SECTIONS 363 AND 364—USE, SALE, OR LEASE OF PROPERTY AND OBTAINING CREDIT

By Bruce Grohsgal[*]

I. INTRODUCTION

Section 363 of the Bankruptcy Code generally governs the use, sale, or lease of property of the bankruptcy estate.[1] Section 364 governs a debtor's or trustee's obtaining credit.[2] This article reports on opinions regarding those Code sections published from early 2011 to early 2012.

II. SECTION 363—USE, SALE, OR LEASE OF PROPERTY IN THE ORDINARY COURSE AND NOT IN THE ORDINARY COURSE

Section 363 permits the use, sale, or lease by the trustee or debtor-in-possession of property of the estate over which the bankruptcy court has jurisdiction.

The threshold dividing line under section 363 is between (1) transactions entered into (including sale and lease) or use of property of the estate in the ordinary course of the debtor's business, for which court approval is not required with respect to operating debtors,[3] and (2) those transactions and uses that are out of the ordinary course, for which court approval is required pursuant to section 363(b)(1) (as discussed in § III below).

In determining whether a transaction is in the ordinary course of the debtor's business, the courts most often apply either or both of (1) the horizontal or industry-wide test of whether the transaction is of a type that other similar businesses would

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[1]11 U.S.C.A. § 363.

[2]11 U.S.C.A. § 364.

[3]Code § 363(c)(1) provides that: "If the business of the debtor is authorized to be operated under section 721, 1108, 1203, 1204, or 1304 of this title and unless the court orders otherwise, the trustee may enter into transactions, including the sale or lease of property of the estate, in the ordinary course of business, without notice or a hearing, and may use property of the estate in the ordinary course of business without notice or a hearing."

engage in as ordinary course (the objective standard), or (2) the vertical or creditor's expectation test, which focuses on the debtor's prepetition business practices and the transaction at issue from the vantage point of a hypothetical creditor, and asks whether the transaction subjects the creditor to economic risks of a nature different from those he accepted when he decided to extend credit (the subjective standard).

In *In re Sportsman's Warehouse, Inc.* the debtor leased real property under a prepetition lease that gave it, as lessee, the option to purchase the property. Six months later, but still prior to the debtor's bankruptcy filing, the parties executed a lease confirmation memorandum, that stated that the lessee "will purchase the property on or before the Initial Term Expiration Date of December 25, 2008." The debtor did not purchase the property by that date, though it remained in possession of the property after that date.[4]

In March of 2009, the debtor commenced its Chapter 11 proceeding and shortly afterward the parties entered into an amendment of the lease that extended the initial term to March 1, 2010 and reduced the monthly rent, but did not specifically refer to the purchase provision of the lease. The debtor did not seek court approval of the postpetition lease amendment. In July 2009, the debtor sought to assume the lease, listing the cure amount as $0. The court approved the assumption of the lease on the same day that it confirmed the debtor's plan, and the assumption became effective shortly thereafter.[5]

In February 2010, the lessor commenced a state court action in Montana seeking among other things to compel the reorganized debtor to purchase the property, after which the reorganized debtor vacated the property and commenced an adversary proceeding in the Delaware bankruptcy court.[6] The reorganized debtor in that action sought, among other things, the bankruptcy court's ruling (1) on Count I that the purchase provision was a mere option and not an obligation of the reorganized debtor for the purchase of the property, and (2) on Count VI that the lease amendment extending the lease term (and thus the date for closing under the asserted purchase obligation) was void pursuant to Bankruptcy Code § 363.[7] The Montana state action was removed

[4] *In re Sportsman's Warehouse, Inc.*, 457 B.R. 372, 382 (Bankr.D.Del. 2011).

[5] *In re Sportsman's Warehouse, Inc.*, 457 B.R. at 382.

[6] *In re Sportsman's Warehouse, Inc.*, 457 B.R. at 382–383.

[7] *In re Sportsman's Warehouse, Inc.*, 457 B.R. at 386.

to federal court and the two actions eventually were consolidated in the Delaware bankruptcy court.[8]

The reorganized debtor argued with respect to Count VI that it could not have assumed the lease agreement with a mandatory purchase obligation because the agreement to purchase the property would have been out of the ordinary course of the debtor's business and thus would have required the bankruptcy court's approval.[9]

The court applied the horizontal and vertical tests, noting that, under the vertical test the primary focus is on the debtor's prepetition business practices and conduct, though a court must also "consider the changing circumstances inherent in the hypothetical creditor's expectations."[10]

The court concluded that under both prongs the debtor's entering into a contract binding it to purchase the real property before the expiration of the lease term could not be deemed an "ordinary course" transaction within the meaning of section 363. The horizontal test was not satisfied because it was unlikely that retailers of sporting goods, such as the debtor, "ordinarily purchase multi-million dollar properties; rather, it is much more likely that such businesses simply lease commercial space to operate their stores. Second, executing the Lease Amendment, to the extent that it contained the alleged mandatory purchase provision, could have likely exposed" the creditor "to greater risk during the pendency of [the debtor's] bankruptcy case than that to which it had been exposed when it executed the Lease Agreement prepetition. Simply put, there [was] nothing 'ordinary' about a commitment to buy a $7.5 million asset. Accepting the truth of [the debtor's] allegations—that it was indeed in the business of selling goods instead of buying multi-million dollar properties—the Court conclude[d] that the Lease Amendment, to the extent that it contained a mandatory purchase provision, could not have been executed without this Court's approval and, to the extent that it was, such a transaction would have violated § 363(b)(1)." Accordingly, the court found that the debtor had sufficiently alleged that it "could not have entered into the Lease Amendment and thereafter assumed the lease without violating the Bankruptcy

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[8] *In re Sportsman's Warehouse, Inc.*, 457 B.R. at 383.

[9] *In re Sportsman's Warehouse, Inc.*, 457 B.R. at 399.

[10] *In re Sportsman's Warehouse, Inc.*, 457 B.R. at 399, citing *In re Roth Am., Inc.*, 975 F.2d 949, 952 (3rd Cir. 1992).

