company bankruptcies employing some form of asset sale.[52] As a result,

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46. *See In re Lionel Corp.*, 722 F.2d at 1067.

47. *Id.*

48. *See In re* Pure Penn Petroleum Co., 188 F.2d 851, 854 (2d Cir. 1951) (recognizing that "upon cause shown" should be interpreted to limit pre-confirmation sales to an emergency exception standard).

49. *See, e.g.*, Int'l Bank of Miami v. Brock (*In re* Dania Corp.), 400 F.2d 833, 836–37 (5th Cir. 1968) (rejecting the emergency exception standard and holding that a pre-confirmation sale may be authorized if it generates substantial equity for the debtor); Marathon Foundry & Mach. Co. v. Schwartz (*In re* Marathon Foundry & Mach. Co.), 228 F.2d 594, 597–99 (7th Cir. 1955) (upholding the sale of stock in order to secure a loan prior to reorganization); Flynn v. Brewery Mgmt. Corp. (*In re* V. Loewer's Gambrinus Brewery Co.), 141 F.2d 747, 748–50 (2d Cir. 1944) (upholding an order to sell vats, kettles brewing equipment, and virtually all of the debtor's income-producing assets prior to confirmation of reorganization); Frank v. Drinc-O-Matic, Inc., 136 F.2d 906, 906 (2d Cir. 1943) (upholding the sale of a debtor's nineteen vending machines by a trustee prior to confirmation of a reorganization).

50. Don J. Miner, *Business Reorganization Under the Bankruptcy Reform Act of 1978: An Analysis of Chapter 11*, 1979 BYU L. REV. 961, 961 (1979).

51. *See* Alla Raykin, Comment, *Section 363 Sales: Mooting Due Process*, 29 EMORY BANKR. DEV. J. 91, 92 (2012).

52. *See 363 Sales of All or Substantially All Assets in Large, Public Company Bankruptcies, as a Percentage of all Cases Disposed, by Year of Case Disposition*, UCLA-LOPUCKI BANKR. RES. DATABASE, http://lopucki.law.ucla.edu/tables_and_graphs/363_sale_percentage.pdf (last visited Oct. 22, 2018). A "large public company" is defined as a company whose "Annual Report reported assets worth $100 million or more, measured in 1980 dollars (about $297 million in current dollars)." *A window on the world of big-case bankruptcy*, UCLA-LOPUCKI BANKR. RES. DATABASE, http://lopucki.law.ucla.edu/ (last visited Oct. 24, 2018).

Section 363 has become a prominent feature of our Bankruptcy Code.

B. The Structure of Section 363

So, what is Section 363? Section 363(b)(1) of the Bankruptcy Code permits bankruptcy trustees and debtors-in-possession (DIPs), after notice and a hearing, to use, sell, or lease all or substantially all of the bankruptcy estate's property outside its ordinary course of business, prior to the confirmation of the debtor's reorganization or liquidation plan.[53] While Section 363 applies to both liquidations and reorganizations, Section 363(b) is typically invoked to either fund a reorganization plan or allow a Chapter 11 debtor that is strapped for cash to continue its operations through bankruptcy.[54] The primary policy goal behind permitting Section 363 sales is to achieve greater value for a debtor's creditors and shareholders by means of preserving the going-concern value of the business.[55] For example, by allowing debtors to complete transactions prior to the confirmation of a

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53. *See* 11 U.S.C.A. § 363(b)(1) (Westlaw through Pub. L. No. 115-232). Although Section 363 does not use the term "all or substantially all," courts widely construe Section 363 as permitting the sale of all or substantially all of a bankruptcy estate's property. The phrase "all or substantially all" in the context of Section 363 sales first appeared when the U.S. Bankruptcy Court for the District of Massachusetts cited to 11 U.S.C. § 1123(b)(4) affirming a trustee's ability to sell "substantially all" of the debtor's property in a Section 363 sale. *In re* WHET, Inc., 12 B.R. 743, 750 (Bankr. D. Mass. 1981). Following *In re WHET, Inc.*, the U.S. Bankruptcy Court for the Northern District of Ohio rejected this interpretation for Section 363, holding that Congress deliberately removed the term "all or substantially all" from an earlier bill for Section 363(b) when codifying the finalized statute. *In re* White Motor Credit Corp., 14 B.R. 584, 590 (Bankr. N.D. Ohio 1981). Despite this, several courts adopted the holding of *In re WHET, Inc.* and found that Section 363 permitted the sale of "all or substantially all" of a bankruptcy estate's property outside the ordinary course of business. *See In re* Ancor Expl. Co., 30 B.R. 802, 806–08 (N.D. Okla. 1983); *see also In re* Brookfield Clothes, Inc., 31 B.R. 978, 984 n.9 (S.D.N.Y. 1983) (citing *In re White Motor Credit Corp.*, but still finding that Section 363 permitted the sale of substantially all of a bankruptcy estate's property by a debtor-in-possession). In *In re Lionel Corp.*, the U.S. Court of Appeals for the Second Circuit acknowledged in a footnote that the Commission on the Bankruptcy Laws recommended during hearings for the 1978 Act that Section 363(b) permit the sale of "all or substantially all" of a bankruptcy estate's property. Equity Sec. Holders v. Lionel Corp. (*In re* Lionel Corp.), 722 F.2d 1063, 1069 n.3 (2d Cir. 1983). In doing so, it rejected the logic employed by the court in *In re White Motor Credit Corp.* and found that Section 363(b) does permit the sale of "all or substantially all" of a bankruptcy estate's property. *Id.* Since *In re Lionel Corp.*, courts have frequently recognized that Section 363 authorizes the sale of "all or substantially all" of a bankruptcy estate's property. Scott D. Cousins, *Chapter 11 Asset Sales*, 27 DEL. J. CORP. L. 835, 838–39 (2002).

54. Matthew P. Goren, *Chip Away at the Stone: The Validity of Pre-Bankruptcy Clauses Contracting Around Section 363 of the Bankruptcy Code*, 51 N.Y.L. SCH. L. REV. 1077, 1082 (2006–2007).

55. H.R. REP. NO. 95-595, at 220 (1978), *as reprinted in* 1978 U.S.C.C.A.N. 5963, 6179.

Chapter 11 reorganization plan, Section 363 sales enable debtors to dispose of rapidly depreciating assets and create the liquidity needed to continue their ordinary business operations through bankruptcy.[56]

Section 363 is divided into several different sections which outline the procedures for using, selling, or leasing assets prior to confirmation.[57] Section 363(b) outlines the mechanisms distressed companies may use to sell assets "outside the ordinary course of business."[58] Sales of assets are considered "outside the ordinary course of business" if they are either dissimilar to the sales that the debtor would typically engage in as part of its ordinary day-to-day operations or different from the types of transactions the debtor typically engaged in prior to seeking bankruptcy protection.[59] In order to sell property in compliance with Section 363(b), the debtor must provide adequate notice to the court.[60] Adequate notice is established when the debtor provides all relevant parties with information on "(1) the nature of the claims being sold under the Sale Motion, (2) how to participate in the bidding process, if interested, and (3) the date by which any objections should be filed and served."[61] Prior to filing a sale motion, the debtor must identify a prospective purchaser, known as a "stalking horse," of the property and have the stalking horse enter into a conditional asset purchasing agreement for the property with the debtor.[62] As part of the debtor's motion, the court will typically specify the bidding procedures for the auction, in the event other parties are interested in the property, and will set the floor bid for the action as the stalking horse's initial bid.[63] If the stalking horse is unsuccessful at auction, typically it is awarded a "break-up fee."[64] "A 'break-up fee' is a deal-protection mechanism . . . that is designed to compensate an initial bidder in an auction

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56. Raykin, *supra* note 51, at 94.

57. 11 U.S.C.A. § 363 (Westlaw).

58. Jason Brege, *An Efficiency Model of Section 363(b) Sales*, 92 VA. L. REV. 1639, 1640 (2006).

59. Cass S. Weil, *Section 363 of the Bankruptcy Code – A Tool for Buying and Selling Financially Distressed Assets*, MOSS & BARNETT FIRM NEWSL. (Moss & Barnett, Minneapolis, Minn.) Fall 2013, at 1.

60. Joseph S. Bolnick, *Revisiting Clear Channel – Acquiring Real Property in a Section 363 Bankruptcy Sale "Free and Clear" of Liens*, 20 AM. BANKR. INST. L. REV. 517, 518 (2012).

61. *In re* Nicole Energy Servs., Inc., 385 B.R. 201, 234 (Bankr. S.D. Ohio 2008).

62. Weil, *supra* note 59, at 9.

63. *Id.* at 10.

64. *See* Timothy E. Graulich & Brian M. Resnick, *Breaking Up (and Getting Paid) Is Hard to Do*, AM. BANKR. INST. J., May 2010, at 30.

for its efforts in connection with the transaction and induce the stalking horse to make the first bid."[65]

Section 363(c) permits distressed companies to make certain types of sales that arise during their ordinary course of business, provided those sales are made in the interest of preserving company operations.[66] Section 363(c) sales may be made with or without the court's approval,[67] and typically involve transactions similar to the sale of inventory by a retailer made in order to keep its business alive during the bankruptcy period.[68] The purpose behind not requiring court approval of Section 363(c) sales is to allow businesses to continue their daily operations without incurring the burden of having to obtain court approval or provide creditors notifications for every routine transaction.[69] Because transactions made during the ordinary course of business should already be getting the highest price available and are less likely to subject creditors to risk, it makes little sense to impose additional costs on the debtor and require judicial intervention.[70]

Under Section 363(f), a debtor's assets may be sold "free and clear" of any liens, encumbrances, or prepetition interests on the title.[71] In order to be sold free and clear, the moving party must establish that at least one of the five prerequisites outlined in Section 363(f) is met.[72] The most common grounds for satisfying Section 363(f) are that "(1) the other party consents to the sale, (2) the other party holds a lien and the purchase price is greater than the aggregate value of all liens on the property, or (3) the interest is in bona fide dispute."[73] However, courts may also sell assets "free and clear" if (4) an applicable nonbankruptcy law permits the sale or (5) the creditor could be compelled to accept the payment for its interest in a legal or equitable proceeding.[74]

Section 363(m) protects purchasers of property sold pursuant to Section 363 by stating that "no assets can be taken back from a good faith purchaser, regardless of other equitable concerns."[75]

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65. *Id.*

66. Brege, *supra* note 58, at 1639–40.

67. 11 U.S.C.A. § 363(c)(1) (Westlaw through Pub. L. No. 115-231).

