LJN LAW JOURNAL NEWSLETTERS

The Bankruptcy Strategist®

An ALM Publication

Volume 26, Number 2 • December 2008

Clear Channel Muddies the Waters of § 363(m) Mootness Protection

By Shirley S. Cho & Bennett L. Spiegel

It is one of the fundamental tenets of bankruptcy law that a sale order will not be disturbed on appeal if no stay pending appeal is obtained so long as the purchaser is a good-faith purchaser. The Ninth Circuit BAP's recent opinion in *Clear Channel v. Knupfer*, 391 B.R. 25 (B.A.P. 9th Cir. 2008), threatens the sanctity of the mootness rule under Bankruptcy Code § 363(m). In Clear Channel, the BAP held that § 363(m) applies only to protect the portion of sale orders issued under § 363(b) or (c), but not to the "free and clear" relief under § 363(f). In reaching its conclusion, the BAP made two primary arguments: 1) on its face, § 363(m) only applies to sales of property under § 363(b) or (c); and 2) § 363(m) only protects the "validity of the sale" and not the "free-and-clear" relief under § 363(f), which it deemed merely a term of the sale.

Was the BAP's 'Plain' Reading of § 363(m) Correct?

The BAP held that § 363(m) "by its terms applies only to an 'authorization under subsection (b) or (c) of this section'" and not also to subsection (f). The BAP argued that although § 363(m) expressly protects authorizations to sell property under § 363(b) from attack on appeal, it does not expressly protect "authorizations under section 363(f) to 'sell property under subsection (b) … free and clear of any interest in such property." In other words, because § 363(m) does not specifically call out § 363(f), it must not apply to § 363(f).

But, if the plain reading of § 363(m) is so readily apparent and straightforward, one must ask why numerous courts before *Clear Channel*, including the Ninth Circuit,

have mooted appeals attacking § 363(f) relief under § 363(m) without hesitation. *See In re Robert L. Helms Const. & Dev. Co., Inc.*, 110 F.3d 1470, 1475 (9th Cir. 1997) ("*Helms I*"), vacated as to one of the consolidated appeals on other grounds; *In re Colarusso*, 382 F.3d 51, 61-62 (1st Cir. 2004); *In re Wintz Companies*, 230 B.R. 840, 844-45 (B.A.P. 8th Cir. 1999); *International Union, et al. v. Morse Tool*, Inc., 85 B.R. 666, 668 (D. Mass. 1988); *In re Lake Placid Co.*, 78 B.R. 131, 135 n.1 (W.D. Va. 1987); *In re Whatley*, 169 B.R. 698, 701 (D. Colo. 1994).

The answer seems obvious. Section 363(m) encompasses § 363(f) through § 363(b). Section 363(f) is a subcategory of sales under § 363(b) and by its plain terms incorporates subsection (b) as follows: "The trustee may sell property *under subsection (b) or (c) of this section* free and clear of any interest in such property … " 11 U.S.C. § 363(f) (emphasis added). While subsection (f) provides independent and additional relief from (b), *i.e.*, the ability to sell assets free and clear of liens or other interests in property, subsection (f) does not exist independently of subsection (b). In short, its authority is derived from subsection (b). At least three courts whose decisions are not referenced in *Clear Channel*, agree: "Because Section 363(f) simply refers to the trustee's authority under 363(b), this court holds that Section 363(m) applies to appeals from orders authorized under Section 363(f)." *In re Wieboldt Stores, Inc.*, 92 B.R. 309, 311 n.1 (N.D. Ill. 1988); *Morse Tool, Inc.*, 85 B.R. at 668; *In re Lake Placid Co.*, 78 B.R. 131, 135 n.1 (W.D. Va. 1987).

