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## Feature

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



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

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

#### Background

The *Free Lance-Star* was a family-owned business involved in publishing, print and radio broadcasting primarily in Fredericksburg, Va.<sup>5</sup> In business for more than 130 years, the company relied intermittently on financing to expand its operations, which initially consisted of newspaper publishing, followed by expansion into radio

broadcasting beginning in the 1960s. In 2007, in an attempt to further diversify its business, the company expanded into the commercial printing business.<sup>6</sup> The company, along with a related entity, William Douglas Properties LLC, obtained a loan from BB&T Bank of \$50.8 million to finance the design and construction of a state-of-the-art commercial printing facility.<sup>7</sup>

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

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

1 *In re Fisker Auto. Holdings Inc.*, No. 13-13087 (KG) 2014 Bankr. LEXIS 230 (Bankr. D. Del. Jan. 17, 2014); *Hybrid Tech Holdings LLC v. Official Committee of Unsecured Creditors of Fisker Auto. Holdings Inc. (In re Fisker Auto. Holdings Inc.)*, No. 14-CV-99 (GMS) 2014 U.S. Dist. LEXIS 17689 (D. Del. Feb. 7, 2014). See also Oscar N. Pinkas and Joseph G. Selby, "Is Fisker Automotive Holdings a New Limit on Credit-Bidding?," XXXIII *ABI Journal* 4, 14, 84-86, April 2014.

2 *In re The Free Lance-Star Publishing Co. of Fredericksburg, Va.*, No. 14-30315-KRH 2014 Bankr. LEXIS 1611 (April 14, 2014); *DSP Acquisition LLC v. The Free Lance-Star Publishing Co. of Fredericksburg, Va. (In re The Free Lance-Star Publishing Co. of Fredericksburg, Va.)*, Nos. 3:14cv303-HEH, 3:14cv304-HEH 2014 U.S. Dist. LEXIS 63274 (E.D. Va. May 7, 2014). Hunton & Williams LLP represented the official unsecured creditors' committee in *Free Lance-Star*.

3 *Free Lance-Star*, 2014 Bankr. LEXIS 1611, at \*26.

4 *Free Lance-Star*, 2014 U.S. Dist. LEXIS 63274, at \*9, 10-15.

5 *Free Lance-Star*, 2014 Bankr. LEXIS 1611, at \*7.

6 *Id.* at \*8.

7 *Id.*

8 *Id.* at \*9.

9 *Id.* at \*10. The bankruptcy court assumed for the purpose of the opinion that DSP was the holder of the debtors' debt, as there was some uncertainty regarding the noteholder's identity.

10 *Id.*

11 *Id.*

12 *Id.* at \*11.

13 *Id.*

14 *Id.*

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

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

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

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

15 *Id.* at \*12.

16 *Id.*

17 *Id.* at \*13.

18 *Id.* at \*14.

19 *Id.*

20 *Id.* at \*14-15.

21 *Id.*

22 *Id.* at \*15.

23 *In re The Free-Lance Star Publishing Co. of Fredericksburg, Va.*, No. 14-30315-KRH, Docket Nos. 111, 112 (March 10, 2014).

24 *Free Lance-Star*, No. 14-30315-KRH, Adv. Proc. No. 14-3038-KRH (March 10, 2014).

## The Bankruptcy Court’s Decision

Following combined hearings concerning the motions for summary judgment in the adversary proceeding and the issues identified in the bid procedure orders, the bankruptcy court determined that “cause” existed under § 363(k) to limit DSP’s right to credit-bid,<sup>25</sup> finding that

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

The bankruptcy court also stated that

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

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

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

## The District Court’s Decision

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

25 The bankruptcy court also determined that DSP’s liens did not extend to certain of the debtors’ assets, including the tower parcels, motor vehicles, Federal Communications Commission licenses, insurance policies and bank accounts. The court entered an order in the adversary proceeding filed by DSP that denied DSP’s motion for summary judgment and granted, in part, the debtor’s motion for summary judgment. *Free Lance-Star*, Adv. Proc. No. 14-3038-KRH 2014 Bankr. LEXIS 1644 (April 14, 2014).

26 *Free Lance-Star*, 2014 Bankr. LEXIS 1611, at \*20.

27 *Id.* at \*22.

28 *Id.* at \*24.

29 *Id.* at \*12.

30 *Id.* at \*26-27.

31 *Free Lance-Star*, No. 14-30315-KRH, Docket No. 191 (April 15, 2014).

32 *Free Lance-Star*, No. 14-30315-KRH, Docket No. 2013 (April 18, 2014).

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

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

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

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

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

a difference of opinion existed where the Third Circuit had previously identified that one of the reasons for denying a credit-bid right was "to foster a competitive bidding environment."<sup>43</sup>

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

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

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

## The Sale

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

## Conclusion

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

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33 *Id.*

34 *Free Lance-Star*, 2014 U.S. Dist. LEXIS 63274, at \*7-8.

35 *Id.* at \*8.

36 *Id.*

37 *Id.* at \*9.

38 *Id.* at \*10.

39 *Id.* at \*11.

40 *Id.* at \*15.

41 *Id.* at \*11.

42 *Id.* at \*11-12.

43 *Id.* at \*12.

44 *Id.* at \*13-14.

45 *Id.* at \*14.

46 *Id.* at \*14-15.

47 *Id.*

48 *Id.*