Code. Such a transaction outside the 'ordinary course' of the debtor's business," was voidable.[11]

Ordinary course analysis also applies in Chapter 13 cases, since a Chapter 13 debtor who is self-employed may operate his or her business unless the court orders otherwise, and may enter into "transactions, including the sale or lease of property of the estate, if in the ordinary course of business, without notice or a hearing." The bankruptcy court in *In re Wheeler* characterized the horizontal and vertical tests in a Chapter 13 case as "requir-[ing] inquiry into the nature of industry practice and into a debtor's prepetition business conduct."[12] The *Wheeler* court considered the postpetition lease extension of property of which the Chapter 13 debtor was the "undisputed owner." Nonetheless, the debtor's wife (who was not a co-debtor) extended the lease and gave a purchase option of the property to third parties, under an agreement that listed the debtor's wife as "owner." The debtor had entered into previous agreements with the same third parties with respect to the same property, and was "personally present" at his wife's execution of the postpetition lease and option document.[13] The court found that the postpetition lease transaction was not made in the ordinary course of business and that the debtor intended to conceal the income from the lease and option transaction, thereby shielding it from the reach of the debtor's creditors. The court found unconvincing the debtor's claim that he had authorized his wife to sign the postpetition lease and option agreement as his agent, since the debtor "provided no cogent explanation as to why such authorization was needed given he was present when the documents were executed." Further, the debtor did not disclose the postpetition lease transaction or the income generated from that transaction to the Chapter 13 trustee, to the subsequently appointed Chapter 7 trustee of the debtor's estate, or to the court.[14]

In *In re Hawaiian Telcom Communications, Inc.*, the debtor terminated an employee without cause prepetition, triggering the obligation to make severance payments under the prepetition employment agreement. Postpetition, the debtor inadvertently made severance payments to the employee, and by an adversary

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[11] *In re Sportsman's Warehouse, Inc.*, 457 B.R. at 399–400.

[12] *In re Wheeler*, 444 B.R. 598, 612 (Bankr.D.Idaho 2011).

[13] *In re Wheeler*, 444 B.R. at 604, 612–613.

[14] *In re Wheeler*, 444 B.R. at 612–613.

proceeding sought to recover them.[15] The bankruptcy court observed that the "payment of a pre-petition debt by a debtor in possession or trustee has repeatedly been held to be out of the ordinary course of business" under section 363, and avoided the payments.[16]

The horizontal and vertical tests also apply to the determination of whether postpetition credit extended to the debtor is out of the ordinary course, and thus requires court approval under Bankruptcy Code § 364.[17] See § XIII of this update, below.

III. USE, SALE OR LEASE OF PROPERTY OUT OF THE ORDINARY COURSE OF BUSINESS—COURT APPROVAL REQUIRED

Bankruptcy Code § 363(b)(1) provides that a trustee or debtor-in-possession, "after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate."[18]

Estate Must Have Interest in the Property Proposed to be Used, Sold or Leased

A threshold requirement is that the estate must have an interest in the property proposed to be used, sold or leased. Section 363(b) indicates "the general rule that only 'property of the estate' may be sold pursuant thereto."[19] The question "of whether an interest claimed by a debtor is property of the estate is a matter of federal law"; however, the court must "look to state law to determine whether and to what extent the debtor has any legal or equitable interests in property as of the commencement of the case."[20]

The bankruptcy court's jurisdiction is essentially in rem, and thus the requirement that the property proposed to be used, sold

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[15] *In re In re Hawaiian Telcom Communications, Inc.*, 2012 WL 273614 *2 (Bankr.D.Ha.).

[16] *In re In re Hawaiian Telcom Communications, Inc.*, 2012 WL 273614 *5 (Bankr.D.Ha.).

[17] *In re Living Hope Southwest Medical SVCS, LLC*, 450 B.R. 139 (Bankr. W.D.Ark. 2011).

[18] 11 U.S.C.A. § 363(b)(1).

[19] *In re Interiors of Yesterday, LLC*, 2007 WL 419646 at *5 (Bankr. D. Conn. 2007).

[20] *In re NJ Affordable Homes Corp.*, 2006 WL 2128624 at *8 (Bankr. D. N.J. 2006) (citing *In re The Ground Round, Inc.*, 335 B.R. 253, 259, 45 Bankr. Ct. Dec. (CRR) 204, 55 Collier Bankr. Cas. 2d (MB) 629 (B.A.P. 1st Cir. 2005), aff'd, 482 F.3d 15, 48 Bankr. Ct. Dec. (CRR) 1, Bankr. L. Rep. (CCH) P 80904 (1st

or leased must be estate property is often referred to as jurisdictional. In *In re Wilkinson*, the Chapter 7 debtors owned (1) an exempt homestead, and (2) acreage that they had purchased from the Chapter 7 trustee free and clear of liens. The debtors, by adversary proceeding, sought court approval for the sale of part of the homestead and the acreage they had purchased from the trustee, free and clear of liens and interests. The bankruptcy court refused to do so. First, as the court noted, section 363(b) empowers a Chapter 7 trustee or a debtor-in-possession—not the debtor—to seek approval of sale of property of the estate.[21] Second, "and perhaps more importantly, because the property at issue [was] not property of the bankruptcy estate," the court "lack[ed] the subject matter jurisdiction to entertain the [debtors'] claims with respect to this property. '[W]hen property is transferred out of a bankruptcy estate free and clear of all liens, the bankruptcy court ceases to have jurisdiction over that property.' "[22]

A claim or cause of action is property of the estate, and the bankruptcy court in *In re Livingston* held that it "generally remains within the trustee's control until he or she sells, abandons, or otherwise disposes of the claim under one of several Bankruptcy Code sections. *See, e.g.,* 11 U.S.C. §§ 363, 554, and 725." Though "[s]ome courts regard exempt property as no longer included within the bankruptcy estate, . . . this view is difficult to square with the Supreme Court's decision in *Schwab v. Reilly*, 130 S. Ct. 2652 (2010), which effectively authorized the trustee to sell property under 11 U.S.C. § 363(b) even though the debtor, without objection from the trustee, claimed the full value of the property as exempt under 11 U.S.C. § 522. In other words, *Schwab* suggests that the personal property remains within the estate notwithstanding an exemption of an interest in that property."[23]

By contrast, the bankruptcy court in *In re Obrizzo* found that the value of the debtor's ownership interest in an auto body shop as of the petition date "was no greater than the amount of his claimed exemption therein; and that, because such interest was

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Cir. 2007) and citing *Butner v. U.S.*, 440 U.S. 48, 55, 99 S. Ct. 914, 918, 59 L. Ed. 2d 136, 19 C.B.C. 481, Bankr. L. Rep. (CCH) P 67046 (1979)).

