New York Law Journal
Corporate Update

WWW.NYLJ.COM

An incisivemedia publication

VOLUME 241—NO. 77

THURSDAY, APRIL 23, 2009

DISTRESSED MERGERS AND ACQUISITIONS

'Clear Channel': A Sea Change In 363 Sales?

By **Corinne Ball**

Last year, the Bankruptcy Appellate Panel of the Ninth Circuit (BAP) issued a controversial ruling in *Clear Channel Outdoor Inc. v. Knupfer (In re PW, LLC)*,[1] reversing an order of the bankruptcy court selling property "free and clear" of a junior lien under section 363(f) of the Bankruptcy Code. Despite the safe harbor provisions associated with bankruptcy sales under section 363, the appellate ruling resulted in the property remaining subject to the junior lien after the sale, when the negotiations, asset purchase agreement and the bankruptcy court's sale order all contemplated that the sale would be "free and clear" of all liens, claims and encumbrances. Additionally, the BAP's analysis of "363 sales" was unnecessarily broad, and overly limited a debtor's ability to use the "free and clear" provisions, thereby departing from the approach adopted by many bankruptcy and appellate courts.

Background

In *Clear Channel*, the debtor was a real estate development enterprise that owned property subject to several liens. The senior secured debt was nearly $43 million, and the junior lien secured just over $2.5 million in debt. The senior secured debt had been purchased by DB Burbank, an affiliate of a hedge fund, and the junior debt was held by Clear Channel Outdoor Inc. Since the real estate securing the debtor's loans constituted "single asset real estate" under the Bankruptcy Code,[2] the trustee needed to act quickly, or else the senior secured lender was likely to be granted relief from the automatic stay in order to prosecute its state foreclosure action against that real estate.[3] Thus, the trustee quickly negotiated with DB to establish procedures for a sale of the real estate "free and clear" of all liens, pursuant to section 363(f) of the Bankruptcy Code.

Judge Bluebond of the Bankruptcy Court for the Central District of California approved the bidding and sale procedures, where DB offered to serve as a "stalking horse" bidder, offering roughly $41 million for the real estate by "credit bidding" its claim.[4] After receiving no other bids conforming to the approved procedures, the trustee moved the court to approve a sale of the real estate, free and clear of several liens, including Clear Channel's lien, to DB for approximately $41 million, none of which would be paid in cash, since DB was owed in excess of that amount on its senior secured loan. DB also agreed to pay the state receiver's fee and a $550,000 "carve out" to pay the trustee, her attorneys and other administrative fees.

Clear Channel opposed the sale, claiming that a sale free and clear of liens was not authorized under section 363(f) of the Bankruptcy Code. Judge Bluebond disagreed and approved the sale. In her bench ruling, Judge Bluebond found that DB was a good faith purchaser of the real estate and found that section 363(f)(5) authorized the sales free and clear of all liens. Clear Channel immediately appealed this ruling and simultaneously sought a stay pending appeal in the bankruptcy court and later, the BAP. Both courts denied the request for a stay. DB and the trustee were unsuccessful in moving to dismiss the appeal as moot. Clear Channel convinced the BAP that the order of the bankruptcy court stripping Clear Channel's lien was not moot. While Clear Channel's appeal on the merits was pending, DB and the trustee closed the sale of the real estate, presumably in reliance upon the safe harbor provision of section 363(m).

Analysis of the Bankruptcy Appellate Panel

The BAP's analysis on appeal represents a novel approach to determining the extent to which a sale "free and clear" is authorized by section 363(f). It refuses to follow existing precedent, and instead purports to clarify the issues surrounding free and clear sales. Before it could reach the section 363(f) issue, however, the BAP first addressed whether Clear Channel's appeal was mooted by the fact that the sale had already occurred.

Mootness

After quickly dispensing with the idea that the appeal might be constitutionally moot, the court turned to the doctrine of equitable mootness. The court held that any appeal requesting that the court unwind the transaction as equitably moot would have to be premised upon findings that the process of unwinding the transaction would be too complex and would prejudice too many third parties who had relied on the validity of the sale. To the contrary, the BAP determined that the bankruptcy court's order was not moot because reinstating the lien was not complex. Additionally, there would be limited prejudice to third parties. The only parties who had relied on the bankruptcy court order selling the property free and clear were also parties to the appeal.

