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Delaware Bankruptcy Court Overrules Objection of Lone Dissenting Syndicate Lender to Collateral Agent's Credit Bid

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One of the key protections afforded to secured creditors under the Bankruptcy Code is the right of a holder of a secured claim to credit bid the allowed amount of its claim as part of a sale process under section 363 of the Bankruptcy Code. Specifically, section 363(k) of the Bankruptcy Code provides that:

> At a sale under subsection (b) of this section of property that is subject to a lien that secures an allowed claim, unless the court for cause orders otherwise the holder of such claim may bid at such sale, and, if the holder of such claim purchases such property, such holder may offset such claim against the purchase price of such property.

11 U.S.C. §363(k).

Although straightforward in concept, the notion of credit bidding can be complicated by the realities of large chapter 11 cases, where oftentimes the senior secured lender is a syndicate of lenders under a common credit agreement or secured indenture. In such instances, the collective nature of the debt gives rise to potential conflicts among lenders regarding the appropriate strategy in pursuing recovery on their claims.

In the bankruptcy sale context, this can lead to disputes among lenders in a syndicate as to whether to pursue a credit bid under section 363(k). If the majority of lenders pursue a credit bid, but certain lenders object, is the credit bid valid? Can the sale process proceed over the objection of the hold-out lenders?

When debt documents specifically address these issues, the result may be clear. When there is ambiguity in the debt documents or the debt documents fail to address the issue, litigation may ensue, as was the case in the recently decided opinion by Bankruptcy Judge Peter Walsh of the District of Delaware in the case of *In re GWLS Holdings, Inc.*, Case No. (08-12430) (February 23, 2009) ("*GWLS*").

The facts of *GWLS* are straightforward. Prior to the petition date, the debtors' capital structure comprised (i) a first lien credit agreement (the "First Lien Credit Agreement") in the amount of $337 million, which was secured by a first lien in substantially all of the debtors' assets (the "First Lien Facility"), and (ii) a second lien credit agreement (the "Second Lien Credit Agreement") in the amount of $117 million secured by a second lien in substantially all of the debtors' assets (the "Second Lien Facility"). Concurrently with the execution of the First and Second Lien Credit Agreements, two related documents were executed: (i) the first lien guaranty and collateral agreement (the "Collateral Agreement") and (ii) an intercreditor agreement between the agents under the First and Second Lien Credit Facilities (the "Intercreditor Agreement").

Shortly after the petition date, the debtors filed a motion for approval of bidding procedures and the sale of substantially all of their assets. The debtors' bidding procedures contemplated the first lien lenders acting as the "stalking horse" buyers under an asset purchase agreement that would consummate the sale transaction primarily through a credit bid in the amount owing under the First Lien Facility. The court approved the debtors' bidding procedures motion, and, thereafter, the debtors engaged in a marketing process for the sale of their assets. Ultimately, having received no qualified competing bids, the debtors cancelled their scheduled auction and proceeded to seek court approval of a sale of their assets to the first lien lenders.

Grace Bay Holdings, II, LLC ("Grace Bay"), a first lien lender that did not consent to the first lien lenders' credit bid, filed an objection to the sale, arguing that the First Lien Credit Agreement and Intercreditor Agreement each required the unanimous consent of the first lien lenders before a credit bid could proceed. Grace Bay held approximately $1 million in the First Lien Facility. Grace Bay's objection centered on two provisions set forth in the First Lien Credit Agreement and the Intercreditor Agreement. Specifically, Grace Bay highlighted the "Amendment and Waiver" provision of the First Lien Credit Agreement, which provided, in relevant part, as follows:

> 11.1 Amendment and Waiver ... no Credit Document nor any terms thereof may be amended, supplemented or modified in accordance with the provisions of this subsection 11.1.
>
> ***
>
> (a) no such waiver and no such amendment, supplement or modification shall (i) release all or substantially all of the

> Collateral or alter the relative priorities of the secured obligations entitled to the Liens of the Security Documents, in each case without the written consent of all Lenders ...

Grace Bay then cited the following provision of the Intercreditor Agreement:

> (a) So long as the Discharge of the First Lien Obligations has not occurred, whether or not any Insolvency or Liquidation Proceeding has been commenced by or against the Borrower or any other Credit Party:
>
> ***
>
> (ii) the First Lien Collateral Agent and the [first lien lenders] shall have the exclusive right to enforce rights, exercise remedies ... and make determinations regarding the release, disposition or restrictions with respect to the Collateral without any consultation with or the consent of the Second Lien Collateral Agent or any Second Lien Secured Party.

Grace Bay argued that the credit bid contemplated in the asset purchase agreement was an "amendment or waiver" of the First Lien Credit Agreement that had the effect of releasing the collateral securing the First Lien Facility. Consequently, Grace Bay argued that the unanimous consent of the first lien lenders was required to proceed with the credit bid. Moreover, Grace Bay argued that the Intercreditor Agreement, as cited above, did not allow for the first lien collateral agent to act unilaterally in moving against the collateral, but that the first lien collateral agent and the first lien lenders, collectively, had the exclusive right to move against the collateral.