[21] *In re Wilkinson*, 2012 WL 112945 *4 (Bkrtcy.W.D.Tex.), citing *Central State Bank v. McCabe (In re McCabe)*, 302 B.R. 873, 877 (Bankr.N.D.Iowa 2003).

[22] *In re Wilkinson*, 2012 WL 112945 *4, quoting *Borrego Springs Bank, LLC v. Skuna River Lumber, L.L. C. (In re Skuna River Lumber, LLC)*, 564 F.3d 353, 355 (5th Cir.2009).

[23] *In re Livingston*, 2011 WL 2694557 *1, n. 2 (Bankr.W.D.Mich.).

removed from the bankruptcy estate and revested in the Debtor, it [was] no longer property of the estate." Accordingly, the Chapter 7 trustee lacked the authority to sell the property, and the court sustained the debtor's objection to the trustee's notice of sale.[24]

The district court in *In re Friwat* affirmed the bankruptcy court's decision that the debtor's equitable title was sufficient for it to approve the sale of the property to a third party by the Chapter 7 trustee under section 363(b). The appellant, who held a judgment against Friwat, argued that the bankruptcy court did not have jurisdiction to approve the sale, because the real property did not belong to the debtor at the time of the bankruptcy, and thus it was never property of the estate. The appellant contended that because the debtor, Friwat, had transferred legal title to the property to JF Oil prepetition, JF Oil held legal title to the property when the debtor Friwat filed his Chapter 7 bankruptcy. The district court ruled that "[b]ankruptcy courts have subject matter jurisdiction to determine what is property of the estate," citing section 105(a).[25]

Because the debtor, Friwat, was "the sole owner of JF Oil, and the grant deed indicated that Friwat and JF Oil were comprised of the same party and continued to hold the same interest notwithstanding the transfer," the bankruptcy court "determined that the debtor retained equitable title to the property even after he transferred the legal title to the property to JF Oil Company" and approved the sale. The district court affirmed.[26]

An unexpired lease is property that the trustee or debtor-in-possession may sell pursuant to section 363.[27]

Section 363(b) Applies Only to Debtors in Possession, Trustees and Other Estate Representatives

In *In re Wilson*, a loan servicer obtained stay relief to foreclose on the Chapter 13 debtor's real property. In the midst of the foreclosure proceedings, the servicer was approached by ostensible representatives of the debtor and asked to, and did, accept a reduced payoff in full satisfaction of the mortgage. That settlement enabled one of the debtor's purported "representatives" to purchase the property and sell it at a profit. The debtor's case converted to Chapter 7 and the Chapter 7 trustee sued the

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[24]*In re Obrizzo*, 2011 WL 4344540 *3 (Bankr.D.Conn.).

[25]*In re Friwat*, 2011 WL 5217826 *2 (S.D.Cal.).

[26]*In re Friwat*, 2011 WL 5217826 *2.

[27]*In re C.W. Mining Co.*, 641 F.3d 1235, 1243 (10th Cir. 2011).

servicer, alleging among other things that the servicer should have sought approval of the transaction under section 363(b), and seeking sanctions.[28] Factually, the trustee posited that had the servicer refused the payoff, a foreclosure sale would have generated surplus funds for the estate.[29] The court held that section 363, "on its face, applies only to trustees and debtors." It did not place a duty on the servicer to get court approval and provide notice. "Negotiation and acceptance of a Payoff do not constitute selling the Property." Further, sanctions were not appropriate where the servicer's conduct demonstrated substantial compliance with the lift stay order and applicable law.[30]

Other Jurisdictional Issues

The bankruptcy court does not have jurisdiction to determine all disputes that may arise under its sale order, especially those arising post-closing and among non-debtors. In *In re Midway Games Inc.* the court approved the sale to Warner Brothers Entertainment of substantially all of the debtor's assets, including the videogame "Mortal Kombat." A third party, Threshold, had commenced an adversary proceeding asserting that it owned certain license, copyright and other intellectual property interests in "Mortal Kombat." Threshold had objected to the sale on the same grounds, and the sale order expressly provided that the sale was subject to Threshold's rights, if any. After the sale closed, Threshold sought to substitute the asset purchaser, Warner Brothers, as the defendant in the adversary proceeding regarding the intellectual property.[31]

The bankruptcy court denied Threshold's motion noting that, as an initial matter, notwithstanding the jurisdiction retention provision in the sale order, the nature of the dispute brought the court's jurisdiction over the Mortal Kombat litigation into question. The dispute was between two unrelated third parties, Threshold and Warner Brothers, and the Mortal Kombat property was not part of the bankruptcy estate. The controversy at issue did not involve an attempt by Threshold "to readjust the terms of the Sale or anything which might even remotely place the Debtors' estate at risk. Any possible 'related to' jurisdiction would be attenuated at best." Moreover, the fact that Threshold also had asked the court to transfer the case to the district court

[28]*In re Wilson*, 454 B.R. 546, 549–550 (Bankr.N.D.Ga. 2011).

[29]*In re Wilson*, 454 B.R. at 550.

[30]*In re Wilson*, 454 B.R. at 553.

[31]*In re Midway Games Inc.*, 446 B.R. 148, 150 (Bankr.D.Del. 2011).

showed that "even Threshold" did "not believe this matter" belonged before the court."[32]

The district court in *Midway* noted that, though "[a]n exercise of jurisdiction over matters connected to a sale under section 363 of the Bankruptcy Code is proper if the case turns on interpretation of the sale order," nothing in the adversary required the court to interpret or enforce the terms of the sale order. Moreover, the district court was "certain that the relief Threshold was seeking with respect to the intellectual property claims "could have no conceivable effect on the bankruptcy estate."[33] The court determined that it did not have subject matter jurisdiction over the adversary proceeding, and thus was mandated to dismiss it.[34]

In *In re Sportsman's Warehouse, Inc.*, also discussed in § II above, the bankruptcy court determined that it had "related to" jurisdiction over the question of whether a purchase provision in a lease was a mere option or an obligation of the debtor-lessee, because any damage award that the lessor obtained would be recoverable from the bankruptcy estate and thus subject to the claims resolution process. The court decided that its jurisdiction on the question of whether the postpetition lease amendment altering the purchase provision was void "arose under" section 363(b)[35] The court further reasoned that its exercise of subject matter jurisdiction was favored by the law of the case doctrine, to prevent a vicious circle of litigation by the parties.[36]

An appeal of an order authorizing a trustee's use, sale or lease of estate property does not necessarily deprive the bankruptcy court of all jurisdiction to interpret or enforce its order, absent a stay. In *In re CPJFK, LLC* the Chapter 11 trustee reached a settlement with the debtor's secured creditor. Under the settlement agreement: (1) the secured creditor would make a cash contribution to the estate in connection with a sale of the debtor's assets, which would be used to pay administrative expenses, certain unsecured claims, and United States Trustee fees, (2) the secured creditor would make available to the estate a parking lot adjacent to the hotel for use by the hotel, (3) the amount of the secured creditor's credit bid would be limited to $14,500,000 (its proof of claim asserted a claim of $15,732,162.61), (4) the secured

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[32] *In re Midway Games Inc.*, 446 B.R. at 152.