The court next turned to the safe harbor provision of section 363(m). The section provides an order approving a 363 sale cannot be reversed where the purchaser has acted in good faith and a stay pending appeal was not issued. Remarkably, the court separated the consummation of the sale from the consideration received, determining that section 363(m) protects only the sale itself under section 363(b), and not the "free and clear" determination under section 363(f). Rather than rely on well-established principles of mootness and prejudice as they apply to the specific facts presented, the appellate court instead sustained the sale but reinstated the junior lien. This left the buyer who intended to acquire a property free and clear of liens with newly-acquire property that was still subject to a lien.

The BAP's ruling, therefore, places significant limitations on the heavily relied upon safe harbor protections of section 363(m).

CORINNE BALL *is a partner at Jones Day.*

Section 363(f)(3)

The sale of property free and clear of all non-debtor interests is predicated upon the satisfaction of at least one of the five requirements of section 363(f).[5] On appeal, the BAP addressed whether the sale satisfied either section 363(f)(3) or (f)(5). Section 363(f)(3) requires that the sale price "exceed the aggregate value of all liens" on the property being sold. The appellate court attempted to reconcile this language with the language of section 506 of the Bankruptcy Code, which bases a secured creditors allowed claim on the economic value of collateral, not the face amount of the lien. Despite precedent supporting an interpretation of section 363(f)(3)'s reference to "value" be predicated on the economic value of the underlying property, the appellate panel held otherwise. Reasoning that if generally applicable economic approach of valuing the collateral was intended, there would be no basis for the differing language. Thus, the court held "value of all liens" must be interpreted to refer to the nominal amount of all the lien claims.

The court took comfort in the number of cases that similarly adopted the face value interpretation—that is, section 363(f)(3) requires that the debtor have "equity" in the property. These courts reason that statutory construction militates in favor of this interpretation; if Congress meant to refer to the value of the allowed secured claim, it could have worded the paragraph similarly to the rest of the Bankruptcy Code.

The appellate panel sought additional support for its interpretation of section 363(f)(3) in the precise wording, which requires that the sale price "exceed" the value of the liens, not "equal" this value. Their analysis explored the controversy by positing that if the "economic value," as opposed to the nominal value, were the correct interpretation, the standard of section 363(f)(3) could never be met. If the liens were valued in accordance with the sale price of the underlying collateral, the standard would never be met. The sale price at an effective auction should be precisely the economic value of the property, not in excess of it.

Unfortunately, the BAP's nominal value interpretation fails to account for the impact it has on the application of section 363(b). One of the major reforms effected by the Bankruptcy Code, section 363(b) enables a debtor to sell property—even property subject to liens—outside of a plan. By requiring the sale price in a 363 sale to exceed the face amount of all debt secured by the property sold, *Clear Channel* limits this provision to situations in which a debtor has equity in the property to be sold.

Section 363(f)(5)

To pursue a sale free and clear of liens under section 363(f)(5), the lienholder must be capable of being "compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest." Judge Bluebond had reasoned that liens can be satisfied by money payment, so all liens satisfy the section 363(f)(5) test. In the portion of the BAP opinion where the court moved away from a strict textual analysis, it held that "money satisfaction," in 363(f)(5) means satisfaction by payment of money less than the face amount of the lien, rejecting Judge Bluebond's analysis as impermissibly broad.

The appellate panel reasoned instead that if all liens were susceptible to stripping under section 363(f)(5), then section 363(f)(3) would be rendered superfluous. Interestingly, the appellate panel ignored the obvious argument that if their limited view of section 363(f)(3) were correct such that section 363(f)(3) is not available unless the debtor has equity in the property to be sold, Judge Bluebond's interpretation of section 363(f)(5) would not be superfluous. Instead, the court cited a number of cases for the proposition that section 363(f)(5) actually requires that there exists some proceeding to force satisfaction of the interest for money. As examples of such proceedings, the court offered proceedings that enforced liquidated damages provisions in contracts and settlement provisions in partnership agreements. The appellate panel then addressed precedent suggesting that confirming a plan of reorganization over the objection of a secured lender by providing such lender with the value of its collateral, the so-called "cramdown" provisions, was a proceeding within the ambit of section 363(f)(5).

