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Renewed Clarity After *Clear Channel*: Recent Cases Reaffirm the Finality of Section 363 Asset Sales

BENTON B. BODAMER AND JOSEPH J. BASILE

The finality of a Section 363 asset sale is a critical consideration for any potential buyer contemplating a purchase of assets from a debtor's estate. This article examines a purchaser's deal certainty under Section 363 of the Bankruptcy Code in the wake of an "aberrational" 2008 decision by the 9th U.S. Circuit Court of Appeals Bankruptcy Appellate Panel, which called into question longstanding jurisprudence that, absent bad faith or a stay, a consummated Section 363 asset sale could not be overturned on appeal. Notwithstanding the 9th Circuit Bankruptcy Appellate Panel's opinion in Clear Channel, several recent cases from other jurisdictions have fortunately confirmed the previously accepted wisdom.

Section 363(b) of the Bankruptcy Code permits a Chapter 11 debtor,¹ with court approval, to sell assets of the estate outside of the ordinary course of business prior to confirmation of a Chapter 11 plan. The predecessor statute to Section 363(b) was intended to facilitate the expeditious sale of assets that were either perishable or liable to deteriorate in value if not sold quickly, with the ultimate goal of preserving as much value as possible.² With that in mind, Congress included several provisions in Section 363 that are intended to encourage potential buyers to bid up, thereby maximizing proceeds for the estate.

Among these provisions is Section 363(f), the so called "lien stripping provision," which permits the bankruptcy court to approve a sale of assets

under Section 363(b) “free and clear of any interest in such property of an entity other than the estate”³ if any one of five conditions is satisfied. Assets may be sold “free and clear” if (1) applicable non-bankruptcy law permits, (2) the holder of the interest in the assets consents, (3) the interest is a lien and the sale price exceeds the value of all liens, (4) the interest is in *bona fide* dispute, or (5) the holder of the interest in the assets could otherwise be required to accept “a money satisfaction” of the interest.⁴

Perhaps even more important than the ability to sell assets free and clear is Congress’ recognition of the value of transaction certainty to a bidder. A potential purchaser of estate assets intending to utilize those assets in a business operation needs to know before opening her purse that the sale of assets to that purchaser will not thereafter become subject to appeal and prolonged litigation. Section 363(m) of the Bankruptcy Code is designed to address these concerns. In relevant part, Section 363(m) provides that:

[t]he reversal or modification on appeal of an authorization under subsection (b) or (c) of this [S]ection [363] of a sale or lease of property does not affect the validity of a sale or lease under such authorization to an entity that purchased or leased such property in good faith, whether or not such entity knew of the pendency of the appeal, unless such authorization and such sale or lease were stayed pending appeal.

In other words, if a bankruptcy court authorizes a debtor to sell its assets to a good faith purchaser pursuant to a Section 363(b) sale order, and the bankruptcy court does not stay consummation of such sale pending appeal, then the sale cannot be unwound once consummated, even if the underly-

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ing sale order is later challenged on appeal.⁵ Absent a stay, Section 363(m) has been described “as creating a *per se* rule automatically mooted appeals for failure to obtain a stay of the sale at issue.”⁶ Most U.S. appellate courts recognize this “statutory mootness rule,” that is, the non-appealable finality of an unstayed Section 363 sale to a good faith purchaser.⁷

***CLEAR CHANNEL* MAKES THINGS UNCLEAR**

On July 18, 2008, the Bankruptcy Appellate Panel (“BAP”) of the Ninth Circuit U.S. Court of Appeals struck a blow to the previously widespread certainty surrounding the finality of Section 363 sales with its decision in *Clear Channel Outdoor, Inc. v. Knupfer (In re PW, LLC)*⁸ (“*Clear Channel*”). At issue in *Clear Channel* was the sale of a bankruptcy estate’s assets to a senior creditor under Section 363(b). The bankruptcy court’s sale order permitted the senior creditor to credit bid the entire purchase price and, pursuant to Section 363(f) of the Bankruptcy Code, acquire the assets free and clear of the liens previously held by a junior creditor. The BAP acknowledged that (i) no stay was granted pending appeal, (ii) the sale was consummated during the appeals process, and (iii) the senior creditor purchased the assets in good faith.