68. Brege, *supra* note 58, at 1639–40.

69. Lopa v. Selgar Realty Corp. (*In re* Selgar Realty Corp.), 85 B.R. 235, 240 (Bankr. E.D.N.Y. 1988).

70. Peter J. Davis, *Settlements as Sales under the Bankruptcy Code*, 78 U. CHI. L. REV. 999, 1004 (2011).

71. 11 U.S.C.A. § 363(f) (Westlaw).

72. *Id.*

73. Joseph J. Bellinger, *Sale of Company in Bankruptcy: What Every Purchaser and Creditor Should Know*, 40 MD. B.J. 54, 55 (2007).

74. 11 U.S.C.A. § 363(f) (Westlaw).

75. Raykin, *supra* note 51, at 102.

Section 363(m) states that "the reversal or modification on appeal of an authorization under [Section 363] . . . of a sale or lease of property does not affect the validity of a sale or lease under such authorization" to a "good faith" purchaser, "unless . . . [the authorization and] sale or lease were stayed pending approval."[76] This provision furthers the bankruptcy law's goal of finality and makes appeals not based on the good faith of the buyer statutorily moot.[77]

To object to a Section 363 asset sale, the objecting party must file its objections at least seven days before the court hears the sale motion.[78] An objection may be based on the purchase price being suboptimal, Section 363(e), Section 363(n), or on the sale constituting a "sub rosa" plan.[79] Section 363(e) seeks to provide holders of an interest in the property being sold adequate protection,[80] and states that the court "shall prohibit or condition" the use, sale, or lease of the debtor's property "as is necessary to provide adequate protection [to] such interest."[81] Section 363(n) provides remedies for collusive bidding.[82] Collusive bidding occurs when a bidder secretly cooperates with other bidders to fraudulently reduce or control the sale price of property being sold at an asset sale.[83] If a party conducting an action under Section 363(n) is able to establish collusive bidding, courts may award either damages from the collusive bidders or allow the bankruptcy estate to avoid the sale altogether.[84] "Sub rosa" plans are Section 363 sales that do more than transfer assets and have the practical effect of dictating the terms of the reorganization.[85] Section 363(p) states that the debtor bears the burden of showing a Section 363 sale should be authorized;[86] however, courts rarely refuse to authorize a sale.[87] Section 363(o) seeks to ensure that the consumer protection laws of the Truth in Lending Act remain in

76. 11 U.S.C.A. § 363(m) (Westlaw).

77. *See* Raykin, *supra* note 51, at 102–03.

78. FED. R. BANKR. P. 6004(b).

79. Raykin, *supra* note 51, at 100.

80. *See In re* Haskell L.P., 321 B.R. 1, 6 (Bankr. D. Mass. 2005).

81. 11 U.S.C.A. § 363(e) (Westlaw).

82. *Id.* § 363(n).

83. N.Y. Trap Rock Corp. v. Compania Naviera Perez Companc (*In re* N.Y. Trap Rock Corp.), 42 F.3d 747, 752 (2d Cir. 1994).

84. *In re* Am. Paper Mills, Inc., 322 B.R. 84, 88–89 (Bankr. D. Vt. 2004).

85. Pension Benefit Guaranty Corp., v. Braniff Airways, Inc. (*In re* Braniff Airways, Inc.), 700 F.2d 935, 939–40 (5th Cir. 1983).

86. 11 U.S.C.A § 363(p) (Westlaw).

87. *See* Raykin, *supra* note 51, at 98–99.

place during a Section 363 sale of consumer loan portfolios.[88] Finally, Section 363(k) grants secured creditors the right to credit bid.[89]

III. SECTION 363(K) CREDIT BIDDING

A. The Legislative History of Credit Bidding

Unlike asset sales, credit bidding was not explicitly authorized by Congress under either the 1867 Act or the 1898 Act.[90] While the 1867 Act and 1898 Act did not explicitly authorize credit bidding, Section 57(h) of the 1898 Act did have a provision that provided for the valuation of security interests and stated that the value of collateral "shall be determined by converting the same into money according to the terms of the agreement[.]"[91] Under this section, secured creditors could, by agreement, petition the court to value their collateral, pledge that collateral to the bankruptcy estate, and receive a dividend for it in return for deducting the dividend amount from their provable claim against the estate.[92] In 1934, Congress passed the Frazier-Lemke Act, which added subsection (s) to Section 75 of the 1898 Act.[93] Section 75(s) provided, among other things, that farmers, upon being adjudged bankrupt, could acquire alternative options with respect to their mortgaged property.[94] The alternative options included either purchasing the property for its then-appraised value or paying a reasonable rental amount annually to the secured creditor in return for having the bankruptcy court stay the bankruptcy proceeding for a period of five years.[95] When examining the constitutionality of this section and how it affected secured creditors, the Supreme Court recognized that absent procedures ensuring just compensation and due process of law, secured creditors have a right to bid up to the value of their

88. John J. Monaghan & Diane N. Rallis, *Bankruptcy Practice in Massachusetts Chapter 11: Sale and Lease of Property*, Mass. Continuing Legal Educ. Inc., §§ 11.1, 11.2.1(b) (2014).

89. *See* 11 U.S.C.A. § 363(k) (Westlaw).

90. *See* Bankruptcy Uniform System Act of 1898, ch. 541, 30 Stat. 554; Act to Establish a Uniform Bankruptcy System of 1867, ch. 176, 14 Stat. 517.

91. Bankruptcy Uniform System Act of 1898, § 57(h), 30 Stat. at 560.

92. *See In re* Nat'l Pub. Serv. Corp., 88 F.2d 19, 20 (2d Cir. 1937).

93. Frazier-Lemke Act, ch. 869, 48 Stat. 1289 (1934).

94. Louisville Joint Stock Land Bank v. Radford, 295 U.S. 555, 575 (1935).

95. *Id.* at 575–76.

mortgage in the context of sales of distressed property.[96] Thus, Section 75(s) of the 1898 Act constituted an impermissible taking of a secured creditor's property under the Due Process Clause of the Fifth Amendment.[97]

Following the Supreme Court's decision, Congress enacted a revised Section 75(s) to protect secured creditors that held mortgages on farm property.[98] When examining the constitutionality of this revised Act, the Supreme Court noted that the Act's provisions did not deprive creditors of any substantive right.[99] While the Act limited creditor's abilities to determine when such sale would take place and control property during periods of default, the Act was found to not impair their ability to retain liens until the indebtedness was paid, realize repayment by the sale, and protect their interest in the property.[100] As a result, the Supreme Court held that Congress's revised Section 75(s) did not violate the Fifth Amendment.[101] While Congress further amended the Bankruptcy Act in 1938, Congress did not codify a section specifically granting secured creditors the right to credit bid.[102] Rather, Congress chose to amend Section 57(h) of the 1898 Act to allow secured creditors to rely on their contractual relationships with the debtor and use applicable nonbankruptcy law to govern this process.[103] Secured creditors could seek a valuation of their secured interests and receive a dividend in that amount.[104]

In 1978, Congress finally explicitly recognized credit bidding.[105] The 1978 Act, which represented a full-scale reform of the federal bankruptcy system, contained Section 363(k).[106] Section 363(k) codified a secured creditor's right to credit bid in asset sales outside a plan of reorganization.[107] In addition to Section 363(k), Congress also added Section 1129(b)(2)(A)(ii) as part of the "cramdown" provisions of a bankruptcy plan.[108] Section 1129(b)(2)(A)(ii) provides for "credit bidding as a way to cram down

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96. Riley Orloff, Note, *Chapter 11 Asset Sales: Will There Be A Chilling Effect on Section 363(k) Credit Bidding After in Re Fisker Automotive Holdings LLC?*, 20 FORDHAM J. CORP. & FIN. L. 269, 273–74 (2014).

97. *Id.*

98. Act of Aug. 28, 1935, ch. 792, sec. 6, § 75, 49 Stat. 942, 943 (1935).

99. Wright v. Vinton Branch of the Mountain Tr. Bank, 300 U.S. 440, 457–470 (1937).

100. *Id.* at 457–59.

101. *Id.* at 470.

102. Orloff, *supra* note 96, at 274.

103. *Id.*

104. Chandler Act, ch. 575, § 57(h), 52 Stat. 840, 866 (1938).

105. Orloff, *supra* note 96, at 275.

106. *Id.*

107. *Id.*

108. *Id.*

a dissenting creditor and confirm a Chapter 11 plan."[109] When enacting these sections, Congress cited to Section 75 of the 1938 Act, which provided for the rights of secured creditors in farm mortgage bankruptcies, and Section 57(h) from the 1898 Act.[110] Section 363(k) and Section 1129 were enacted in response to a number of well-publicized bankruptcy cases in which the rights of secured creditors were negatively affected by less than favorable court valuations, and value was diverted to junior creditor interests.[111] By specifically authorizing creditors that have an interest in property to bid the face value of that interest at the time of the sale of the property, credit bidding aims to provide secured creditors adequate protection over their property interests during a bankruptcy asset sale.[112] In 1984, Congress made further revisions to credit bidding.[113] While Section 363(k) originally did not facially permit courts to limit a creditor's right to credit bid,[114] in 1984 Congress amended Section 363(k) to add a "for cause" limitation that afforded courts the ability to restrict credit bidding.[115] This was done to foster a competitive bidding environment and to prevent chilling of the bidding process.[116]

B. The Structure of Credit Bidding

Section 363(k) of the Bankruptcy Code empowers secured creditors to use up to the full face value of the debt owed to them by the debtor as currency in bankruptcy auctions of the collateral against which they hold claims.[117] Section 363(k) 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

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109. *Id.*

110. *See Bankruptcy Act Revision: Hearing on H.R. 31 and H.R. 32 Before the Subcomm. on Civil and Constitutional Rights of the House Comm. on the Judiciary*, 94th Cong., at 397, 466–67, 519–22 (1975) (discussing reports submitted for Agricultural Extensions in Bankruptcy, Amend the Bankruptcy Act, Amend the Bankruptcy Act (Agricultural Compositions)) (noting *In re* Chicago, Rock Island & Pac. Ry., 294 U.S. 648 (1935) interprets Section 57(h)).