The Majority View

Indeed, the Ninth Circuit itself follows the majority view that a challenge to a free and clear sale order issued pursuant to § 363(f) can be mooted by § 363(m). *Helms I*, 110 F.3d at 1475. In *Helms I*, Southmark Corporation ("Southmark") sold a ranch to Double Diamond Ranch Limited Partnership (the "Debtor") subject to Southmark's option to repurchase. Southmark filed for Chapter 11. In Southmark's Chapter 11 case, it confirmed a Chapter 11 plan of reorganization that provided for the rejection of all executory contracts not previously assumed. The option to repurchase the ranch was not expressly assumed and therefore rejected to the extent executory. The Debtor then filed its own Chapter 11 case wherein it sought to sell the ranch to South Meadows Properties Limited Partnership (the "Purchaser"), free of Southmark's option. Southmark objected. The bankruptcy court determined that Southmark's option was an executory contract that was rejected under Southmark's Chapter 11 plan. Prior to the sale closing, the bankruptcy court granted a motion to amend the sale order to provide the Purchaser with additional comfort that the ranch was free and clear of Southmark's option pursuant to § 363(f)(4).

Two Related Appeals

There were two related appeals before the Ninth Circuit panel in *Helms I*. The first appeal by Southmark was whether its option was an executory contract under § 365, and the second appeal by the Purchaser directly raised the issue of whether the sale order it obtained under § 363(f)(4) was entitled to the protections of § 363(m). In connection with the second appeal, the Purchaser argued that § 363(m) protected the validity of its sale as a good-faith purchaser, including delivery of the ranch free and clear of the option pursuant to § 363(f)(4). *See* Reply Brief of Appellant, *South Meadows Properties Limited Partnership v. Southmark Corp.*, 1995 WL 17847679 at *2 (9th Cir. Dec. 26, 1995) ("Reply Brief"). The Ninth Circuit in *Helms I* agreed, ruling that the § 363(f) portion of the sale order "was not affected by these proceedings, and therefore [the] appeal is moot. 11 U.S.C. § 363(m)." *Helms I*, 110 F.3d at 1475 (citation omitted).

Subsequently, the Ninth Circuit vacated

Bennett L. Spiegel is a partner in the Jones Day's Business Restructuring & Reorganization practice, resident in Los Angeles. He would like to thank **Lance Miller**, an associate at the firm, for his assistance with this article. Mr. Spiegel is also on the Board of Editors of The Bankruptcy *Strategist*.

the *Helms I* opinion in an *en banc* decision only as to the first appeal (*i.e.*, regarding whether the option was executory), but noted in a footnote that *Helms I* also addressed the second appeal as to the 363(m) issue, which was not before the Ninth Circuit, en banc:

> The second [appeal], between South Meadows and Southmark, addressed whether, regardless of the ultimate validity of the option, the sale was free and clear under 11 U.S.C. § 363(f) and could not now be modified due to 11 U.S.C. § 363(m). The panel held the sale was free and clear of the option, and that case is now final. *See Unsecured Creditors' Comm. v. Southmark* (*In re Helms Constr. & Dev. Co.*), 110 F.3d 1470, 1475 (9th Cir. 1997) [*Helms I*].

In re Robert L. Helms Const. & Development Co., Inc., 139 F.3d 702, 704 n.2 (9th Cir. 1998) ("*Helms II*"). Notably, Judge Kozinski sat on both the *Helms I* panel as well as writing the *en banc* opinion in *Helms II*. Thus, it appears that the Ninth Circuit in *Helms I* addressed and decided the very issue considered by *Clear Channel*, *i.e.*, does § 363(m) protect against challenges to sale orders under § 363(f)? Whereas *Clear Channel* held that § 363(m) does not apply to sale orders under § 363(f), the Ninth Circuit in *Helms I* held otherwise. Although the focus of the *Helms I* opinion was the issue raised on the first appeal regarding the executory nature of the option and only addressed the § 363(m) appeal issue summarily, the issue was nonetheless addressed and decided by the Ninth Circuit. Notably, the BAP in *Clear Channel* did not address or cite *Helms I* or *Helms II*.

Does 'Free and Clear' Go to The 'Validity' of the Sale?