[33] *In re Midway Games Inc.*, 446 B.R. at 152–153.

[34] *In re Midway Games Inc.*, 446 B.R. at 153, citing Fed. R. Civ. Proc. 12(h)(3), made applicable to bankruptcy proceedings by Fed. R. Bankr. Proc. 7012(b).

[35] *In re Sportsman's Warehouse, Inc.*, 457 B.R. at 386–387.

[36] *In re Sportsman's Warehouse, Inc.*, 457 B.R. at 388.

creditor would exercise its rights as mortgagee under the ground lease of the hotel property to facilitate the transfer of the lease to any purchaser of the hotel property, and (5) the trustee would release all claims held by the estate against the secured creditor. The debtor appealed, but did not obtain a stay, of the order approving the settlement.[37]

The Chapter 11 trustee filed a motion to sell the hotel property, and the debtor argued that the bankruptcy court was without jurisdiction to consider it. The bankruptcy court acknowledged that "a bankruptcy court is without jurisdiction to modify any orders that are under appeal."[38]

"However, in the absence of a stay pending appeal pursuant to Bankruptcy Rule 8005, '[i]t is equally established . . . that while an appeal of an order or judgment is pending, the court retains jurisdiction to implement or enforce the order or judgment.' "[39] The bankruptcy court held that "the approval of the sale of the Hotel Property [did] not require the Court to modify or expand upon the order approving the Settlement Motion or the decision to reopen the record." Therefore, the bankruptcy court determined that it had "jurisdiction to approve the sale of the Hotel Property notwithstanding the Debtor's appeal of the order approving the Settlement Motion and the decision to reopen the record."[40]

See also *In re Teleservices Group, Inc.* discussed in this § II, "Due Process, Notice, and Opportunity to Be Heard—Fifth Amendment Issues," below.

Is A Land Swap a Sale?

The bankruptcy court in *In re EQK Bridgeview Plaza, Inc.* recently considered the novel question of whether a land swap proposed by a debtor constitutes a "sale" under section 363(b), and concluded that it likely did not. The court compared the language of section 363(b)—that refers only to "use, sell, or lease"—with that of sections 1123(a)(5)(B) and 1129(b)(2)(A) regarding plan provisions, which include the word "transfer." The

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[37] *In re CPJFK, LLC*, 2011 WL 1257208 *2–3.

[38] *In re CPJFK, LLC*, 2011 WL 1257208 *4, citing *In re Duratech Industries*, 241 B.R. 283, 290 (E.D.N.Y.2009); and *Toliver v. County of Sullivan*, 957 F.2d 47, 49 (2d Cir.1992) (quoting *Ryan v. United States Line Co.*, 303 F.2d 430, 434 (2d Cir.1962).

[39] *In re CPJFK, LLC*, 2011 WL 1257208 *5, quoting *DiCola v. Am. S.S. Owners Mut. Prot. and Indem. Ass'n (In re Prudential Lines, Inc.)*, 170 B.R. 222, 243 (S.D.N.Y.1994), and citing *C.H. Sanders Co. v. BHAP Hous. Dev. Fund Co.*, 750 F.Supp. 67, 69 (E.D.N.Y.1990).

[40] *In re CPJFK, LLC*, 2011 WL 1257208 *5.

court noted that it had "not been presented with any authority that convince[d] it that the proposed transaction" was "indeed, a '*sale*' that might be accomplished under Section 363, versus a '*transfer*' that might be accomplished under Section 1123 and 1129," and declined to approve the swap under section 363(b). Nonetheless, the court's greater concern appears to have been whether certain lienholders were receiving adequate protection under section 363(e), as discussed more fully in § IV below.[41]

Standing To Sell or Use

Upon the appointment of a Chapter 7 or Chapter 11 trustee, the debtor has no authority over the estate, and only the trustee, and not the debtor, has standing to sell or use estate property.[42] If the property reverts to the debtor, the authority or standing of the trustee to sell or use the property ends. See e.g., *In re Obrizzo* in this § II above.

Standing To Object

The standing of a party to object to a section 363(b) transaction is typically that applicable to civil actions generally.

In *In re Farmland Industries, Inc.*, the debtor sought approval of bidding procedures and solicited bids for the sale of its refinery. GAF did not object and the bidding procedures were approved by the bankruptcy court. GAF submitted a bid, which the debtor rejected because "it was submitted without the required 10% deposit of the bid amount, in an improper format, without required exhibits and schedules, and missing information necessary for [the debtor] to determine the bid's actual value. GAF did not contest the determination."[43] One qualifying bid was received, and the court approved the sale to that buyer. GAF did not object or appeal from the sale order.[44]

Instead, GAF moved the bankruptcy court to reconsider and set aside the sale order under Federal Rule of Civil Procedure 60(b), contending that the sale was the product of collusion between a former executive of the debtor. GAF asserted that, at the time of the sale, the executive was discussing the possibility of his employment by the buyer, and that he subsequently obtained employment with the buyer. GAF also argued that it "did not

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[41] *In re EQK Bridgeview Plaza, Inc.*, 447 B.R. 775, 784 (Bankr.N.D.Tex. 2011).

[42] *In re McKay*, 2010 WL 5620928 *1, 9 and 10 (Bankr.D.Ark 2010).

[43] *In re Farmland Industries, Inc.*, 639 F.3d 402, 403–404 (8th Cir. 2011).