111. *Bankruptcy Reform Act of 1978: Hearing on S. 2266 and H.R. 8200 Before the Subcomm. on Improvements in Judicial Machinery, of the Comm. on the Judiciary U.S. S.*, 95th Cong., at 577 (1977).

112. *Id.* at 618 (Supplemental Statement of the Commercial Law League of America with Respect to S. 2266); *id.* at 712 (Prepared Statement of Edward J. Kulik); *id.* at 717 (Memorandum of the National Association of Real Estate Investment Trusts).

113. *See* Bankruptcy Amendments and Federal Judgeship Act, sec. 442, § 363(k), 98 Stat. 333 (1984).

114. *But see* 11 U.S.C.A. § 363(k) (Westlaw through Pub. L. No. 115-231).

115. Bankruptcy Amendments and Federal Judgeship Act § 363(k).

116. *Cf.* 3 COLLIER ON BANKRUPTCY ¶ 363.09; 11 U.S.C.A. § 363(k) (Westlaw).

117. 11 U.S.C.A. § 363(k) (Westlaw).

> may bid at such sale, and, if the holder of such claim purchases such property, such holder may offset such claim against the purchase price of such property.[118]

Under Section 363(k), secured creditors who successfully bid on the property may offset the purchase price by either the debt they hold or the value of their secured property.[119] Secured creditors can acquire property on a dollar-for-dollar basis without having to finance the transaction.[120] By enabling secured creditors to use the debt they are owed as currency, credit bidding allows secured creditors to purchase their collateral for what they consider to be the fair market price and to protect against having their collateral undervalued without having to expend capital.[121]

Section 363(k) only applies to secured debt holders.[122] Generally, a secured creditor's right to credit bid only extends to the collateral that is secured by its lien and does not extend to other assets.[123] If a secured creditor wishes to credit bid on property that consists of both collateral and non-collateral assets, the creditor may be able to allocate value between these assets and provide separate consideration for each asset.[124] Situations where separate consideration may be required include bidding on foreign non-debtor subsidiaries, assets that cannot be attached by liens,

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118. *Id.*

119. *See id.*

120. CREDIT BIDDING IN SECTION 363 BANKRUPTCY SALES, PRACTICAL LAW PRACTICE NOTE 7-500-4339 (2018), 2013 WL 4864228 [hereinafter PRACTICE NOTES ON CREDIT BIDDING].

121. *See* RadLAX Gateway Hotel, LLC v. Amalgamated Bank, 566 U.S. 639, 644 n.2 (2012).

122. *See* 11 U.S.C.A. § 363(k) (Westlaw) (section 363(k) only applies to holders of valid and properly perfected claims that are deemed allowed by the court). An adversary proceeding that applies state law to the claim is used to determine validity. HON. DOMINIC R. MASSARO & F. PAUL VELLANO, JR., § 5:125. SECURED CLAIMS—VALIDITY AND EXTENT OF LIEN, N.Y. PRAC., ENFORCING JUDGMENTS AND COLLECTING DEBTS, Westlaw (database update Dec. 2017). A claim is considered perfected if the creditor properly filed its claim and established priority over other creditors. *Security Interest*, BLACK'S LAW DICTIONARY (10th ed. 2014). A claim is considered allowed if it complies with 11 U.S.C § 502. *In re* CS Mining LLC, 574 B.R. 259, 285 (Bankr. D. Utah. 2017). Section 502 states that a claim is allowed if (1) proof of such claim has been filed and there are no pending objections to its validity, or (2) or if the debtor files the claim with the bankruptcy court in its schedule of liability as undisputed, non-contingent, or liquidated. 11 U.S.C.A. § 502 (Westlaw through Pub. L. 115-231); Fed. R. Bankr. P. 3003. A claim can be challenged by a person who has standing to be heard by the court, known as a "party-in-interest," and if a party-in-interest successfully challenges the secured creditor's claim, the claim can no longer be used to bid on the debtor's property. PRACTICE NOTES ON CREDIT BIDDING, *supra* note 120; *Party in Interest (Bankruptcy) Law and Legal Definition*, USLEGAL, https://definitions.uslegal.com/p/party-in-interest-bankruptcy/ (last visited Oct. 7, 2018).

123. *See* SubMicron Sys. Corp. v. KB Mezzanine Fund II, LP (*In re* SubMicron Sys. Corp.), 432 F.3d 448, 451 (3d Cir. 2006).

124. PRACTICE NOTES ON CREDIT BIDDING, *supra* note 120.

or government licenses.[125] When credit bidding, secured creditors are empowered to "bid the total face value of their claims."[126] A secured creditor's ability to credit bid is not limited to the economic value of their collateral and thus secured creditors can utilize both the secured and under-secured portion of their claim to bid on property at a bankruptcy auction.[127]

While empowered to bid the total face value of their claim, secured creditors may still elect to either bid the total face value or less than the total face value of their claim during a sale of their collateral.[128] If the secured creditor bids less than its claim and is successful, the creditor will hold a deficiency claim, which is the difference between the sale price and the amount owed on the lien.[129] If the creditor has no remaining secured collateral, the deficiency claim is treated as a nonrecourse unsecured loan and the creditor will share in a pro rata distribution made to other nonpriority unsecured creditors.[130] In the event collateral is secured by both a junior and senior lender, the junior lender cannot credit bid unless it pays cash to the senior creditor to remove the superior lien.[131]

The right to credit bid extends beyond pre-confirmation asset sales. Under Section 1129(b)(2)(A), a plan for reorganization may be confirmed against the objection of a class of secured claims if it meets one of the three requirements for being fair and equitable to the nonconsenting creditor: (i) the secured creditor retains its lien on the property and receives deferred cash payments equal to at least the value of its claim as of the effective date of the plan; (ii) for property sold free and clear of the lien, the secured creditor is given the opportunity to credit bid under Section 363(k), and the creditor receives a lien on the proceeds of the sale; or (iii) the secured creditor receives the "indubitable equivalent" of its secured claim.[132] Under both Section 363(k) and Section 1129(b)(2)(A)(ii), courts have the power to limit a secured creditor's

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125. *Id.*

126. *In re* SubMicron Sys. Corp., 432 F.3d at 459; RadLAX Gateway Hotel, LLC, 566 U.S. at 644 n.2 ("[Section 363(k)] enables the creditor to purchase the collateral for . . . up to the amount of its security interest.").

127. *In re SubMicron Sys. Corp.*, 432 F.3d at 459–61.

128. *See* Home & Hearth Plano Parkway, L.P. v. LaSalle Bank, N.A. (*In re* Home & Hearth Plano Parkway, L.P.), 320 B.R. 596, 606 (Bankr. N.D. Tex. 2004).

129. *Id.*

130. *See In re* Five Boroughs Mortg. Co., 176 B.R. 708, 712 (Bankr. E.D.N.Y. 1995).

131. PRACTICE NOTES ON CREDIT BIDDING, *supra* note 120.

132. RadLAX Gateway Hotel, LLC v. Amalgamated Bank, 566 U.S. 639, 643–44 (2012).

right to credit bid for cause.[133] Courts tasked with interpreting Section 363(k) have cited to cases that have involved Section 1129(b)(2)(A)(ii).[134]

C. *An Absolute Right to Credit Bid*

Prior to the Supreme Court's decision in *RadLAX Gateway Hotel, LLC v. Amalgamated Bank* that examined credit bidding under Section 1129(b)(2)(A),[135] there was a circuit split regarding the right to credit bid in connection with cramdown plans. In two circuits, the Third and the Fifth, courts found that secured creditors could be denied their right to credit bid under a confirmation plan under which the debtor's property would be sold free and clear of liens.[136] These circuits found that based on Section 1129(b)(2)(A)(iii), a debtor could exercise its cramdown powers to prohibit a secured creditor from credit bidding.[137] As a result, the secured creditor could be forced to accept the "indubitable equivalent" of its secured claim in a bankruptcy sale where the property would be sold free and clear of encumbrances.[138] Although these two courts' holdings were invalidated by the Supreme Court's decision in *RadLAX*,[139] it is nevertheless useful to examine them because they helped form the basis for the later bankruptcy court decisions *In re Fisker* and *In re Free Lance-Star* which examined the doctrine of "for cause" in the wake of *RadLAX*.[140]

1. *In re Pacific Lumber Co.*

In re Pacific Lumber Co. was the first of these two decisions to hold that a confirmation plan under Section 1129(b)(2) could be fair and equitable to an objecting class of secured creditors even if the secured creditor was not given the right to credit bid.[141] In *In*

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133. *See* Citizens Bank v. Official Comm. of Unsecured Creditors (*In re* Phila. Newspapers, LLC), 599 F.3d 298, 314–15 (3d Cir. 2010).

134. *See, e.g.*, *In re* Fisker Auto. Holdings, Inc., 510 B.R. 55, 59–60 (Bankr. D. Del. 2014); *In re* Free Lance-Star Publ'g Co., 512 B.R. 798, 805 (Bankr. E.D. Va. 2014) (citing *In re* Phila. Newspapers, LLC, 599 F.3d 298, 316 n.14 (3d Cir. 2010)).

135. *RadLAX Gateway Hotel*, 566 U.S. at 641.

136. *See In re Phila. Newspapers*, 599 F.3d at 318; Bank of N.Y. Trust Co., v. Official Unsecured Creditors' Comm. (*In re* Pac. Lumber Co.), 584 F.3d 229, 249 (5th Cir. 2009).

137. *See In re Phila. Newspapers*, 599 F.3d at 318.

138. *In re Phila. Newspapers*, 599 F.3d at 305–06; *In re Pac. Lumber Co.*, 584 F.3d at 245–46.

139. *RadLAX Gateway Hotel*, 566 U.S. at 647–49.

140. *See In re* Fisker Auto. Holdings, Inc., 510 B.R. 55, 59–60 (Bankr. D. Del. 2014); *In re* Free Lance-Star Publ'g Co., 512 B.R. 798, 805 (Bankr. E.D. Va. 2014) (citing to *In re* Phila. Newspapers, 599 F.3d at, 316 n.14).