Despite the language of Section 363(m), the BAP overturned the bankruptcy court’s order as to the lien stripping of the junior creditor’s interests, and thus unwound the 363 sale as to the “free and clear” transfer. In a detailed and academic opinion, the BAP concluded (without citing any case law on point) that Section 363(m) did not protect all terms of the final sale, only the fundamental transfer of title to the assets. The BAP explained that its holding effectively maintained validity of the transfer of the assets, albeit making the transfer subject to the pre-existing liens of junior creditors. From the perspective of the buyer, who was hardly expecting that the assets it agreed to purchase would remain subject to the liens of other creditors, the BAP’s decision effectively unwound the economics of the bargained-for sale and thereby also upset longstanding conventional wisdom regarding the finality of a sale under Section 363(b).

Unfortunately, the decision in *Clear Channel* left the business and legal communities to wallow in uncertainty regarding whether finality can

truly be obtained in a consummated sale under Section 363(b). Fortunately for those seeking to achieve deal certainty in Section 363 sales, other appellate courts have recently emphasized the continued existence of the statutory mootness rule, including as to lien stripping.

FREE AND CLEAR OF *CLEAR CHANNEL*?

Numerous federal circuit courts of appeals have taken advantage of recent opportunities to distance their jurisprudence from that of the Ninth Circuit BAP in *Clear Channel*. These recent reaffirmations of finality under Section 363(m), when viewed in light of pre-existing case law in many of these jurisdictions,⁹ show a general trend toward establishing *Clear Channel* as more “aberration”¹⁰ than law of the land. The U.S. Courts of Appeals for the Second Circuit, Sixth Circuit and Eighth Circuit have each reaffirmed the general applicability of the statutory mootness rule and the finality of unstayed Section 363 sales to good faith purchasers.

IN RE NASHVILLE SENIOR LIVING*: SIXTH CIRCUIT BAP REJECTS *CLEAR CHANNEL

In its 2009 opinion, *Official Comms. of Unsecured Creditors v. Anderson Senior Living Prop., LLC (In re Nashville Senior Living, LLC)* (“*Nashville I*”), the Sixth Circuit BAP reemphasized the applicability of Section 363(m) to “free and clear” sales under Section 363(f), and unflatteringly called the *Clear Channel* decision an “aberration.”¹¹ The appellants in *Nashville I* were challenging whether the bankruptcy court erred in granting a motion to sell property of a Chapter 11 debtor pursuant to Sections 363(b), (f) and (h).¹² The merits of the appeal and specific facts surrounding the bankruptcy court’s original order were deemed irrelevant in the BAP’s decision. The BAP cited the undisputed facts that the Section 363 sale was unstayed and had been consummated, and the good faith of the third party purchaser was uncontested. Upon determination of these facts, the BAP concluded that the appeal was moot without further consideration of the merits of the appeal, citing the statutory mootness rule embodied in

Section 363(m).

The Sixth Circuit BAP's 2009 opinion was recently upheld on appeal by the Sixth Circuit Court of Appeals ("*Nashville II*").¹³ Citing the various public policies underlying the Bankruptcy Code, the Sixth Circuit Court of Appeals in *Nashville II* focused on the desirability of "affording finality to judgments approving sales in bankruptcy," highlighting that "[f]inality is important because it minimizes the chance that purchasers will be dragged into endless rounds of litigation to determine who has what rights in the property" and that "finality increases the value of the property of the estate by protecting good faith purchasers from modification by an appeals court of the bargain struck with the debtor."¹⁴

IN RE POLAROID: EIGHTH CIRCUIT EMBRACES NASHVILLE, REJECTS CLEAR CHANNEL

In a recent 2010 decision, *Asset Based Resource Group, LLC v. U.S. Trustee (In re Polaroid Corporation)*¹⁵ ("*Polaroid*"), the U.S. Court of Appeals for the Eighth Circuit rejected the logic of the Ninth Circuit BAP in *Clear Channel*, and explicitly embraced the logic of *Nashville I*.¹⁶ *Polaroid* involved an appeal by creditors following conclusion of an auction process and closing of the resulting Section 363(b) sale. The sale order stripped such creditors of pre-existing liens pursuant to Section 363(f), resulting in a transfer of unencumbered title to the purchaser. The lienholders in *Polaroid* argued à la *Clear Channel* that reinstating their liens would not invalidate the sale order, but merely preserve the creditors' pre-existing rights. The court of appeals was not persuaded, holding that reinstatement of the liens would effectively unwind the benefit of the bargained-for sale embodied in the bankruptcy court's order. Citing Eighth Circuit precedent in multiple opinions and rejecting the logic of the *Clear Channel* decision, the *Polaroid* decision pointed to a long history of consistent jurisprudence regarding the statutory mootness rule. Specifically, the *Polaroid* court held that "Section 363(m) moots any challenge to an order approving the sale of assets to a good faith purchaser where (1) no party obtained a stay of the sale pending appeal, and (2) reversing or modifying the authorization to sell would affect the validity of the sale[.]"¹⁷

