## *Managing The Risk Of General Jurisdiction…*
*continued*

independence so it furthers its own goals rather than serving the goals of the foreign parent. If the local entity is a parent or sister, the local business and foreign business must be operated with sufficient corporate formalities and maintain sufficient separateness to avoid being viewed as a single entity through alter ego or apparent agency principles. So despite changes in the law, the fundamental message remains the same: corporate separateness is paramount.

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2 134 S. Ct. 746, 754 (2014).

3 95 U.S. 714, 731 (1877).

4 326 U.S. 310, 319-20 (1945).

5 *Burger King Corp. v. Rudzewicz*, 471 U.S. 462, 475 (1985).

6 *Helicopteros Nacionales de Colombia, S.A. v. Hall*, 466 U.S. 408, 414 (1984).

7 131 S. Ct. 2846, 2851 (2011) (internal quotation marks and citation omitted).

8 *Id*. at 2857.

9 134 S. Ct. at 754 (quoting *International Shoe*, 326 U.S. at 316) (internal quotation marks and citation omitted).

10 *Id*. at 761 (internal quotation marks, citation, and brackets omitted).

11 *See Helicopteros*, 466 U.S. at 418.

12 *CollegeSource, Inc. v. AcademyOne, Inc.*, 653 F.3d 1066, 1074 (9th Cir. 2011) (internal quotation marks and citation omitted).

13 *Shute v. Carnival Cruise Lines*, 783 P.2d 78, 79 (Wash. 1989) (internal quotation marks and citation omitted).

14 *See Doe v. Unocal Corp.*, 248 F.3d 915 (9th Cir. 2001).

15 *Id*. at 928 (internal quotation marks and citation omitted).

16 *Id*. at 929 (internal quotation marks and citation omitted).

17 134 S. Ct. at 759.

18 *Id*.

19 *Id*. at 749 (internal quotation marks and citation omitted).

20 *Id*. at 759.

21 *Unocal*, 248 F.3d at 926 (internal quotation marks and citation omitted; brackets in original).

22 796 F.2d 299 (9th Cir. 1986).

23 *Id*. at 300.

24 *Id*. at 301.

25 *Id*. at 301-02 (citing *Uston v. Hilton Casinos, Inc*. 564 F.2d 1218, 1219 (9th Cir. 1977)).

26 131 S. Ct. at 2857 (internal quotation marks and citation omitted).

27 134 S. Ct. at 762.

28 *Perkins v. Benguet Consol. Mining Co.*, 342 U.S. 437, 444 (1952).

29 134 S. Ct. at 759.

30 131 S. Ct. at 2857.

# The Fallout from *Fisker* on Secondary Lenders and Loan-to-Own

It is a general expectation among secured creditors in bankruptcy that in the event a debtor seeks to sell property that is subject to a lien, the lienholder can "credit bid" its allowed claim for the assets being sold. This expectation holds where a debtor is seeking to implement a stand-alone sale of its assets under section 363(b) of the Bankruptcy Code or where the sale is to be consummated pursuant to a plan of reorganization or liquidation in accordance with section 1129(b)(2) of the Code. Under both scenarios, the right to credit bid is essentially a right to set a price floor for the assets on the auction block. By credit bidding its claim, or a portion of its claim, the creditor is effectively requiring interested third-party purchasers (or other secured lenders in the case) to overbid the credit bid and cash out the existing creditor.

### Stand-Alone Sales

The ability of a secured lender to credit bid its claim has generally been viewed as a sacrosanct right. This right is codified in section 363(k) of the Bankruptcy Code, which provides that in connection with a sale of property subject to a lien that secures an allowed claim, the holder of the allowed claim may bid at a sale and may offset its claim against the purchase price of the property "unless the court for cause orders otherwise."

This statutory provision raises a number of considerations. First, the statute provides that the bankruptcy court can limit, condition, or modify the secured creditor's credit bid right "for cause." What constitutes cause under the statute is not defined. Second, the statute authorizes a creditor to bid its "allowed claim" for the property being sold by the debtor. It does not authorize a secured creditor to bid its debt; nor does it authorize a creditor to bid a claim that is disputed. In addition, contingent or unliquidated claims that may exist must be allowed in a specific amount in order for a lender to participate in a bankruptcy auction. If a timing issue arises -- i.e., the bankruptcy auction is scheduled prior to the claim allowance process -- a bankruptcy court can authorize a secured creditor to credit bid its secured claim on the condition that the creditor true up its bid with cash in the event its lien is avoided and/or its claim is disallowed, subordinated, or recharacterized down the road.

Due to a number of factors, including (i) the expensive nature of chapter 11, (ii) the challenges facing an operating business with assets that are fully encumbered and/or significantly overleveraged, and (iii) the prevalence of distressed debt traders in chapter 11 cases, stand-alone sales of substantially all of a debtor's assets under section 363(b) have become much more common over the past five years. In devising loan-to-own strategies in connection with distressed

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## *The Fallout from Fisker on Secondary Lenders and Loan-to-Own* *continued*

companies, the Delaware Bankruptcy Court's decision in *In re Fisker Auto. Holdings, Inc.* should be kept closely in mind.