141. *In re Pac. Lumber Co.*, 584 F.3d at 247–49.

re Pacific Lumber Co., the debtor filed for Chapter 11 bankruptcy protection and sought to sell timberland secured by a $740 million claim.[142] The court had previously valued the land as worth not more than $510 million, and the debtor proposed a plan where it would sell the property for $513.6 million in cash and distribute the proceeds to its allowed claimholders.[143] Following the proposal, the secured creditor voted to reject the plan and moved to enforce its right to credit bid.[144] The bankruptcy court allowed the plan and the debtor's secured creditors appealed, arguing that encumbered property could only be sold free and clear of liens if it complied with Section 1129(b)(2)(A)(ii).[145]

The court first acknowledged that the main requirement for a sale under Section 1129(b) is that the plan is fair and equitable, and that the secured creditor needed to demonstrate that Section 1129(b)(2)(A)(ii) was exclusively applicable to this transaction of the encumbered property.[146] While the debtor's plan constituted a sale of assets, the court found that since the three subsections of Section 1129(b)(2)(A) are joined by the word "or," they are alternatives and the debtors only needed to comply with one for the plan to be fair and equitable.[147] Additionally, the court determined that because Congress used the word "includes," Section 1129(b)(2)(A) is not an exhaustive list, and the three requirements listed in this section may not necessarily be fair and equitable.[148] The Fifth Circuit concluded that Section 1129(b)(2)(A) permits a court to confirm an asset sale yielding the indubitable equivalent of the creditor's claim and held that the secured creditor was not required to have the opportunity to credit bid.[149] *In re Pacific Lumber Co.* played a pivotal role in guiding the Third Circuit's decision in *In re Philadelphia Newspapers*, which similarly required the court to decide whether a confirmation plan under Section 1129(b)(2)(A) could prohibit credit bidding if it gave the secured creditor the indubitable equivalent of its claim.[150]

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142. *Id.* at 236–37.
143. *Id.* at 238–39.
144. *Id.*
145. *See id.*
146. *Id.* at 244–45.
147. *Id.* at 245–46.
148. *Id.*
149. *See id.* at 249 n.24.
150. *In re* Phila. Newspapers, LLC, 599 F.3d 298, 304–05, 309–11, 316–17 (3d Cir. 2010).

2. *In re Philadelphia Newspapers*

In re Philadelphia Newspapers concerned a debtor that purchased three news publications for $515 million, $295 million of which was financed through a secured loan.[151] Following the financial crisis of 2007–2008, the debtor's assets depreciated in value, the debtor defaulted on its loan covenants, and the debtor filed for Chapter 11 bankruptcy protection.[152] The debtor proposed a confirmation plan by which it would sell substantially all of its assets for $66.5 million, $37 million of which would be received by the lenders in cash and $29.5 million in real property, and the secured creditor would be precluded from credit bidding.[153] At the time of the proposed sale, the secured creditor's lien was worth over $318.7 million.[154] The secured creditor objected to the proposed sale, and the bankruptcy court issued a ruling holding that the debtor could not restrict the secured creditor's right to credit bid.[155] The debtor appealed, asserting that the plan was valid under Section 1129(b)(2)(A)(iii) and *In re Pacific Lumber Co.*[156] The district court reversed the bankruptcy court's decision and the secured creditor appealed.[157]

On appeal, the Third Circuit examined Section 1129(b)(2)(A) and *In re Pacific Lumber Co.*[158] Examining Section 1129(b)(2)(A), the court noted that the use of the word "or" indicates that any one of the subsections of Section 1129(b)(2)(A) could be used to confirm a plan, and the debtor need not satisfy more than one subsection.[159] The court concluded that Section 1129(b)(2)(A)(iii) allows a plan to be confirmed against the objections of a secured creditor if that secured creditor receives the indubitable equivalent of its claim.[160] Since the debtor's plan involved subsection (iii) and not subsection (ii), which requires the debtor to allow a secured creditor to credit bid, Section 363(k) did not come into play, and the secured lender did not have any right to credit bid.[161] Additionally, the court recognized that like Section 1129(b)(2)(A), credit bidding under Section 363(k) could be limited "for cause," and "cause" may extend beyond actions undertaken by

151. *Id.* at 301.
152. *See id.*
153. *Id.* at 302.
154. *Id.*
155. *Id.*
156. *Id.* at 302–03.
157. *Id.*
158. *Id.* at 304–18.
159. *Id.* at 305.
160. *Id.*
161. *Id.* at 311.

the secured creditor.[162] As a result, the court held that the debtor could proceed with its confirmation plan.[163]

In re Philadelphia Newspapers was an important decision because it established that Section 1129(b)(2)(A) and Section 363(k) do not afford creditors an absolute right to credit bid.[164] Courts are free to limit credit bidding based on actions undertaken by either the secured creditor or another party to the bankruptcy proceeding.[165] While the Supreme Court ultimately invalidated part of *In re Philadelphia Newspapers*, courts still cite to *In re Philadelphia Newspapers* when deciding whether to restrict a secured creditor's right to credit bid.[166] The dissent's argument that Section 1129(b)(2)(A) offers three distinct paths for confirming a cramdown plan in practice makes more sense than the majority's view. Under the majority's view, debtors could avoid credit bidding altogether if they structured an asset sale as part of their reorganization plan.[167] It makes little sense that credit bidding would be required for stand-alone asset sales but could be avoided in asset sales under a Chapter 11 plan. Ultimately, the Supreme Court agreed with the dissent when it had the opportunity to examine Section 1129(b)(2)(A) in *RadLAX*.[168]

3. *RadLAX Gateway Hotel, LLC v. Amalgamated Bank*

After *In re Pacific Lumber Co.* and *In re Philadelphia Newspapers*, the Seventh Circuit got its chance to examine Section 1129(b)(2)(A) and the right to credit bid.[169] In *RadLAX*, the debtor, RadLAX Gateway Hotel, LLC (RadLAX) and its affiliates, borrowed $142 million from Longview Ultra Construction Loan Investment Fund (Longview) to finance the purchase of a hotel and adjacent lot near Los Angeles International Airport, build a

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162. *Id.* at 315–16.

163. *Id.* at 318. In dissent, one Third Circuit judge argued that the Bankruptcy Code defined "or" as an exclusive limitation because "[n]umerous sections of the Bankruptcy Code employ the disjunctive 'or' in a context where the alternative options render the 'or' exclusive." *Id.* at 323–24. When applying principles of statutory interpretation to Section 1129(b)(2)(A), Section 1129(b)(2)(A) provides three distinct requirements that are dependent on the debtor's plan proposal. *Id.* at 334–36. As a result, this judge argued that Section 1129(b)(2)(A)(ii) should apply and the right to credit bid should be preserved for cramdown plans involving free and clear sales of secured property. *Id.* at 337–38.

164. *Id.* at 317–18.

165. *See id.* at 304, 317–18.

166. *E.g.*, *In re* Aéropostale, Inc., 555 B.R. 369, 417 n.31 (Bankr. S.D.N.Y. 2016); *In re* Tempnology, LLC, 542 B.R. 50, 68 (Bankr. D.N.H. 2015); *In re* Free Lance-Star Publ'g Co., 512 B.R. 798, 805 (Bankr. E.D. Va. 2014).

167. *See In re Phila. Newspapers*, 599 F.3d at 318.

168. 566 U.S. 639, 649 (2012).

169. River Rd. Hotel Partners, LLC v. Amalgamated Bank, 651 F.3d 642, 643 (7th Cir. 2011), *aff'd sub nom* RadLAX Gateway Hotel, LLC, 566 U.S. 693.

parking garage on the adjacent lot, and renovate the hotel.[170] As a condition to obtaining the loan, the lender obtained a blanket lien on all of RadLAX's assets.[171] Faced with unexpected costs and liquidity constraints, RadLAX filed for Chapter 11 bankruptcy protection.[172] RadLAX filed a bankruptcy plan in which it sought to dissolve and sell substantially all of its assets at auction free and clear of liens, and it proposed that Section 1129(b)(2)(A)(iii) permitted it to prohibit Longview from credit bidding at the auction.[173] The United States Bankruptcy Court for the Northern District of Illinois denied RadLAX's plan,[174] and the United States Court of Appeals for the Seventh Circuit affirmed the lower court's decision.[175] Following the Seventh Circuit's decision, RadLAX appealed to the Supreme Court, arguing that the plan provided Longview with the indubitable equivalent of its claim and conformed with the Third and Fifth Circuits' decisions.[176]

Examining whether RadLAX was permitted to prohibit credit bidding, the Supreme Court noted that the general/specific statutory interpretation cannon provides that specific provisions control over general, broad provisions.[177] The Bankruptcy Code provides three specific provisions for how a Chapter 11 plan may be approved against the objections of a secured class of creditors under Section 1129(b)(2)(A).[178] First, the secured creditor may retain its lien on the property and receive deferred cash payments equal to at least the value of its claim as of the effective date of the plan.[179] Second, the property may be sold free and clear of the secured creditor's lien, provided that the secured creditor has the opportunity to credit bid its claim to offset the purchase price.[180] Third, the secured creditor may receive the indubitable equivalent of its claim.[181]

When drafting this statute, Congress used the word "or" to show each provision governs a specific procedure.[182] Selling property free and clear of liens is governed specifically by the

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170. RadLAX Gateway Hotel, LLC v. Amalgamated Bank, 566 U.S. 639, 641 (2012).
171. *Id.*
172. *Id.*
173. *Id.* at 642.
174. *Id.* at 642–43.
175. *River Rd. Hotel Partners, LLC*, 651 F.3d at 653.
176. *RadLAX Gateway Hotel*, 566 U.S. at 643–44.
177. *Id.* at 645–46.
178. *Id.* at 643.
179. *Id.* at 643–44.
180. *Id.*
181. *Id.*
182. *Id.* at 647–48.