In response, the debtors and the first lien lenders argued that the credit bid was valid and enforceable pursuant to two sections of the First Lien Credit Agreement and the Collateral Agreement. The applicable provision of the First Lien Credit Agreement provided that:

> Each of the Lenders and the Issuing Lenders hereby irrevocably appoints UBS AG, Stamford Branch, to act on its behalf as ... the Collateral Agent hereunder and under the other Credit Documents and authorizes such Agents to take such actions on its behalf and to exercise such powers as are delegated to such Agents by the terms hereof or thereof, together with such actions and powers as are reasonably incidental thereto.

Further, the Collateral Agreement provided in relevant part that:

> If an Event of Default shall occur and be continuing, the Collateral Agent, on behalf of the other Secured Parties, may exercise ... all rights and remedies of a secured party under the New York UCC or any other applicable law.

The debtors and the first lien lenders argued that the First Lien Credit Agreement appointed and authorized the collateral agent to exercise, on behalf of the first lien lenders, all rights and powers delegated to the collateral agent under the First Lien Credit Agreement and the Collateral Agreement. The debtors and first lien lenders further argued that the Collateral Agreement authorized the collateral agent, upon an event of default, to exercise all rights and remedies on behalf of the first lien lenders available under applicable law, including the right to credit bid pursuant to section 363(k) of the Bankruptcy Code.

The Court agreed with the debtors' and first lien lenders' position, approving the sale to the first lien lenders and overruling Grace Bay's objection.[1] The Court first dismissed Grace Bay's argument that the credit bid effectuated an "amendment or waiver" of the Credit Agreement, which required unanimous lender consent. The Court found that the Collateral Agreement came into existence at the same time as the First Lien Credit Agreement and that the Collateral Agreement, or any exercise of the rights thereunder, could not effect an amendment, supplement, or modification of the First Lien Credit Agreement.

Moreover, pursuant to the First Lien Credit Agreement, the first lien agent was authorized to exercise all of the rights delegated to the first lien agent under the First Lien Credit Agreement and Collateral Agreement, including all rights the first lien agent had under the New York UCC or any applicable law. In that regard, the Court found that "[a]ny applicable law includes the Bankruptcy Code in general, and §363(k) in particular." Taking the Credit Agreement and Collateral Agreement together, the Court found that the first lien agent was clearly authorized to exercise a credit bid in furtherance of the amounts owing under the First Lien Facility, and that nothing in the Credit Agreement—including the amendment and waiver provision highlighted by Grace Bay—overrode that authorization.

The Court also found Grace Bay's argument with respect to the Intercreditor Agreement to be "strained and unpersuasive." The Intercreditor Agreement, the Court found, governed the respective rights of the first and second lien lenders with respect to the subject collateral and was not relevant to the question of whether the first lien agent could proceed with a credit bid without the unanimous consent of the first lien lenders.

Although the Court's decision preserved what likely it perceived to be the only viable conclusion to the debtors' bankruptcy case—a sale of the debtors' assets to the only apparent buyer—the analysis supporting the Court's decision is worth exploring.

For instance, although the Collateral Agreement may have authorized the collateral agent to act on the lenders' behalf during a default, a credit bid in a bankruptcy sale process is not necessarily a remedy exercisable upon an event of a default. Indeed, the rights under section 363(k) are bankruptcy-specific rights given expressly to holders of secured claims that can be exercised irrespective of the existence of an event of default under any lending documents.

In addition, presumably what is bid in a credit bid scenario is not the lien of the lenders held by the collateral agent but, instead, the debt against the borrower held by the lenders. While the collateral agent on behalf of the first lien lenders may have held the lien of the lenders on their collective behalf, it is not clear that the collateral agent held the lenders' claims, and, in fact, typically such an agent would not hold claims on behalf of the lenders. Instead, the lenders would hold such claims themselves. As such, it is not clear from the documents cited by the Court that the collateral agent actually had the authority to purchase the debtors' assets with claims held by other parties.

Finally, it is worth considering whether the Court would have reached the same result if the hold-out lender had a significantly larger portion of the syndicated debt than Grace Bay's $1 million claim. For instance, what if the lender held $168 million, or slightly less than 50 percent of the facility? While, as a technical matter, the amount of the claim should not matter, as an equitable matter, there might be a question as to whether it is reasonable to force the holder of almost half of a syndicated loan to credit bid against its wishes.

These issues can be mitigated through clear drafting that authorizes a collateral or administrative agent to credit bid an entire facility upon the direction of the requisite percentage of the syndicated loan. The requisite percentage of lenders, as well as other limits on the ability of the majority of lenders to require the minority to credit bid their debt, of course, could be the subject of significant negotiations at the inception of the loan.

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[1] The Court initially addressed and dismissed a challenge by Grace Bay to the Court's jurisdiction to address the contract interpretation dispute.