IN RE WESTPOINT STEVENS: SECOND CIRCUIT REAFFIRMS STATUTORY MOOTNESS RULE

In another 2010 decision, *Contrarian Funds LLC v. Aretex LLC (In re Westpoint Stevens, Inc.)*,¹⁸ the Second Circuit Court of Appeals upheld the continued validity of the statutory mootness rule in that jurisdiction, but highlighted the importance of the stay aspect of the mootness rule's finality. *Westpoint* involved a contest between two secured creditor groups for control of Westpoint Stevens, Inc. Pursuant to an auction process, a group of secured creditors affiliated with Aretex LLC and holding 40 percent of the first lien debt and a majority of the second lien debt submitted the winning bid. The Aretex group structured its bid so as to include a distribution of securities that would ultimately give control of Westpoint to the Aretex group. A competing bidder group of secured creditors holding a majority of the first lien debt and none of the second lien debt sought to appeal the sale order and moved for a stay of the sale.

As a result of negotiations between the two secured creditor groups, the parties agreed to dismiss the motion to stay the sale, while allegedly preserving via contractual agreement certain issues on appeal, including the lien release on the assets sold and distribution of certain securities following consummation of the sale (both of which were technically resolved in the Aretex group's favor pursuant to the sale order). Because the appellant secured creditors no longer sought a stay, the sale was consummated and the assets were purchased by the Aretex group as a good faith purchaser pursuant to the bankruptcy court's sale order. Consequently, the Second Circuit found that the appeal was moot, not only as to consummation of the sale itself, but also as to the other aspects of the sale as to which the right to appeal was allegedly preserved pursuant to agreement (including lien stripping and distribution of securities). Finding these issues to be integral to the approved sale, which had already closed, the Second Circuit held that Section 363(m) prevented any appeal from unwinding the transaction, despite a finding that the sale order itself was contrary to the pre-petition intercreditor arrangements.

CONCLUSION

The above recent cases show that, despite the “aberrational” Ninth Circuit BAP decision in *Clear Channel*, the finality of unstayed Section 363 sales to good faith purchasers remains unambiguous in most other jurisdictions. As highlighted by the *Westpoint* decision, the importance of obtaining a stay of the entire sale order is essential to protecting a secured creditor against a sale of assets free and clear of existing liens pending resolution of any aspect of the proposed sale.¹⁹

NOTES

¹ Although the statute by its terms permits a “trustee” to effect such a sale, a debtor in possession in a Chapter 11 case may avail itself of Section 363(b) as well.

² See *Comm. of Equity Sec. Holders v. Lionel Corp. (In re Lionel Corp.)*, 722 F.2d 1063, 1066-70 (2d Cir. 1983) (describing origins of and policies leading to Section 363(b)).

³ Although Section 363(f) contains no precise definition of an “interest in property,” there is a judicial trend toward a broad and expansive interpretation of the term to include not only mortgages, Article 9 security interests and other liens, but also obligations arising from ownership of the assets such as third party contract and tort claims. See, e.g., *In re Trans World Airlines, Inc.*, 322 F.3d 283 (3d Cir. 2003) (“[T]he trend seems to be toward a more expansive reading of ‘interests in property’ which encompasses other obligations that may flow from ownership of the property.” *Id.* at 289 (internal citation and quotation marks omitted)).

⁴ This last condition has been interpreted expansively to include interests that are “subject to monetary valuation.” *In re Trans World Airlines, Inc.*, 322 F.3d at 290-91.

⁵ See, e.g., *In re Amir*, --- B.R. ---, 2010 WL 3057573, at *5 (B.A.P. 6th Cir. Aug. 5, 2010) (citing Section 363(m) and *Weingarten Nostat, Inc. v. Serv. Merch. Co., Inc.*, 396 F.3d 737, 742 (6th Cir. 2005) in holding that “[t]he only jurisdiction an appellate court has over an unstayed [363] sale order is to determine if the buyer was a good faith purchaser[.]”).