second provision.[183] While the general/specific statutory interpretation cannon can be overcome by other textual indicators of statutory meaning, RadLAX failed to provide any specific alternatives for this interpretation.[184] The general language of Section 1129(b)(2)(A)(iii) is broad enough to encompass RadLAX's reorganization plan.[185] However, because Section 1129(b)(2)(A)(ii) specifically deals with selling encumbered property free and clear of liens, RadLAX's reorganization plan could not rely on Section 1129(b)(2)(A)(iii).[186] The Supreme Court concluded that cramdown plans involving the sale of property free and clear of loans must satisfy Section 1129(b)(2)(A)(ii) and may not be confirmed if the secured creditor is only offered the indubitable equivalent of its claim.[187] Further, the Supreme Court noted that absent cause for denying credit bidding, Section 363(k) ensures creditors the absolute right to credit bid.[188]

The Supreme Court's decision in *RadLAX* was important because it answered the question created by the Third Circuit's decision in *In re Philadelphia Newspapers* as to whether credit bidding is a right of secured creditors.[189] As a result of *RadLAX*, secured creditors can protect against low appraisals or sale prices on their collateral without having to spend additional cash to bid on the property.[190] While the Supreme Court's decision invalidated the Third Circuit's holding that any one of the subsections of Section 1129(b)(2)(A) could be used to confirm a Chapter 11 plan if the secured creditor was provided the "indubitable equivalent" of its claim, it did not address the issue of when credit bidding could be restricted "for cause."[191] As a result, bankruptcy courts have still cited to *In re Philadelphia Newspapers* when deciding whether to limit credit bidding to promote other policy goals of the Bankruptcy Code.[192] Thus, the

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183. *Id.*
184. *Id.* at 646–47.
185. *Id.* at 646–48.
186. *Id.*
187. *Id.*
188. *Id.* at 644 n.3.
189. *See id.* at 649.
190. *See id.*
191. *See id.* at 645–49.
192. *In re* Fisker Auto. Holdings, Inc., 510 B.R. 55, 59–60 (Bankr. D. Del. 2014) (examining whether limiting credit bidding would foster and facilitate a competitive bidding environment in light of *In re Philadelphia Newspapers*); *In re* Free Lance-Star Publ'g Co., 512 B.R. 798, 805 (Bankr. E.D. Va. 2014) (recognizing that while secured creditors are entitled to credit bid their allowed claim, under *In re Philadelphia Newspapers* courts may deny a secured creditor's right to credit bid under Section 363(k) in the interest of any policy advanced by the Bankruptcy Code).

Supreme Court's decision did not fully establish credit bidding as an absolute right.

D. Policies Behind Credit Bidding

Credit bidding helps maximize the value of the debtor's assets while protecting a secured creditor's rights. First, credit bidding protects a secured creditor's property rights by allowing creditors with secured interests in the debtor's property to compete with cash bids in asset sales.[193] Under the Bankruptcy Code, once a debtor files for bankruptcy, an automatic injunction is granted that temporarily prevents creditors from pursuing their claims against the debtor.[194] This injunction is known as an "automatic stay."[195] While the automatic stay prevents secured creditors from foreclosing on their collateral while bankruptcy proceedings are ongoing, "a secured creditor's interest in its collateral survives after the stay is lifted."[196] In the event the debtor engages in an asset sale, credit bidding grants the secured creditor the right to bid on its property interest.[197] If the secured creditor wants the property, it can prevent outside parties from obtaining the collateral for less than the amount of its allowable claim.[198] In addition to providing protection against outside bidders, credit bidding also protects the value of secured creditor's property.[199] At the time of filing for bankruptcy, the debtor's property is at risk of experiencing a bankruptcy discount, which occurs when asset value depreciates because of bankruptcy.[200] Credit bidding increases the amount secured creditors will realize because secured creditors can force other bidders to bid a higher rate without requiring the secured creditor to commit additional funds

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193. Donald S. Bernstein, Brian M. Resnick, & Hilary Dengel, *Credit Bidding in Chapter 11 after* RadLAX, AM. BANKR. INST. (091912 ABI-CLE 181, 2012), https://www.westlaw.com/Document/I792a4c9000d711e28b05fdf15589d8e8/View/FullText.html?transitionType=Default&contextData=(sc.Default)&VR=3.0&RS=cblt1.0.

194. *See generally* 11 U.S.C.A. § 362 (Westlaw through Pub. L. No. 115-231) (providing statutory support for automatic stay).

195. *Id.*

196. *See* Bruce H. White & William L. Medford, *A Secured Creditor's Rights to Intellectual Property Licensed by a Debtor in Bankruptcy*, 20 AM. BANKR. INST. J., MAY 2001, at 24, 24.

197. *See id.*

198. Bernstein, Resnick & Dengel, *supra* note 193.

199. *Id.*

200. *Id.*

to the deal.[201] If a secured creditor believes proceeds will be low, it can elect to obtain possession of the property.[202]

Credit bidding also maximizes the value of the debtor's assets by enabling a larger pool of bidders to submit meaningful bids on the debtor's property.[203] Bidding on distressed property can be a costly and compressed process.[204] Credit bidding allows secured creditors to avoid transactional costs associated with preparing and financing a cash bid, and allows them to pay for the debtor's property with money that has already been invested.[205] This theoretically leads to more competitive bidding and can entice other bidders into participating in the auction who might be afraid that the bankruptcy estate will favor a specific bidder.[206] During a bankruptcy asset sale, there is a risk that a "white knight bidder" may obtain the debtor's property.[207] White knight bidders are usually insiders who might not be offering the highest bid price but promise to utilize the debtor's property in a way that preserves or benefits the debtor's management.[208] Credit bidding prevents this problem by creating increased participation and competition during the bidding process and can reduce the possibility of the debtor accepting a less than optimal bid for its property.[209]

Finally, credit bidding protects a secured creditor's rights while maximizing the value of the debtor's assets by offering sophisticated creditors a powerful tool for obtaining distressed property. Private equity and hedge funds utilize credit bidding as an offensive weapon for engaging in "loan-to-own" investment strategies.[210] For some creditors, the bankruptcy process can be an unfriendly place where property rights and recovery become compromised.[211] Rather than risk non-recovery, some creditors elect to sell their debt to loan-to-own investors to avoid the bankruptcy process altogether.[212] Loan-to-own investors purchase "certain classes of a distressed company's debt," usually "at a deep discount," "encourag[e] the debtor to enter bankruptcy," and then

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201. *Id.*
202. *Id.*
203. *Id.*
204. *See id.*
205. *Id.*
206. *Id.*
207. River Rd. Hotel Partners, LLC v. Amalgamated Bank, 651 F.3d 642, 651 n.6 (7th Cir. 2011).
208. *See id.*
209. Bernstein, Resnick & Dengel, *supra* note 193.
210. *See* L.P. Harrison III, *Recent Legal Developments in the Distressed Debt Market*, 30 REV. BANKING & FIN. SERV. 133, 136–38 (2014).
211. *See id.* at 134.
212. *See In re* Fisker Auto. Holdings, Inc., 510 B.R. 55, 57 (Bankr. D. Del. 2014).

exercise their rights as creditors to gain either equity or managerial control over the debtor or its property.[213] For secured creditors that elect to sell their claims to loan-to-own investors, credit bidding maximizes the value they receive for the debtor's assets by offering these creditors a recovery that might otherwise have been compromised.[214] For loan-to-own investors that purchase secured debt, credit bidding protects against the undervaluation of their collateral and ensures they will receive just compensation for the inherent risk they undertake when purchasing an interest in distressed property.[215]

IV. LIMITING CREDIT BIDDING FOR CAUSE

Traditionally, courts in most jurisdictions "have been hesitant to limit a secured creditor's right to credit bid."[216] While Congress amended Section 363(k) in 1984 to grant courts the discretion to deny for cause creditors' opportunity to credit bid,[217] the statute itself was silent as to what constituted cause, and courts were reluctant to restrict credit bidding.[218] As a result, courts still tended to focus on disputes involving the validity of the secured creditor's claim,[219] failures to comply with court procedures,[220] and collusive bidding when restricting credit bidding for cause.[221] When deciding whether to restrict credit bidding for cause under this standard, courts focused on (1) the notice provided to other parties in interest, (2) the ability of the credit bidder to provide a

213. Harrison, *supra* note 210, at 136.

214. *See generally id.* at 137–38.

215. *See id.*

216. Orloff, *supra* note 96, at 276.

217. Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, sec. 442(g), § 363(k) 98 Stat. 333, 372.

218. *See, e.g.*, SubMicron Sys. Corp. v. KB Mezzanine Fund II (*In re* SubMicron Sys. Corp.), 432 F.3d 448, 459–60 (3rd Cir. 2006) (holding that Section 363(k) does not limit a secured creditor's ability to bid the economic value of its claim); *In re* Finova Capital Corp., 356 B.R. 609, 625–26 (Bankr. D. Del. 2006) (holding that because the lender had a valid interest in the debtor's property, the lender was allowed to credit bid under Section 363(k)); *In re* Morgan House Gen. P'ship, Nos. 96-MC-184, 96-MC-185, 1997 WL 50419, at *1–2 (E.D. Pa. Feb 7, 1997) (holding that a secured creditor was authorized to bid on its collateral to the extent of its claim under Section 363(k)).

219. *See, e.g.*, Morgan Stanley Dean Witter Mortg. Capital, Inc. v. Alon USA LP (*In re* Akard St. Fuels, L.P.), No. CIV.A.3:01-CV-1927-D, CIV.A.3:01-CV-2066-D, CIV.A.3:01-CV-2068-D, 2001 WL 1568332, at *3 (N.D. Tex. Dec. 4, 2001) (finding that there was sufficient cause under Section 363(k) to disallow credit bidding because there was a bona fide dispute regarding a creditor's lien amount).

220. *See, e.g.*, Greenblatt v. Steinberg, 339 B.R. 458, 462–63 (N.D. Ill. 2006) (finding that a secured creditor was prohibited from credit bidding because the secured creditor failed to conform to the bankruptcy's sales procedures).

