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CREDIT BIDDING: BACK TO BASICS

In this article, the authors offer a compact treatise on a secured lender's right to credit bid obligations owed to it in a sale of a borrower's assets. The topics covered include: the right to credit bid; the reasons to credit bid; limitations to credit bidding; the effect of loan documents; and the importance of diligence and strategy when preparing a credit bid.

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As we entered 2022, defaults and bankruptcies were at historic lows. Since then, however, inflation, rising rates, and supply chain issues (among other things) have increased the possibility of an uptick in distress activity. Regardless of whether we see continued growth and prosperity, or the pendulum swings the other way, understanding, and if applicable, properly negotiating and/or exercising, your rights and remedies as a lender (or potential lender) is an important tool to prepare for whatever is to come.

This article focuses on a secured lender's right to credit bid obligations owed to it in a sale of a borrower's assets. Specifically, we discuss legal considerations of credit bidding under the Bankruptcy Code, as well as practical considerations under a lender's loan documents.¹ While this article discusses credit bidding in the context of a secured lending relationship, the concept of credit bidding equally applies to secured creditors generally.

¹ While addressing credit bidding generally, the article does not address credit bidding in out-of-court situations such as Article 9 Sales and foreclosures.

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WHAT RIGHTS DOES A SECURED LENDER HAVE TO CREDIT BID UNDER THE BANKRUPTCY CODE?

With limited exceptions, the Bankruptcy Code permits a debtor to sell its assets free and clear of a secured lender's liens if certain conditions are met.² In connection with such a sale, however, a secured lender can generally "credit bid" its claim — i.e., offset its claim against the purchase price for the assets that are subject to such secured lender's lien.³

² 11 U.S.C. § 363(f) (estate's property can be sold free and clear of a third-party's interest in such assets if, among other things: (a) applicable nonbankruptcy law allows the sale free and clear of such interest, (b) the third-party consents to the sale, (c) the interest is a lien and the sale price is greater than the value of all liens, (d) the interest is in *bona fide* dispute, or (e) the entity could be compelled to accept money in satisfaction of its interest).

³ Specifically, section 363(k) of the Bankruptcy Code provides that "[a]t a sale under [section 363(b)] 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,