In *Clear Channel*, the BAP next reasoned as follows:

> Second, the subsection limits only the ability to "affect the validity of a sale or lease under such authorization …"
>
> This limitation leads us to conclude that Congress intended that § 363(m) address only changes of title or other essential attributes of a sale … The terms of those sales, including the "free and clear" term at issue here, are not protected. *Clear Channel*, 391 B.R. at 35-36.

In reaching its conclusion, the BAP assumed that "free and clear" relief is a "term" of a sale as opposed to an "essential attribute" going to the "validity" of a sale. Yet, the Ninth Circuit had considered this precise argument in *Helms I*. In its briefing to the Ninth Circuit in *Helms I*, the Purchaser rebutted Southmark's argument that a challenge to the § 363(f)(4) portion of the sale order did not go to the "validity" of a sale as follows:

> On appeal, Southmark concedes that Bankruptcy Code section 363(m) protects the validity of a sale of a debtor's property. Incredibly, however, Southmark argues that transforming a free and clear sale of the Property into a sale subject to Southmark's disputed option … somehow would not affect the sale's "validity." In sum, having failed to obtain a stay pending appeal, Southmark asks this Court to rewrite the terms of the consummated sale to decrease, after the fact, the value of the consideration received by the good faith purchaser. However, an unbroken line of authorities in this Circuit, a lack of appellate jurisdiction, and the statutory prohibition of section 363(m) simply do not allow for such a "modification on appeal." *Section 363(m) protects far more than the bare transfer of title*; it ensures that a good faith purchaser of a debtor's assets receives the full benefit of its bargain regardless of the pendency of an appeal … In order for South Meadows to obtain the benefit of its bargain, none of the sale's terms can be affected by an appeal, including whether the buyer takes the property free and clear of (or subject to) disputed interests. The protections afforded by section 363(m) would be rendered meaningless if on appeal a good faith buyer could be forced to pay a greater price or to accept previously eliminated disputed interests that would diminish the property's value or interfere with its enjoyment. Reply Brief, 1995 WL 17847679 at *2.

As discussed above, the Ninth Circuit ruled, albeit summarily, for the Purchaser, opining that § 363(m) did indeed moot any challenge to the Purchaser's free and clear title under § 363(f)(4). *Helms I*, 110 F.3d at 1475. Other courts agree. *See, e.g., Morse Tool*, 85 B.R. at 668.

An interpretation of § 363(m) that we find much more compelling than that of the BAP in *Clear Channel* has been advanced by Judge Haines (Bankr. D. Ariz.) in commenting on the *Clear Channel* decision. He points out that the language of § 363(m) is broader than protecting the "validity of a sale." Rather, it protects "the validity of a sale or lease *under such authorization*." *See* Clearing the Channel: Navigating the Sale Waters after Clear Channel, Written Materials to Accompany Sept. 3, 2008 Insolvency Law Committee Webinar, at 11 (emphasis added). Section 363(b) does not technically authorize sales. *Id.* Instead, under § 363(b), the court issues an order authorizing a sale after notice and a hearing. *Id.* So, § 363(m) protects authorizations by the court, or put another way, it protects sale orders issued by the court under § 363(b). *Id.* It follows that § 363(m) would extend to all portions of the sale order issued under the bankruptcy court's authorization, including free and clear relief under § 363(f). *Id.*

If the quality of title to assets being purchased is not an "essential attribute of a sale", we do not know what is. As Judge Haines observed in commenting on the Clear Channel decision, "an asset subject to liens is a very different asset than one free and clear of liens … Is it not sophistry to suggest that the 'validity of the sale' of an Escalade is not affected by an appellate court ruling that instead you get a Volkswagen?" *Id.*

Conclusion

Clear Channel invites disgruntled parties to challenge the "free and clear" provisions of § 363 sale orders without obtaining a stay pending appeal. In so doing, it cuts against the long-standing and well-established body of case law that holds that § 363(m) protection is necessary to promote finality of bankruptcy sales. Additionally, *Clear Channel* conflicts with numerous cases, including precedent from the Ninth Circuit in *Helms I*. We predict that *Clear Channel*, for the reasons discussed above, among others, will not be followed.