221. *See, e.g., In re* Theroux, 169 B.R. 498, 498–99 (Bankr. D.R.I. 1994) (finding cause to limit credit bidding because the debtor and the secured creditor engaged in collusion).

deposit to the estate to protect the estate in the case that its lien is subsequently successfully challenged, (3) the "adequacy of the purchase price," and (4) the "benefit to the debtor's estate."[222]

During the mid-2000s, private equity and hedge funds began to increasingly pursue investments in distressed and bankrupt companies in a quest for continued above-market returns.[223] As a result, hedge funds became pervasive participants in corporate bankruptcy proceedings because they offered competitive financing and increased liquidity.[224] While these benefits help distressed companies and bankruptcy estates by providing the additional capital needed to operate during bankruptcy, hedge funds are predominantly designed to be short-term investment vehicles.[225] As short-term investment vehicles, some hedge funds engage in loan-to-own strategies where the fund's main intent is to convert the distressed debt into equity after the company defaults.[226] As a result, it is difficult for distressed companies to know whether their hedge fund investors are investing to rebuild their business or force them into bankruptcy.[227]

For example, in *In re Radnor Holdings Corp.*, a hedge fund was sued by a group of unsecured creditors for entering into loan agreements with the debtor without having any expectation that the debtor would be able to pay it back.[228] The hedge fund, Tennenbaum Capital Partners (TCP), had its loans secured by substantially all of the debtor's property.[229] While the group of unsecured creditors asserted that TCP should be prohibited from credit bidding on the debtor's assets because TCP could acquire the debtor's property for a grossly inadequate price and the validity of TCP's liens had not yet been determined,[230] the United States Bankruptcy Court for the District of Delaware found that TCP was allowed to credit bid its claim in full.[231] While loan-to-own strategies like the one seen in *Radnor* have been criticized for harming other creditors because they allow investors to purchase distressed debt at a discount with the intention of using its full

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222. John T. Gregg, *A Review of Credit Bidding Under 11 U.S.C.A. § 363(k), in* 2008 NORTON ANN. SURV. BANKR. L. 17 (Thompson Reuters publ., 2008) (Westlaw).

223. *See* Eric B. Fisher & Andrew L. Buck, *Hedge Funds and the Changing Face of Corporate Bankruptcy Practice*, AM. BANKR. INST. J., Dec./Jan. 2007, at 24, 24.

224. *Id.*

225. Robert J. Rosenberg & Michael J. Riela, *Hedge Funds: The New Masters of the Bankruptcy Universe*, 17 NORTON J. BANKR. L. & PRAC. 701, 703 (2008).

226. *Id.*

227. *Id.*

228. *See In re Radnor Holdings Corp.*, 353 B.R. 820, 826–27 (Bankr. D. Del. 2006).

229. *See id.* at 836.

230. *See id.* at 826–27.

231. *Id.* at 846.

value to obtain assets, courts were reluctant to limit credit bidding for cause in these situations because they felt loan-to-own investing was an insufficient reason for restricting credit bidding.[232] That changed, however, when the Bankruptcy Courts for the District of Delaware and the Eastern District of Virginia decided *In re Fisker* and *In re Free Lance-Star*.

A. Changes to "For Cause"

In *In re Fisker*, the Bankruptcy Court for the District of Delaware examined whether cause existed to limit the right of a secured creditor to bid on bankruptcy estate property when it purchased that property at a steep discount.[233] Hybrid Tech Holdings LLC (Hybrid) purchased the United States Department of Energy's secured $168.5 million loan to Fisker Automotive Holdings LLC (Fisker), a competing hybrid car company, for $25 million just months before Fisker filed for bankruptcy with the intent of obtaining ownership of Fisker.[234] After Fisker filed for bankruptcy, it motioned the court to approve a private sale of substantially all of its assets to Hybrid in return for a $75 million credit bid.[235] After Fisker's motion, a committee of unsecured creditors objected to the proposed sale, sought an open auction, and endorsed Wanxiang America Corporation (Wanxiang) as a bidder for the encumbered property.[236] As part of the unsecured creditors committee's proposal, Wanxiang refused to participate in the auction unless Hybrid's credit bid was capped at $25 million.[237]

Examining Hybrid's ability to credit bid, the bankruptcy court noted that "it is beyond peradventure that a secured creditor is entitled to credit bid its allowed claim."[238] Citing to the Third Circuit's decision in *In re Philadelphia Newspapers*, the bankruptcy court recognized that the right to credit bid is not absolute and may be restricted or denied for cause.[239] Cause exists when a credit bid would chill competitive bidding, give an unfair advantage to a secured creditor, or go against the policy goals of the Bankruptcy Code.[240] Here, the bankruptcy court found that

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232. Roger G. Schwartz et al., *Outline of Recent Cases Relating to Credit Bidding, Equitable Powers, Chapter 15 and Fraudulent Transfers*, AM. BANKR. INST. (042414 ABI-CLE 599, 2014).

233. *See* 510 B.R. 55, 59 (Bankr. D. Del. 2014).

234. *Id.*

235. *Id.*

236. *Id.* at 57–58.

237. *Id.* at 57–58.

238. *Id.* at 59.

239. *Id.* at 59–60.

240. *See id.*

credit bidding should be limited for four reasons: (1) Hybrid purchased its $168.5 million secured claim for only $25 million, and allowing this bid would be inconsistent with the notion of fairness in the bankruptcy process; (2) there were questions about the validity of Hybrid's lien; (3) the court schedule gave creditors just twenty-four days to challenge Fisker's Sale Motion and Hybrid's secured liens; and (4) Wanxiang made it clear that it would not participate in bidding unless Hybrid's credit bid was capped at $25 million.[241] Based on these factors, the bankruptcy court held that Hybrid's credit bid would prevent bidding and thus should be limited for cause.[242] It is worth noting that the bankruptcy court in *In re Fisker* emphasized that had Hybrid been permitted to credit bid its full claim, bidding would not just have been chilled,[243] but there would be no other bids at the auction despite that Wanxiang was more than financially capable of bidding on Fisker's property.[244]

Following the bankruptcy court's order, Hybrid appealed, arguing that the bankruptcy court violated the Supreme Court's ruling in *RadLAX* and that *In re Philadelphia Newspapers* was no longer good law.[245] The committee of unsecured creditors opposed the request, arguing that (1) the bankruptcy court's order was not final and thus not appealable, and (2) Hybrid failed to establish the requirements for an interlocutory appeal.[246] Considering the first argument, the district court noted that there were "many issues other than Hybrid's credit bid that [were] yet unresolved by the bankruptcy court's order" which would impact the sale, including "the nature of Hybrid's statutory right and whether Hybrid's lien [was] . . . valid."[247] While considering the second argument, the district court noted that Section 363(k) clearly authorizes courts to prohibit or restrict credit bidding for cause.[248] Citing to *In re Philadelphia Newspapers*, the district court stated that it was within the bankruptcy court's discretion to deny a secured lender's right to credit bid in order to foster a competitive

241. *See id.* at 59–61, 59 n.2.

242. *Id.* at 61.

243. *Id.*

244. *Id.* at 59–60.

245. Opposition of the Official Committee of Unsecured Creditors to the Emergency Motion of Hybrid Tech Holdings, LLC for Leave to Appeal Decision Limiting Credit Bid at 16 n.12, 18, *In re Fisker Auto. Holdings, Inc.*, 510 B.R. 55 (Bankr. D. Del. 2014) (No. 1:13-bk-13087, ECF No. 518).

246. *In re* Fisker Auto. Holdings, Inc., No. 14-CV-99, 2014 WL 546036, at *2–5 (D. Del. Feb. 7, 2014).

247. *Id.* at *3.

248. *Id.* at *4.

bidding environment.[249] The district court found that Hybrid did not articulate an exceptional circumstance that warranted its appeal, and upheld the bankruptcy court's decision to limit Hybrid's credit bid.[250]

Following *In re Fisker*, the United States Bankruptcy Court for the Eastern District of Virginia faced a similar question regarding the limits of credit bidding.[251] In *In re Free Lance-Star*, the debtor, Free Lance-Star, obtained a $50.8 million secured loan in 2006 from Branch Banking and Trust (BB & T) to finance expanding its commercial printing business.[252] After the debtor obtained the loan, the United States' economy was affected by the financial crisis of 2007–2008, and the debtor began to fall out of compliance with the loan's covenants.[253] BB & T and Free Lance-Star attempted to refinance the loan.[254] However, after failing to reach an acceptable solution, BB & T sold its interest to the hedge fund Sandton Capital Partners (Sandton).[255] Sandton immediately informed the debtor that it wanted it to file for bankruptcy and sell substantially all of its assets pursuant to Section 363.[256] Free Lance-Star filed for bankruptcy, and Sandton filed a motion seeking a declaration that it could credit bid on substantially all of the debtor's assets, including four radio stations.[257] In response, Free Lance-Star filed a cross-motion arguing that cause existed to limit Sandton's credit bid pursuant to Section 363.[258]

Examining Section 363(k), the bankruptcy court reached a conclusion similar to the court in *In re Fisker* that cause existed to limit Sandton's credit bid.[259] In coming to this conclusion, the bankruptcy court focused on the fact that Sandton did not have a valid, properly perfected lien on the debtor's four radio stations, and that Sandton had engaged in inequitable conduct during the bankruptcy that required the court to find cause in order to foster a competitive bidding environment.[260] The bankruptcy court found that Sandton engaged in inequitable conduct when it pressured the debtor to expedite its bankruptcy filing, shorten the marketing

249. *Id.*
250. *Id.* at *5.
251. *In re* Free Lance-Star Publ'g Co., 512 B.R. 798, 801 (Bankr. E.D. Va. 2014).
252. *Id.* at 802.
253. *Id.*
254. *Id.*
255. *Id.*
256. *Id.*
257. *Id.* at 800.
258. *Id.* at 801.
259. *Id.* at 805–08.
260. *Id.* at 805–06.

period for the sale of its business, and conspicuously advertise Sandton's right to credit bid.[261] As a result, the bankruptcy court held that "[t]he confluence of (i) [Sandton]'s less than fully-secured lien status; (ii) [Sandton]'s overly zealous loan-to-own strategy; and (iii) the negative impact of [Sandton]'s misconduct" created a perfect storm requiring the court to restrict Sandton's right to credit bid for cause.[262] As a result, Sandton's right to credit bid was restricted to $1.2 million for assets related to the debtor's radio business in which Sandton had a valid, properly perfected lien, and $12.7 million for assets related to the debtor's newspaper and printing business.[263]

In re Fisker and *In re Free Lance-Star* are important cases because they call into question the investment strategy of purchasing distressed debt to obtain ownership of the underlying collateral. Prior to these decisions, courts were reluctant to limit credit bidding based on loan-to-own strategies, and mostly limited credit bidding for disputes involving claim validity, court procedural violations, and collusive bidding.[264] *In re Fisker* and *In re Free Lance-Star* expanded what constituted "for cause" under Section 363(k) by focusing on the secured creditor's conduct and motives when deciding to restrict credit bidding. While the secured creditor in *In re Free Lance-Star* clearly engaged in egregious and inequitable conduct, the court in *In re Fisker* focused on how the secured creditor's loan-to-own strategy would affect the bidding process when deciding to limit the secured creditor's right to credit bid.[265] Both *In re Fisker* and *In re Free Lance-Star* represent a warning for secured creditors hoping to obtain property through credit bidding. However, neither decision fully answers the question of whether courts would limit credit bidding exclusively to promote competitive bidding or if some other violation is required before credit bidding will be restricted "for cause."