[44] *In re Farmland Industries, Inc.*, 639 F.3d at 404.

have the opportunity to conduct due diligence prior to submitting its bid on the [refinery] assets." The bankruptcy court heard arguments on GAF's motion and then denied it, concluding that the sale "was conducted at arm's length and that there was insufficient evidence to support GAF's allegations. GAF did not appeal the denial of its 60(b) motion."[45]

GAF then filed a complaint in bankruptcy court alleging that the buyer, the executive, and the trustee of the debtor's liquidating trust had "intentionally interfered with GAF's business expectancy in purchasing the [refinery] assets and participated in a civil conspiracy to conceal the real value of the [refinery] assets. The appellees moved to dismiss the complaint on various grounds . . ." The bankruptcy court dismissed, and the Eighth Circuit BAP affirmed the dismissal. GAF appealed to the Eighth Circuit Court of Appeals.[46]

The Court of Appeals first considered whether GAF had standing, noting that the "irreducible constitutional minimum of standing requires a showing of injury in fact to the plaintiff that is fairly traceable to the challenged action of the defendant."[47] The court held that GAF had not established an injury traceable to the defendants' actions, since the bankruptcy court had found that GAF's bid did not satisfy the auction and sale bidding procedure requirements. Though GAF asserted that the disqualification of its bid was "unjustified," it did not allege any facts suggesting that the defendants were responsible for the deficiencies in its bid. Moreover, GAF had appealed neither the sale order nor the denial of its Rule 60(b) motion for reconsideration, both of which contained findings that the ultimate buyer was the only qualified bidder.[48]

GAF argued that had standing because its claim was for fraud on the court, and traditional standing analysis does not apply to claims for fraud on the court.[49] However, GAF's complaint did not state a claim for fraud on the court. "Fraud on the court is an

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[45]*In re Farmland Industries, Inc.*., 639 F.3d at 404.

[46]*In re Farmland Industries, Inc.*, 639 F.3d at 404.

[47]*In re Farmland Industries, Inc.*, 639 F.3d at 405, quoting *Braden v. Wal-Mart Stores, Inc.*, 588 F.3d 585, 591 (8th Cir.2009) (internal quotations omitted).

[48]*In re Farmland Industries, Inc.*, 639 F.3d at 405.

[49]*In re Farmland Industries, Inc.*, 639 F.3d at 405, citing *Universal Oil Prods. Co. v. Root Ref. Co.*, 328 U.S. 575, 580, 66 S.Ct. 1176, 90 L.Ed. 1447 (1946) (holding that federal courts have inherent power to investigate whether a judgment was obtained by fraud).

extraordinary means by which to obtain equitable relief and requires the plaintiff to prove no adequate remedy at law."[50] GAF had not alleged that it had no adequate remedy at law. Further, the remedy that GAF had sought—money damages—was "at odds with a fraud on the court claim, for which the remedy is the setting aside of the fraudulently obtained court judgment." In fact, GAF had expressly stated that it did not seek to undo the sale order approving the sale of the refinery. Thus, the court concluded, under traditional standing analysis, GAF lacked standing.[51]

In *In re Viola*, the Chapter 7 trustee sought to sell four custom sports cars owned by the debtor's estate. The debtor objected to the price of the sale. The bankruptcy court approved the sale, and the debtor sought a stay of the order from the district court pending determination of the debtor's motion to withdraw the reference.[52]

The district court found that the debtor lacked standing to object to the sale because he had failed to establish that an alternative sale "would have returned him to solvency or that the sale otherwise detrimentally affect his rights."[53]

In *In re Miller*, the trustee similarly argued that the debtors lacked standing to appeal from the bankruptcy court's order authorizing her to sell certain shares of the debtors' stock in a land company. There was no dispute that the bankruptcy estate was insolvent. The debtors had valued the stock at $282,820.00 in their schedules, and it was their sole asset. There were federal and state tax liens totaling $689,573.41 on all of debtors'

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[50]*In re Farmland Industries, Inc.*, 639 F.3d at 405, citing *Superior Seafoods, Inc. v. Tyson Foods, Inc.*, 620 F.3d 873, 878 (8th Cir.2010).

[51]*In re Farmland Industries, Inc.*, 639 F.3d at 405.

[52]*In re Viola*, 2011 WL 4831200 *1–2 (N.D.Cal.).

[53]*In re Viola*, 2011 WL 4831200 *2 (N.D.Cal.), citing *Willemain v. Kivitz*, 764 F.2d 1019, 1022–23 (4th Cir.1985) (holding that debtor lacked standing to challenge sale of asset because debtor "failed to demonstrate that an alternative sale . . . would return solvency to his estate"); and *In re Fondiller*, 707 F.2d 441, 441 (9th Cir.1983) (no standing to challenge order affecting the size of the estate, as such an order does not diminish the debtor's property, increase the debtor's burdens or detrimentally affect the debtor's rights). The court in Viola further held that, even if the debtor had standing, the bankruptcy court had held a hearing on the sale, and the debtor had filed no objection to any matter concerning the sale, including the sales price. The debtor presented to the district court "nothing more than bald assertions of his belief that the vehicles would 'generate nearly $25 million in profits.' " The evidence in the record established that $80,000 was the best offer received for the sports cars after extensive advertising. For this reason, the district court also rejected the debtor's request for a stay on the ground that the sales price was inadequate.

property. Even a sale of the stock for its full value would not result in a surplus for the estate. The court agreed with the trustee's assertion that the reversal of the bankruptcy court's order "would neither render the bankruptcy estate solvent nor result in a surplus being distributed to the debtor."[54]

The debtors in *Miller* argued that they had standing to pursue their appeal because they would, *in the future*, benefit financially from the sale of their stock in the land company and they would be able to use the proceeds from the sale to pay off their *non-discharged debt*, citing *McGuirl v. White*. The Court of Appeals for the District of Columbia in *McGuirl* had held that non-discharged debtors with insolvent estates could challenge the trustee's application for administrative expenses because an excessive fee award would reduce the funds otherwise available to pay creditors to whom the debtors would remain directly liable on their non-discharged debts. Thus the debtors had a direct, pecuniary interest in the amount of the fee award, and had standing to challenge the amount of that award.[55]

The debtors in *Miller* argued that they thus had a direct, pecuniary interest in the reversal of the bankruptcy court's order authorizing the sale of their shares of stock. The district court was not persuaded. The debtors "*speculated*" that they would "*eventually*" be able to develop the land company's property, sell their shares for a profit of $282,820, and use the profit to pay off their non-discharged debts. There is simply no evidence that the debtors would be able to realize a $282,820 profit from the sale of their shares "*at some unspecified point in the future*." The debtors' "speculation that the real estate market [would] rebound, that they [would] be able to develop the property, and that they [would] then be able to sell their stock for a profit" was exactly the kind of "speculation" that could not establish standing, unlike the debtor in *McGuirl,* who had shown that the reversal of the bankruptcy court's ruling would result in a "non-speculative, direct financial benefit" to him.[56]

In *Wallach v. Kirschenbaum* the appellant, the debtor's wife, had offered to purchase for $5,000 a $6,398,000 claim that the Chapter 7 trustee of RP Corporation held against her husband, who also was in a bankruptcy proceeding. The trustee moved to

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[54]*In re Miller*, 2011 WL 3758712 *4 (D.Md.), citing *Willemin v. Kivitz*, 764 F.2d 1019 (4th Cir.1985).