The court held that allowing cramdown as a conforming type of legal or equitable proceeding would be "circular reasoning," allowing the benefits of cramdown without any of the related "checks and balances" that apply to a plan of reorganization.

Conclusion

Clear Channel presented a unique set of facts. First, it involved a single asset real estate case. Second, all interested parties were active and present in the appeal. Third, it involved a credit bid by the senior lienholder, thereby arguably affording it a form of protection.

Why would the Bankruptcy Code provide for a credit bid, if encumbered property can only be sold if a debtor has equity in the property? Although a credit bid may be subject to the discretion of the bankruptcy court, section 363(k) does not require a secured creditor to bid in excess of its lien, or only where there is a single lien on the property.

Interestingly, the appellate court did not reconcile section 363(k) with its reading of section 363(f)(3). If debtors can only sell for consideration exceeding the nominal amount of all liens on a property, when would a credit bid be relevant? The appellate panel's limited view of section 363(f)(3) makes the credit bid, heretofore perceived as a core creditor protection, superfluous. Had the senior lienholder relied upon the single asset real estate provisions rather than purchasing the assets in a 363 sale, it would have proceeded with its state law foreclosure rights, which would have yielded the same result as approved by the bankruptcy court.

Perhaps forcing lienholders to resort to their state law rights is appropriate in a single asset real estate case. It seems questionable in a more complex enterprise.

Should the reasoning of the appellate panel find support from other courts outside of the single asset real estate situation, debtors with secured debt may be deprived of a major tool to effect a restructuring of their businesses.

It is beyond doubt that chapter 11 should enable debtors to rehabilitate through contracting to a core business and remedy what may have proved to be improvident expansion by selling unprofitable or draining operations or properties. Rehabilitating a debtor to create a viable, sustainable business that has earnings potential to support a plan of reorganization is the critical focus of chapter 11. The limitation announced in *Clear Channel* seems to fly in the face of one of the basic tenets put forth in 1978—debtors can sell property outside of a plan.

The enactment of the Bankruptcy Code confirmed what reorganization courts had already recognized: selling property outside of a plan could be a necessary tool to effect a sensible restructuring and avoid potentially prejudicial control by the senior secured lenders.[6] Rather than show deference to a long line of cases and the avowed purpose of avoiding rigid application of absolute priority, the court limited the usefulness of 363 sales by engaging in a statutory analysis that is at best debatable, and at worst could be paralyzing.

1. 391 B.R. 25 (9th Cir. BAP 2008).
2. See 11 U.S.C. §101(51B).
3. See 11 U.S.C. §362(d)(3) (requiring the court to lift the automatic stay on an action by a lienholder against single asset real estate, unless the debtor makes monthly interest payments to the lienholder).
4. See 11 U.S.C. §363(k) (allowing a secured creditor to bid up to the amount of its secured debt, even if some of that debt translates into an unsecured claim under section 506(a) because the creditor is under-secured).
5. Section 363(f) requires that one of the following be true (1) the interest at issue could be stripped under applicable nonbankruptcy law, (2) the interest holder has consented to this aspect of the sale, (3) the interest is a lien and the sale price exceeds the aggregate value of all liens on the property, (4) the validity of the interest is the subject of a bona fide dispute and (5) there exists a legal or equitable proceeding pursuant to which the interest holder could be compelled to accept money satisfaction of its interest.
6. See H.R. REP. NO. 95-595, at 221 (1977) ("The trustee, or if the debtor remains in possession, the debtor, does what is necessary to reduce the business' losses, by selling unprofitable divisions, by closing certain plants or sto res, by reducing the workforces, or by rejecting or renegotiating burdensome contracts."); see also id. at 222 (criticizing chapter X of the Bankruptcy Act for holding too strictly to the absolute priority rule, and giving too much power to senior creditors).