B. Section 363(k) "For Cause" Since In re Fisker and In re Free Lance-Star

Since *In re Fisker* and *In re Free Lance-Star*, courts have further refined "for cause." One of the first cases to touch on for cause restrictions to credit bidding following *In re Free Lance-Star* was *In re Charles Street African Methodist Episcopal Church of*

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261. *Id.* at 806.
262. *Id.* at 807.
263. *Id.* at 808.
264. *See supra* Part III.
265. *In re Fisker Auto. Holdings, Inc.* 510 B.R. 55, 60 (Bankr. D. Del. 2014).

Boston.[266] In *In re Charles Street*, the United States Bankruptcy Court for the District of Boston decided whether a sufficient bona fide dispute over the secured lender's claim existed to warrant limiting credit bidding for cause.[267] The debtor owned two parcels of real property encumbered by the secured creditor's liens.[268] It filed a motion seeking to (1) auction the property, (2) prohibit credit bidding for cause, and (3) obtain authority to pay a $50,000 break-up fee to the stalking horse bidder if the stalking horse was unsuccessful at auction.[269] The debtor argued that cause existed because the debtor had filed counterclaims against the secured lender that, by set-off, would reduce the secured creditor's claims to zero.[270] Examining Section 363, the bankruptcy court found that credit bidding may be restricted if a bona fide dispute over the claims is established.[271] However, for there to be a bona fide dispute a party must challenge the validity of the secured creditor's underlying claims.[272] Here, while the counterclaim could reduce the secured creditor's claim, it did not challenge the validity of the claim and therefore could not be used as an affirmative defense to undercut the secured creditor's right to credit bid.[273] Thus, the bankruptcy court held that if the secured creditor agreed to pay the stalking horse break-up fee, it would be permitted to credit bid.[274]

Following *In re Charles Street*, the United States Bankruptcy Court for the Western District of Tennessee examined the for cause limitation to credit bidding for inequitable conduct in *In re RML Development, Inc.*[275] In determining whether cause existed to limit the secured creditor's credit bid, the bankruptcy court looked to its own inherent equitable powers and the importance of balancing the interests of debtors, creditors, and other parties in interest to ensure an equitable distribution.[276] Applying its equitable authority, the court found that Section 363(k) should only be modified or denied when equitable concerns give rise to cause and that such modifications or denials of credit bidding

266. 510 B.R. 453, 455 (Bankr. D. Mass. 2014).

267. *Id.* at 455.

268. *See id.*

269. *Id.*

270. *Id.* Set-off is "[a] debtor's right to reduce the amount of a debt by any sum the creditor owes the debtor by the counterbalancing sum owed by the debtor." *Set-off*, BLACK'S LAW DICTIONARY, 1496 (10th ed. 2014).

271. *In re* Charles St. African Methodist Episcopal Church, 510 B.R. at 457–58.

272. *Id.*

273. *Id.* at 458.

274. *Id.* at 459.

275. 528 B.R. 150, 152 (Bankr. W.D. Tenn. 2014).

276. *Id.* at 155.

rights should be considered an extraordinary exception and not the norm.[277] In this case, the bankruptcy trustee asserted numerous allegations against the secured creditor, which included that it operated a Ponzi scheme, engaged in fraudulent transfers, and breached its fiduciary duties.[278] While the bankruptcy court noted that it was "not prepared to go as far as [the courts] in *In re Fisker* and *In re Free Lance-Star* and hold that the mere 'chilling' of third-party bids is sufficient cause to justify modifying or denying a secured creditor's rights[,]" it did recognize that credit bidding was not an absolute right.[279] Thus, the bankruptcy court held that cause existed, and therefore the secured creditor could not credit bid any disputed amounts of its liens and could only credit bid if it provided a letter of credit, surety bonds, or other court-approved instruments as collateral, in the amount of its proposed credit bid.[280]

The United States Bankruptcy Court for the District of New Hampshire has explored whether credit bidding could be limited for cause for insider transactions.[281] In *In re Tempnology, LLC*, the debtor filed for bankruptcy and proposed a sale procedure by which it would sell substantially all of its assets to a stalking horse bidder who was an insider, and permit the stalking horse to credit bid a majority of its initial bid price.[282] The debtor appointed a U.S. Trustee to oversee the sale.[283]After one of the debtor's business partners, Mission Product Holdings, Inc. (Mission), failed to purchase the debtor's assets with an all-cash bid, Mission challenged the stalking horse bidder's ability to credit bid arguing that cause existed to prohibit the stalking horse bidder's ability to credit bid.[284] Mission asserted that cause existed for three reasons: (1) the stalking horse bidder engaged in inequitable conduct through its self-dealing, (2) the validity and amount of the stalking

277. *Id.* at 155–56.

278. *Id.* at 156.

279. *Id.* at 155 n.11. It is worth noting that this court incorrectly interpreted *In re Fisker* and *In re Free Lance-Star* as holding that the chilling of credit bidding could "justify modifying or denying a secured creditor's right" to credit bid. In *In re Fisker*, the court emphasized that there would be no other bids at the bankruptcy auction had the secured creditor been permitted to credit bid the full value of its claim. 510 B.R. 55, 60 (Bankr. D. Del. 2014). In *In re Free Lance-Star* the court held that "(i) [the secured creditor's] less than fully-secured lien status; (ii) [the secured creditor's] overly zealous loan-to-own strategy; and (iii) the negative impact [the secured creditor's] misconduct has had on the auction process has created the perfect storm" that justified modifying its right to credit bid. 512 B.R. 798, 807 (Bankr. E.D. Va. 2014).

280. *See In re* RML Dev., Inc., 528 B.R. at 157.

281. *See generally In re* Tempnology, LLC, 542 B.R. 50, 52 (Bankr. D.N.H. 2015).

282. *Id.* at 54–56.

283. *Id.* at 72.

284. *Id.* at 57–58.

horse bidder's secured claims were in bona fide dispute, and (3) the stalking horse bidder's secured claims should be re-characterized as equity because it lent more money to the debtor than was necessary under the DIP Facility.[285]

While examining the auction, the bankruptcy court noted that there were likely no other alternatives for the debtor and that the debtor's assets would have likely continued to decline had it not been for the stalking horse's bid.[286] The bankruptcy court recognized that higher scrutiny must be afforded to bankruptcy sales involving insiders, however, the court's application of Section 363(k) was no different from any other credit bidding case.[287] While Section 363(k) permits a bankruptcy court to limit credit bidding for cause to promote any policy advanced by the Bankruptcy Code or to punish inequitable conduct, based on (1) the terms of the sale; (2) an examiner's report; (3) the sales procedures; (4) the positions of the creditors; and (5) the good faith of the purchaser, none of these bases were present, and the court held that credit bidding should not be restricted.[288]

In *Matter of Edwards*, the United States Bankruptcy Court for the Northern District of Alabama decided whether Section 363(k) credit bidding restrictions are applicable to state law set-off judgments.[289] The debtor filed for Chapter 7 bankruptcy, owed a secured creditor over $4.2 million, and had previously won a $1.7 million judgment against that secured creditor for breach of contract claims.[290] The debtor also had a $2.2 million judgment entered against it in a different court proceeding, and the secured creditor purchased this claim for $450,000 to use to set-off the debtor's judgment against the creditor.[291] The debtor argued that the assignment was not valid and should be restricted under *In re Fisker* and Section 363(k) of the Bankruptcy Code.[292] Examining the Bankruptcy Code, the bankruptcy court noted that Section 363(k) and Section 553 of the Bankruptcy Code expressly allow courts to limit credit bidding and set-offs for inequitable

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285. *Id.* at 59. A "DIP Facility" is the debtor-in-possession financing that provides "the debtor with the funds necessary to reorganize" its business while in bankruptcy. *See* Paul H. Zumbro, *An Overview of Debtor-In-possession Financing, Debtor-In-Possession and Exit Financing: Leading Lawyers on Securing Funding and Analyzing Recent Trends in Bankruptcy Financing*, Feb. 2010, at *1, 2010 Westlaw 556188.

286. *In re* Tempnology, LLC, 542 B.R. at 66–67.

287. *Cf. id.* at 65, 68–69.

288. *See id.* at 68–72.

289. Edward Specialties, Inc. v. Olive Props., Inc. (Matter of Edwards), 553 B.R. 902, 902 (Bankr. N.D. Ala. 2016).

290. *Id.* at 906–07.

291. *Id.* at 907–08.

292. *Id.* at 909.

conduct.[293] However, Alabama's set-off provisions do not take equity or the court's discretion into consideration.[294] The bankruptcy court found that while equitable concerns similar to those in *In re Fisker* could be grounds for restricting set-offs under Section 553, they were not grounds for restricting state law set-offs, and the secured creditor could continue with the set-off.[295] While the court in *Matter of Edwards* failed to apply "for cause" limitations to state set-off provisions, this case is noteworthy because the court allowed the secured creditor to use the full value of a claim it had purchased against the bankruptcy estate when it had purchased the claim for less than its face value.[296] In coming to this conclusion, the bankruptcy court failed to examine the importance of balancing the interests of debtors, creditors, and other parties in interest to ensure the maximization of the bankruptcy estate and equitable distribution to all creditors.