[55]*In re Miller*, 2011 WL 3758712 *4 (D.Md.), citing *McGuirl v. White*, 86 F.3d 1232 (D.C.Cir.1996).

[56]*In re Miller*, 2011 WL 3758712 *4 (emphasis in original).

sell the claim to the appellant, and the bankruptcy court ruled at the hearing that it would approve the sale, stating nonetheless that the trustee had "met barely a minimum standard here" and that it was approving the sale with "trepidation" because of the effect the sale could have on a related settlement with other parties.[57] Following the sale hearing, the appellant submitted a sale order to the court, and on the same day the Chapter 7 trustee sent a letter to the court stating that in light of the court's concerns the trustee intended to withdraw the sale motion. The trustee subsequently filed its order for withdrawal of the sale motion, and the court entered it. The wife appealed and the trustee moved to dismiss the appeal, on the ground that the wife-appellant was not an "aggrieved person" and had no standing.[58]

The court noted that under the "aggrieved person" standard, an unsuccessful bidder "whose only pecuniary loss is the speculative profit it might have made had it succeeded in purchasing property at an auction usually lacks standing to challenge a bankruptcy court's approval of a sale transaction." Still, the "the rule denying standing to unsuccessful bidders is not absolute."[59] The appellant was not a creditor of the debtor, her deposit had been returned, and any profit she may have made from her purchase of the claim was speculative. She did assert on appeal, however, that she had a prenuptial agreement with her debtor husband, and if he successfully reorganized and paid his unsecured creditors 100% of their allowed claims under a confirmed plan of reorganization, she stood to gain fifty cents for every dollar of unsecured debt that was eliminated. Thus, if she purchased the $6,398,000 claim and had it reduced to the $5,000 purchase price, she could gain up to $3,199,000.[60] The court did not agree, finding that the loss of any pecuniary benefit that the appellant hoped to gain from acquiring the claim and eliminating that debt of her husband "in the event (a) she ever divorce[d] him or (b) there [was] a distribution in [his] Chapter 11 proceeding to unsecured

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[57]*Wallach v. Kirschenbaum*, 2011 WL 2470609 *1–2 (E.D.N.Y.).

[58]*Wallach v. Kirschenbaum*, 2011 WL 2470609 *3.

[59]*Wallach v. Kirschenbaum*, 2011 WL 2470609 *4, quoting *In re Colony Hill Associates*, 111 F.3d 269, 30 Bankr. Ct. Dec. (CRR) 832, Bankr. L. Rep. (CCH) P 77383 (2d Cir. 1997).

[60]*Wallach v. Kirschenbaum*, 2011 WL 2470609 *4–5.

creditors" was "too speculative a harm to constitute injury to property for purposes of the standing test."[61]

In *In re Innkeepers USA Trust* the debtors in possession sought approval of bidding procedures for the sale of certain of their assets, and Appaloosa asserted its standing to object as a "party in interest" under section 1109(b) of the Bankruptcy Code. That section provides that a "party in interest, including the debtor, the trustee, a creditors' committee, an equity security holders' committee, a creditor, an equity security holder, or any indenture trustee, may raise and may appear and be heard on any issue in a case under this chapter."[62] The bankruptcy court noted that it previously had "held that a party in interest is one that has a sufficient interest in the outcome of the case that would require representation, or a pecuniary interest that will be directly affected by the case."[63]

Specifically, "Appaloosa assert[ed] that its status as a holder of various interests in the Debtors' cases—namely, its preferred shares, its $10 million interest in one of the Debtors' two postpetition debtor-in-possession loans, and its certificated interests in [a] Fixed Rate Loan—confer[red] various rights on it as a party in interest sufficient to allow it to participate and be heard in the Debtors' cases on any issue, including with respect to a hearing on the Motion" for approval of the bidding procedures.[64]

The court found that Appaloosa had beneficial interests—in the form of certificates—in real estate mortgage investment conduits ("REMICS") that held various mortgage loans and residential and commercial loans, including the Fixed Rate Loan, in trust. This interest, the court found, made Appaloosa "merely an investor in a creditor." The court found in addition that Appaloosa was "contractually bound by the 'no action' clause" in the servicing agreement for one of the trusts. "None of the conditions precedent to 'action' " had occurred under that servicing agreement "such that Appaloosa [was] entitled to circumvent the special servicer and be afforded independent standing to be heard on the Motion . . . Granting standing to a certificateholder would not only override the terms" of the servicing agreement "and alter

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[61]*Wallach v. Kirschenbaum*, 2011 WL 2470609 *5, quoting *Calpine Corp. v. O'Brien Environmental Energy, Inc. (In re O'Brien Environmental Energy, Inc.)*, 181 F.3d 527, 531 (3d Cir.1999).

[62]*In re Innkeepers USA Trust*, 448 B.R. 131, 139, 141 (Bankr.S.D.N.Y. 2011), citing 11 U.S.C. § 1109(b).

[63]*In re Innkeepers USA Trust*, 448 B.R. at 141, citing cases.

[64]*In re Innkeepers USA Trust*, 448 B.R. at 139.

the bargained-for terms and risks investors undertook when they bought certificated interests in the Fixed Rate Loan, but it would also encourage and embolden other certificateholders to hire their own counsel to challenge the special servicer's authority and to advance their individual and conflicting pecuniary interests." As a result, the court held that Appaloosa could not be given "party in interest" standing to be heard on the motion for approval of bidding procedures in its capacity as a certificateholder with respect to the Fixed Rate Loan. Nonetheless, Appaloosa did have standing to be heard in its capacity as a holder of preferred shares and as a DIP lender.[65]

A settlement under Rule 9019 typically implicates the sale or use of sale of estate property under section 363(b), as more fully discussed in § IX below.