⁶ *Parker v. Goodman (In re Parker)*, 499 F.3d 616, 620-21 (6th Cir. 2007).

⁷ *Id.*, at 621 (citing *In the Matter of The Ginther Trusts*, 238 F.3d 686, 689 (5th Cir. 2001); *U.S. v. Salerno*, 932 F.2d 117, 122-23 (2d Cir. 1991); *In re Stadium Mgmt. Corp.*, 895 F.2d 845, 847 (1st Cir. 1990); *Matter of Gilchrist*, 891 F.2d 559, 561 (5th Cir. 1990); *In re The Charter Co.*, 829 F. 2d 1054, 1056 (11th Cir. 1987); *In re Sax*, 796 F.2d 994, 997 (7th Cir. 1986); *In re Magwood*, 785 F.2d 1077, 1080 (D.C. Cir. 1986)); see also *Contrarian Funds LLC v. Aretex LLC (In re Westpoint Stevens, Inc.)*, 600 F.3d 231, 247 (2d Cir. 2010) (rule of statutory mootness applies “so long as the sale was made to a good faith purchaser and was not stayed pending appeal[.]”). It is worth noting that in order to find an appeal moot under Section 363(m) the Third Circuit employs a two part test requiring that both (1) the appellant failed to obtain a stay of the sale and (2) the reviewing court cannot grant effective relief without impacting the validity of the sale. See *Krebs Chrysler-Plymouth, Inc. v. Valley Motors, Inc.*, 141 F.3d 490, 499 (3d Cir. 1998). The statutory mootness rule is sometimes also referred to as the “finality” rule. See, e.g., *Nieters v. Sevcik (In re Rodriguez)*, 258 F.3d 757, 759 (8th Cir. 2001).

⁸ 391 B.R. 25 (B.A.P. 9th Cir. 2008).

⁹ See, e.g., *supra* at note 7 and accompanying text.

¹⁰ See, e.g., *Official Comms. of Unsecured Creditors v. Anderson Senior Living Prop., LLC (In re Nashville Senior Living, LLC)*, 407 B.R. 222, 231 (B.A.P. 6th Cir. 2009) (“*Clear Channel* appears to be an aberration in well-settled bankruptcy jurisprudence applying [Section] 363(m) to the “free and clear” aspect of a sale under [Section] 363(f).”). The Sixth Circuit BAP in *Nashville I* noted that the Ninth Circuit BAP in *Clear Channel* apparently ignored previous controlling Ninth Circuit jurisprudence applying Section 363(m) to a free and clear sale under Section 363(f). *Id.*

¹¹ *In re Nashville Senior Living, LLC*, 407 B.R. at 231.

¹² Section 363(h) deals with certain property held by the debtors and co-owners as tenants in common.

¹³ *Anderson Senior Living Prop., LLC v. Anderson Senior Living Prop., LLC (In re Nashville Senior Living, LLC)*, --- F.3d ----, 2010 WL 3447746 (6th Cir. Sept. 3, 2010).

¹⁴ *Id.*, at *8 (internal citations and quotation marks omitted).

¹⁵ --- F.3d ----, 2010 WL 2696748 (8th Cir. July 9, 2010).

¹⁶ *Id.*, at *1. See also *U.S. v. Asset Based Resource Group, LLC*, --- F.3d ---, 2010 WL 2791364 (8th Cir. July 16, 2010) (reaching similar conclusions regarding the inapplicability of *Clear Channel* and the persuasiveness of *Nashville I* in the

context of a lease of property in receivership).

¹⁷ *Id.*, at *2.

¹⁸ 600 F.3d 231, 247 (2d Cir. 2010).

¹⁹ It is also worth noting that, in order to invoke Section 363(m), some jurisdictions require the sale order to explicitly establish the “good faith” nature of the purchaser, while others permit good faith to be reviewed and established on appeal. See *In re Abbotts Dairies of Penn., Inc.*, 788 F.2d 143 (3d Cir. 1986) (requiring explicit statement in order approving sale establishing the purchaser as a good faith purchaser); *Onoili-Kona Land Co. v. Estate of Richards (In re Onoili-Kona Land Co.)*, 846 F.2d 1170 (9th Cir. 1988) (permitting establishment of “good faith” on appeal). Even if the case law of a jurisdiction permits a demonstration of good faith on appeal, by far the best practice is to establish the buyer’s good faith before the bankruptcy court and to include an explicit finding of good faith in the sale order.