### *In re Fisker Auto. Holdings, Inc.*, Case No. 13-13087 (KG) (Bankr. D. Del. Jan. 17, 2014)

Fisker Automotive Holdings (the "Debtor") produced hybrid electric cars but ran into financial distress due to operating difficulties. When the company's senior secured loan from the U.S. Department of Energy in the amount of $168 million was purchased by Hybrid Tech Holdings, LLC ("Hybrid") for $25 million, the company entered into negotiations over the terms of its sale to Hybrid. The Debtor filed a chapter 11 petition with the intent to sell substantially all of its assets to Hybrid and immediately filed a sale motion. Hybrid's purchase offer was a credit bid of $75 million of the $168 million loan that it purchased just prior to the bankruptcy petition date. The Debtor planned to propose a liquidating chapter 11 plan after the sale closed.

The Official Committee of Unsecured Creditors (the "Committee") opposed the Debtor's proposed transaction with Hybrid, which essentially amounted to an attempt to consummate a "private sale" within a month or two after the commencement of the bankruptcy case. The Committee favored a public auction in which Hybrid and another interested purchaser, Wanxiang America Corporation ("Wanxiang"), would participate. From the Committee's standpoint, a credit bid provided the unsecured creditors no real benefit. A cash transaction, on the other hand, would provide immediate liquidity to the bankruptcy estate, and could fund distributions to the unsecured creditors, pay administrative expenses, and/or provide the estate with seed money to prosecute claims on behalf of the unsecured creditors. In Wanxiang, the Committee saw a strategic buyer who could provide the bankruptcy estate with real value. Wanxiang had just purchased certain assets of A123 Systems for $300 million, assets that included the lithium ion battery, a key component for the Fisker cars.

The Committee's request to limit Hybrid's right to credit bid was predicated on the Committee's assertions that Hybrid did not have a properly perfected lien on certain of the assets that would be sold (i.e., the assets were not part of Hybrid's collateral) and Hybrid's lien was the subject of a bona fide dispute (i.e., the nature and classification of Hybrid's claim were disputed by the Committee); and further, that limiting the credit bid would facilitate a competitive cash auction. Both the Debtor and Committee agreed that if Hybrid's ability to credit bid was not capped, an auction would be futile because Wanxiang was not prepared to bid an amount in excess of the $75 million credit bid. The Debtor argued that an auction would be futile and would only impose transaction costs on an already insolvent estate.

In deciding to cap Hybrid's right to credit bid its secured claim at $25 million, the Bankruptcy Court reasoned that section 363(k) did not give creditors an unqualified right to credit bid. The court observed that if it did not limit the credit bid of Hybrid, there would be no bidding by Wanxiang. Furthermore, the court reasoned that neither the Debtor nor Hybrid provided the court with a satisfactory reason why the Debtor's assets needed to be sold within a month of the bankruptcy filing pursuant to a private sale (i.e., no auction process). The court ruled that such a rushed and private process was inconsistent with the notion of fairness and transparency. Finally, and perhaps most importantly, the court was cognizant of the Committee's concerns that the nature of Hybrid's claim was uncertain. In fact, Hybrid acknowledged that its lien on certain of the assets to be sold was not perfected. Thus, while the amount of the claim was $168.5 million as of the petition date, it was unclear how much of that claim was secured by the assets being sold versus how much of the claim was unsecured or disputed.

*Fisker* illuminates the uncontroverted principle that the statutory right to credit bid is limited to a bid of an allowed secured claim. In *Fisker*, the court emphasized that the validity of Hybrid's secured status had not been determined. Because the exact scope of its lien was unclear and how much of its claim would be allowed as a secured claim was uncertain, cause existed to cap Hybrid's credit bid. Admittedly, the bankruptcy court's opinion focused on the chilling effect of a credit bid, rather than on the cloud surrounding Hybrid's lien. Nonetheless, the result is the same. Importantly, the Committee was able to limit Hybrid's credit bid without filing a claim objection or commencing an adversary proceeding to avoid Hybrid's lien.

### Subsequent Rulings in *Fisker*

In response to the bankruptcy court's ruling capping Hybrid's right to credit bid, Hybrid filed an emergency motion with the district court for leave to appeal the underlying Bankruptcy Court decision. On February 7, 2014, the district court issued a ruling that Hybrid could not appeal the bankruptcy court's decision because the order capping Hybrid's credit bid was not a final order immediately appealable as of right. Nor was the order an interlocutory one of a nature that warranted an exercise by the district court of its discretion to hear the appeal. In fact, the district court noted that

> there is no reason why the auction contemplated by the Committee and the Bankruptcy Court cannot proceed with Hybrid bidding alongside other parties and Hybrid receiving a cash adjustment should the Bankruptcy Court ultimately decide Hybrid's credit bid should not have been capped. The fact that Hybrid can be reimbursed out of the proceeds of the auction should the Bankruptcy Court ultimately decide that Hybrid's credit bid should not have been capped weighs against permitting the interlocutory appeal. *In re Fisker Auto. Holdings, Inc.*, C.A. No. 14-cv-99, 2014 U.S. Dist. LEXIS 15497, **17-18 (D. Del. Feb. 7, 2014).