Court Approval Required—Business Justification

Recent decisions continued to enunciate several variants of the requirement that the trustee or debtor in possession must establish by the evidence that it has a "good business reason" for the proposed use, sale, or lease of the property out of the ordinary course of business under section 363(b).

The Chapter 7 trustee in *In re Prosser* filed an adversary proceeding seeking to sell certain of the debtor's real property subject to his non-debtor wife's right of first refusal under section 363(i). The bankruptcy court stated the standard as whether: (1) there is a sound business purpose for the sale; (2) the proposed sale price is fair; (3) the debtor has provided adequate and reasonable notice; and (4) the buyer has acted in good faith. The court determined that the trustee had satisfied standard, and approved the sale, subject to the right of first refusal.[66]

The bankruptcy court in *In re Colorado Sun Oil Processing LLC* stated that the "factors for a court to consider under the 'business judgment' test when deciding whether to approve the sale of the debtor's assets outside of the ordinary course of business include whether:

> a) Any improper or bad motive; b) The price is fair and the negotiations or bidding occurred at arm's length; and c) Adequate

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[65]*In re Innkeepers USA Trust*, 448 B.R. at 143–144.

[66]*In re Prosser*, 2011 WL 832945 *2 (Bankr.D.Virgin Islands), citing *In re Exaeris Inc.*, 380 B.R. 741, 744 (Bankr.D.Del.2008).

> procedures, including proper exposure to the market and accurate and reasonable notice to all parties in interest."[67]

The court also considered that:

> "d) The sale of the estate's assets as set forth in the asset purchase agreement was in the best interests of the debtor, the estate, creditors, and all other parties in interest,"[68]

and approved the debtor's sale motion.

The bankruptcy court in *In re JL Building, LLC* held that the trustee or debtor-in-possession "must show (a) a sound business reason exists to sell the property; (b) adequate and reasonable notice including a full disclosure of the sales terms has been given to parties in interest; (c) the sales price is fair and reasonable; and (d) the buyer is acting in good faith," and, since the movant had done so, approved the sale.[69]

The bankruptcy court in *In re GSC, Inc.* stated that the "overriding consideration for approval of a § 363 sale is whether a good business reason has been articulated. The business judgment rule 'is a presumption that in making a business decision the directors of a corporation acted on an informed basis, in' good faith and in the honest belief that the action taken was in the best interests of the company.' " "Courts give deference to the debtor [in possession] as long as there is a 'reasonable basis for its business decision.' "[70] The court in *GSC* also determined that "(i) proper notice was given to all creditors and interested parties, (ii) the proposed sale price was fair and reasonable, and (iii) the purchaser was proceeding in good faith."[71]

A debtor-in-possession or trustee may obtain de minimis asset sales order, essentially pre-approving a series of sales to follow, with subsequent notice limited both in time and extent. The debtors in *In re Borders Group, Inc.*, moved for such an order, and the bankruptcy court concluded "that streamlined procedures for de

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[67] *In re Colorado Sun Oil Processing LLC*, 2011 WL 3585565 *9 (Bkrtcy.D. Colo.), citing *In re Castre, Inc.*, 312 B.R. 426 (Bankr.D.Colo.2004) (citing *In re Lionel*, 722 F.2d 1063 (2d Cir.1983)).

[68] *In re Colorado Sun Oil Processing LLC*, 2011 WL 3585565 *10.

[69] *In re JL Building, LLC*, 452 B.R. 854, 859 (Bankr.D.Utah 2011).

[70] *In re GSC, Inc.*, 453 B.R. 132, 174 (Bankr.S.D.N.Y. 2011), citing, *In re Chrysler LLC*, 576 F.3d 108, 114 (2d Cir.2009); *In re Iridium Operating LLC*, 478 F.3d 452, 466 (2d Cir.2007); *In re Lionel*, 722 F.2d 1063, 1071 (2nd Cir. 1983), quoting *In re Integrated Res.*, 147 B.R. 650, 656 (Bankr.S.D.N.Y. 1992) (citing *Smith v. Van Gorkom*, 488 A.2d 858 (Del.1985)) and *In re Johns-Manville Corp.*, 60 B.R. 612, 616 (Bankr.S.D.N.Y.1986)).

[71] *In re GSC, Inc.*, 453 B.R. at 174, citing, *In re Boston Generating, LLC*, 440 B.R. 302, 329 (Bankr.S.D.N.Y.2010).

minimis asset sales should be approved." However, the relief sought by the debtors was modified by the court "to assure proper notice of proposed sales," requiring that "notice of the sales should be filed on ECF, and, in addition, specific notice should be given to the U.S. Trustee, Counsel for the Official Committee of Unsecured Creditors, and any known creditor asserting a lien against the property Debtors propose to sell. If any buyer wishes protection of section 363(m), a declaration or other competent evidence, as well as a proposed order on presentment, must be filed establishing the requirements of good cause."[72]

The Chapter 7 trustee in *In re Blixseth* filed a motion seeking approval of both a sale to a stalking horse bidder and bid procedures designed to encourage higher and better bids, and the bankruptcy court approved both in the same opinion. The evidence showed that the estate had no equity in the property, and that the stalking horse bid of $10,850,000 was not enough to pay the secured debt against the property. Nevertheless, under the terms of the proposed sale the estate would receive a carve-out of at least $850,000 from the stalking horse bid, and possibly more if a competing bid was received and the property went to auction. The evidence further showed that, without the sale, the secured lender would seek relief from the stay and then foreclosure, against which there would be no defense, so if the sale was not approved the estate would receive nothing and the property would be lost to the estate.[73]

The objector, the former husband and business partner of the debtor, asserted that the $10,850,000 stalking-horse bid was far less than the $56 million which he asserted the buyer had offered and contracted for the purchase of the property from him in 2007. The court observed that the objector was "comparing apples to oranges" since the $56 million bid included other property as well, and "the 2008 recession stopped all sales activity and caused a major decline in sales values." Thus the $56 million sale offer was irrelevant to the market conditions existing at the time of the motion, and involved significantly different assets from those that were subject to the motion.[74]

The bankruptcy court had denied the trustee's prior motion to sell the property because of insufficient notice, and the trustee's failure to engage a real estate professional to ascertain the value and market the property. The court found that the trustee had

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[72] *In re Borders Group, Inc.*, 453 B.R. 477, 486 (Bankr.S.D.N.Y. 2011).