The United States Bankruptcy Court for the Southern District of New York has considered whether credit bidding can be restricted for cause due to pre-bankruptcy inequitable and harmful conduct undertaken by a secured creditor that contributed to the debtor's bankruptcy.[297] In *In re Aéropostale, Inc.*, the secured creditor, Sycamore Partners (Sycamore), a private equity fund, acquired various equity and debt interests in the debtor prior to the debtor filing for bankruptcy.[298] As part of its financing agreements with the debtor, Sycamore required the debtor to use a merchandising supplier chosen by Sycamore for sourcing clothing, and Sycamore could adjust the terms of its financing based on the debtor's financial performance.[299] The debtor's financial performance deteriorated, and the secured creditor sold off a large portion of its equity interest in the debtor, causing the debtor to become non-compliant with the secured creditor's financing terms and eventually leading the debtor to declare bankruptcy.[300] During bankruptcy, the debtor filed a motion to subordinate the secured creditor's claim, recharacterize the secured lender's claims, and prohibit the secured creditor from credit bidding.[301]

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293. *Id.* at 909–13.
294. *Id.* at 913.
295. *Id.* at 913–14.
296. *Id.* at 913.
297. *In re* Aéropostale, Inc., 555 B.R. 369, 374–375 (Bankr. S.D.N.Y. 2016).
298. *Id.* at 376–78.
299. *Id.* at 390.
300. *Id.* at 381, 384–87.
301. *Id.* at 374–75.

When deciding whether to prohibit credit bidding for cause, the bankruptcy court determined that the decision to prohibit credit bidding is squarely within the discretion of the court.[302] In the view of this court, utilizing equitable powers to modify or deny credit bidding should be reserved for extraordinary cases such as where inequitable conduct is present.[303] Examining evidence presented at trial, the court found that nothing on the record supported a finding of inequitable conduct.[304] While the debtor asserted that the secured creditor breached its credit agreement with the debtor and entered into an agreement with investors to push the debtor into bankruptcy, these allegations were without merit; the debtor failed to present evidence of collusion, undisclosed agreements, or other actions that would give the secured creditor an unfair advantage during the bankruptcy asset sale.[305] The debtor then argued that allowing Sycamore to credit bid would chill the bidding process, but the bankruptcy court found that no precedent existed under which chilling effect alone could limit credit bidding for cause, and held that Sycamore could credit bid the full value of its claim.[306]

In *In re CS Mining, LLC*, the United States Bankruptcy Court for the District of Utah was tasked with deciding whether to approve a proposed settlement agreement between the debtor and a secured lender, and whether to permit the secured lender to credit bid at a bankruptcy auction pursuant to the settlement agreement.[307] The secured creditor, Western US Mineral Investors, LLC (WUMI), reached a settlement agreement with the debtor, CS Mining, under which WUMI agreed to dismiss an adversary proceeding, pay $1 million to the debtor's estate, and subordinate its secured assets in return for a $23 million secured and validly perfected claim with the right to credit bid up to that amount.[308] Waterloo Street Limited (Waterloo), a creditor in the bankruptcy proceeding, challenged the settlement arguing that it lacked good faith, amounted to insider dealing, abridged Waterloo's right to be heard, and was not properly approved by the debtor's board of managers.[309] When examining whether cause

302. *Id.* at 415.

303. *Id.*; *see also In re* Fisker Auto. Holdings, Inc., 510 B.R. 55, 58–59 (Bankr. D. Del. 2014). Many bankruptcy courts today would agree with this analysis; however, the court in *In re Fisker* failed to consider inequitable conduct when restricting Section 363(k) and *In re Fisker* is still considered good law.

304. *In re Aéropostale, Inc.*, 555 B.R. at 415–16.

305. *Id.* at 399–400, 407–08, 415–16.

306. *Id.* at 416–18.

307. *In re* CS Mining, LLC, 574 B.R. 259, 268–69 (Bankr. D. Utah 2017).

308. *Id.* at 268–69.

309. *Id.* at 262.

existed to limit credit bidding, the bankruptcy court acknowledged that the right to credit bid is not absolute and may be limited on a case-by-case basis by the court.[310] Here, the court found that cause existed because (1) there was a bona fide dispute over whether the secured creditor's claims would be allowed, (2) allowing WUMI to credit bid would likely chill the bidding process because of the size of the secured creditor's claims, and (3) WUMI had close insider ties with the debtor.[311] As a result, the bankruptcy court held that the settlement agreement was not valid and WUMI was not permitted to credit bid.[312]

V. "FOR CAUSE" LIMITATIONS TO CREDIT BIDDING TODAY

These recent decisions, taken as a whole, offer new insight into what constitutes grounds for a for cause limitation to credit bidding and should be considered by investors before investing in distressed and bankrupt companies. Following the Supreme Court's decision in *RadLAX*, credit bidding is seen as a right retained by secured creditors when their collateral is being sold free and clear during a bankruptcy sale.[313] However, while credit bidding is considered a right for secured creditors, this right is not absolute and may be restricted or prohibited at the court's discretion. The cases following *In re Fisker* and *In re Free Lance-Star* show that while there is no balancing test for determining when credit bidding should be modified or denied, there are a series of bright-line rules that specify which aggregate of bad facts will justify reducing or eliminating the right to credit bid.

Credit bidding will continue to be restricted for cause for disputes involving validity of a claim, lack of compliance with court procedures, and collusive actions during bidding that lead to a lower sale price. When determining whether credit bidding should be restricted for cause due to these traditional limitations, courts will look at (1) the notice provided to other parties in interest, (2) the ability of the credit bidder to provide a deposit to the estate to protect the estate should its lien be subsequently successfully challenged, (3) "the adequacy of the purchase price," and (4) "the benefit to the debtor's estate."[314] The fact that a secured creditor's credit bid will chill the bidding process alone is typically not enough ground a for-cause limitation to credit bidding.[315]

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310. *Id.* at 282–83.
311. *Id.* at 284–85.
312. *Id.* at 285.
313. 566 U.S. 639, 649 (2012).
314. *See generally* Gregg, *supra* note 222.
315. *See In re* Aéropostale, Inc., 555 B.R. 369, 416–18 (Bankr. S.D.N.Y. 2016).

When deciding whether to limit or prohibit credit bidding for reasons outside these traditional limitations, courts will focus on the conduct of the secured creditor at the time at which it obtained its lien. If the secured creditor and the debtor have a close relationship or the secured creditor qualifies as an insider, the debtor should make special arrangements before proposing bidding procedures that grant the secured creditor the absolute right to credit bid. The debtor should consider obtaining (1) a trustee appointed by the Office of the U.S. Trustee to oversee the sale, (2) an examiner's report to examine the fairness of the transaction, and (3) sales terms fair to all parties.[316] If the debtor does not take these precautions, it runs the risk of having the secured creditor's right to credit bid restricted for cause.[317]

If there is a bona fide dispute over whether a claim is valid, the secured creditor should offer to pay any reasonable stalking horse's break-up fee listed in the bankruptcy asset sale procedures and agree to provide a letter of credit as collateral in the event its claims are found to be invalid. These actions may encourage the court to permit the secured creditor to credit bid its claim.[318] Unlike credit bidding, courts are unlikely to limit set-off judgments, even when the party that holds the set-off judgment was assigned the judgment for less than it is worth.[319]

When deciding whether to restrict credit bidding for inequitable conduct or conduct that is against a policy advanced by the Bankruptcy Code, courts will consider whether the conduct affects the liens themselves. If a secured creditor purchased its liens at a discount, courts may restrict the secured creditor's ability to credit bid to the amount the secured creditor paid for its lien, unless the secured creditor can demonstrate that its actions do not unduly harm other creditors.[320] Additionally, if the secured creditor attempts to pressure the debtor into an expedited bankruptcy filing or a shortened marketing period, or it advertises its credit bid to other potential bidders, courts may restrict the secured creditor's right to credit bid.[321] If the secured creditor's alleged inequitable conduct is unrelated to the liens themselves, courts are unlikely to restrict credit bidding for cause. For example, if a debtor agrees to a financing agreement that

316. *See In re* Tempnology, LLC, 542 B.R. 50, 68–71 (Bankr. D.N.H. 2015).

317. *In re CS Mining*, 574 B.R. at 285.

318. *In re* RML Dev., Inc., 528 B.R. 150, 157 (Bankr. W.D. Tenn. 2014); *In re* Charles St. African Methodist Episcopal Church, 510 B.R. 453, 459 (Bankr. D. Mass. 2014).

319. Edward Specialties, Inc. v. Olive Props., Inc. (Matter of Edwards), 553 B.R. 902, 913–14 (Bankr. N.D. Ala. 2016); *In re Charles St.*, 510 B.R. at 459.

320. *In re* Fisker Auto. Holdings, Inc., 510 B.R. 55, 58–60 (Bankr. D. Del. 2014).

321. *In re* Free Lance-Star Publ'g Co., 512 B.R. 798, 807–08 (Bankr. E.D. Va. 2014).

ultimately leads to its bankruptcy, the financing agreement's secured creditor will nevertheless likely retain its right to credit bid.[322]

VI. CONCLUSION

Enacted in 1978, Section 363(k) of the Bankruptcy Code grants secured creditors the formidable right to bid up to the full amount of the debt owed to them during a bankruptcy sale of the property against which they hold a lien.[323] While this right affords secured creditors significant power during a Section 363 asset sale, it is not unlimited and may be modified or denied by the court based on equity or policy concerns. Before making the decision to invest in the debt of distressed or bankrupt companies with the intent of using that debt to credit bid, investors should first consider whether they run the risk of having their claim reduced for cause. While recent court decisions have broadened the grounds upon which a for cause limitation to credit bidding may be based, if secured creditors take proper precautions, they should be able to credit bid their full claim.

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322. *In re* Aéropostale, Inc., 555 B.R. 369, 416–18 (Bankr. S.D.N.Y. 2016).

323. Boris I. Mankovetskiy, *The Nuts And Bolts Of Credit Bidding: A Primer For Traditional Lenders And Distressed Debt Investors*, CORP. COUNS. BUS. J. (Feb. 28, 2011), http://ccbjournal.com/articles/13578/nuts-and-bolts-credit-bidding-primer-traditional-lenders-and-distressed-debt-investor.