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## *The Fallout from Fisker on Secondary Lenders and Loan-to-Own* continued

The district court also denied Hybrid's motion for leave to appeal directly to the Third Circuit Court of Appeals. *In re Fisker Auto. Holdings, Inc.*, C.A. No. 14-CV-99, 2014 U.S. Dist. LEXIS 17689 (D. Del. Feb. 12, 2014). On that motion, the district court noted controlling authority on limiting or denying a credit bid right in order to foster a competitive auction in *In re Philadelphia Newspapers, LLC*, 599 F.3d 298 (3d Cir. 2010).

Because the order capping Hybrid's credit bid right was interlocutory and was not of a kind that the district court sought to decide on appeal, Hybrid was essentially stuck with a capped right to credit bid its claim at $25 million at the bankruptcy auction. The auction went 19 rounds, and resulted in a winning bid by Wanxiang Group in the amount of $149.2 million, six times what the Debtor initially sought when it filed for bankruptcy. Wanxiang's winning bid had a cash component in the amount of $126.2 million.

### Sale of Assets Under a Plan

While *Fisker* involved a stand-alone sale of substantially all the Debtor's assets under section 363(b) of the Bankruptcy Code, there is no reason why the Fisker ruling would not apply in connection with a sale of assets pursuant to a plan of reorganization. After all, section 363(k) is expressly incorporated into section 1129(b)(2)(A)(ii), which provides that a plan of reorganization is fair and equitable with respect to a secured creditor if, with respect to the sale of property that is encumbered by such creditor's liens, the plan allows the secured creditor to credit bid its claim per section 363(k) and the plan provides that the secured creditor's liens attach to the sale proceeds. The issues raised by the Fisker decision, namely the validity of Hybrid's lien, the scope of its lien with respect to the assets being sold, and the deep discount at which Hybrid purchased the outstanding debt, would be on the table even in the case where the Debtor intended to sell the assets pursuant to a plan of reorganization or pursuant to a plan of liquidation.

Less clear is whether a court would limit Hybrid's right to credit bid its claim in the context of a plan of reorganization or liquidation. Rather, it might find that the proposed plan is not in the best interests of the estate given the existence of a cash offer for the assets by a third party. Furthermore, a court might require that the value and scope of a debtor's lien be fully adjudicated prior to or in conjunction with deciding confirmation. In other words, in the context of a plan of reorganization, a court might reach the same outcome by different means.

### General Observations Regarding the *Fisker* Decision

The *Fisker* decision provides a not-so gentle reminder of three maxims. First, bankruptcy courts are suspicious of private sales, especially private sales to a prepetition lender on a fast-track (i.e., within weeks of the commencement of the bankruptcy case). Second, secured creditors can only credit bid secured claims that are allowed, which may not equal the amount of the debt outstanding in instances where the claim holder's lien does not encumber certain of the assets being sold, where the validity of the lien is subject to dispute, or even further, where the amount of the claim is disputed. Third, the statute provides that courts may limit the credit bid right for cause, and cause includes the chilling or freezing of bidding by third-parties as a result of a large secured claim.

The *Fisker* ruling raises serious implications for distressed debt investors looking for strategic loan-to-own opportunities. An attractive buy-in on the front-end of a bankruptcy may very well hamstring the investor's ability to purchase the assets in bankruptcy pursuant to a credit bid, especially if the creditor is not willing to round out its offer with cash consideration in the subsequent bankruptcy case.

*Fisker* is a reminder that the bankruptcy process can be a rocky road. Bankruptcy courts are tasked with weighing not only the secured lender's legal rights in collateral that is property of a debtor's estate, but also the interests of other creditors, employees, state agencies and the public interest. A secured lender who fails to exercise due diligence as to the scope and extent of its liens up front and in advance of fueling a sale process will do itself no favors before a bankruptcy court.

*Fisker* should also be a red flag to investors in the distressed debt market that buying a claim at a deep discount prior to a bankruptcy case will not automatically allow the holder to bid the full amount of the claim for the assets on the back-end of a bankruptcy case. Process is key, and the Delaware bankruptcy court in *Fisker* held that the process was flawed.

At the same time, had Hybrid buttoned up the extent, validity and scope of its lien on the assets being sold prior to the bankruptcy filing or shortly thereafter and had done so prior to Debtor's commencement of the sale process, it is hard to imagine that the Delaware court would have ruled as it ruled. However, had Hybrid done the above, it probably would have realized through its own diligence that it could not have credit-bid the full amount of its claim. By failing to conduct the diligence necessary, Hybrid unsuccessfully tried to pass off that burden onto what amounted to a rushed and flawed sale process.

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