[73] *In re Blixseth*, 2011 WL 1519914 *16 (Bankr.D.Mont.).

[74] *In re Blixseth*, 2011 WL 1519914 *16.

addressed these concerns, including by engaging experienced real estate professionals who had created a detailed marketing plan which included personal contacts, direct mailing, print advertising, and internet marketing which would expose the property to a worldwide market of buyers with the capacity to bid for property. Such marketing increased the likelihood of a competing bid and auction, which gave the estate "its best chance to realize the true and maximum market value" of the property and the estate[75] Accordingly, the motion to sell and under the bidding and sale procedures set forth in the motion was "in the best interests of creditors and the estate" and the court approved it.[76]

The bankruptcy court in *In re Hereford Biofuels, L.P.* stated that it "believe[d], similar to the holding in *Abbotts Dairies,* that 'when a bankruptcy court authorizes a sale of assets pursuant to section 363(b)(1), it is required to make a finding with respect to the 'good faith' of the purchaser.' Good faith in the context of a bankruptcy sale speaks to the integrity of [the purchaser's] conduct in the course of the sale proceedings. Typically, the misconduct that would destroy a purchaser's good faith status at a judicial sale involves fraud, collusion between the purchaser and other bidders, or an attempt to take grossly unfair advantage of other bidders."[77]

The bankruptcy court in *In re Lehman Brothers Holdings Inc.* upheld its order for the sale of Lehman's North American assets to Barclays against motions for relief from the order, filed 2½ years later under Bankruptcy Rule 9024(b) by the debtors, the unsecured creditors committee, and others. The court noted that the " 'most important[ ]' factor for the court in determining whether to approve a § 363 sale is whether the asset is decreasing in value. Thus, a sale should be approved when the court is faced with the situation of a so-called 'melting ice cube,' a sale that would prevent 'further, unnecessary losses,' the failure of other potential buyers to appear despite 'well-publicized efforts,' and where the only alternative 'is an immediate liquidation that would yield far less for the estate' and creditors. With this legal standard from *Lionel* in mind, and having been presented with clear and convincing evidence of the quickly dissipating assets

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[75] *In re Blixseth*, 2011 WL 1519914 *16–17.

[76] *In re Blixseth*, 2011 WL 1519914 *17.

[77] *In re Hereford Biofuels, L.P.*, 2012 WL 10298 *17 (Bankr.N.D.Tex.), citing and quoting *In re Abbotts Dairies of Pa., Inc.*, 788 F.2d 143, 147, 150 (3d Cir. 1986).

remaining in the estate, the Court approved the sale transaction."[78]

The court had found and stated on the record at the sale hearing that "there [was] no better or alternative transaction for these assets, that the consequences of not approving a transaction could prove to be truly disastrous. And those adverse consequences are meaningful to me as I exercise this discretion. The harm to the debtor, its estates, the customers, creditors, generally, the national economy and the global economy could prove to be incalculable." Following trial on the motions for relief from the sale order 2½ years later, the court found that the "evidence at trial support[ed] the statements made during the Sale Hearing. Movants offered no evidence to contradict the proffered Sale Hearing testimony . . . that 'the sale of LBI must be immediately consummated or there will be little or nothing to sell,' that 'these assets have substantially greater value if they are sold as a going concern,' and that '[w]ithout Barclays, Lehman would be forced to sell [discrete] assets for a fraction of the value that will be realized from this transaction.' "[79] The court denied the motions.

Of course, one of the best bases for a business justification is that the debtor's estate is simply out of money and the only course left is to sell the assets. In *In re CPJFK, LLC* the court found that the exigencies of the case demonstrated the need for a prompt sale of the hotel property by the Chapter 11 trustee, over the debtor's objection. The income generated by the hotel property was cash collateral and under the cash collateral order, the right to use cash collateral was expiring. Absent the use of cash collateral, there was no funding to operate the hotel property. When asked at the hearing what would happen if the sale was not approved, the Chapter 11 trustee responded: "Well, I think I could answer it that way. If the sale is not approved, cash collateral will be over. I will be forced to close the hotel so we'll have no operating means by which to continue operations because we would not be generating any cash collateral because I can't utilize any of the cash collateral. We would close the hotel, and I

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[78] *In re Lehman Brothers Holdings Inc.*, 445 B.R. 143, 180 (Bankr.S.D.N.Y. 2011), citing and quoting *In re Lionel*, 722 F.2d 1063, 1071 (2d Cir.1983), and *Ind. State Police Pension Trust v. Chrysler LLC (In re Chrysler LLC)*, 576 F.3d 108, 118–19 (2d Cir.2009).

[79] *In re Lehman Brothers Holdings Inc.*, 445 B.R. at 18–181.

imagine at that point we would have to make a motion to convert the case to Chapter 7."[80]

The debtor's principal objection to the Chapter 11 trustee's motion to sell the debtor's hotel property in *CPJFK, LLC* was that the trustee had not obtained an appraisal of the hotel property in connection with the marketing process, and that the secured creditor's bid, "though clearly the highest obtained, [was] so low in relation to the value of the asset as to 'shock the conscience.' " The court overruled this objection and approved the sale, because an appraisal is not required in connection with the sale of real property under section 363, and because the secured creditor's bid, obtained by a competitive bidding process, reflected the market value of the property.[81]

Other Approvals May Be Required and Other Law May Apply

The approval of other governmental authorities may be required for the sale of estate assets, absent which the sale cannot be consummated even if the bankruptcy court's authorization has been obtained under section 363(b).

Moreover, "[t]he Bankruptcy Code does not serve as an exclusive repository of laws governing the affairs of a debtor-in-possession. In particular, the bankruptcy court in *In re Crawford Furniture Mfg. Corp* noted, "the activities of a trustee or debtor in possession are also constrained by 28 U.S.C. § 959(b), which states as follows:

> 'Except as provided in section 1166 of title 11, a trustee, receiver or manager appointed in any cause pending in any court of the United States, including a debtor in possession, shall manage and operate the property in his possession as such trustee, receiver or manager according to the requirements of the valid laws of the State in which such property is situated, in the same manner that the owner or possessor thereof would be bound to do if in possession thereof.' "[82]

The *Crawford* court noted held that, "[a]s a debtor in possession, Crawford Retail must still comply with state and local laws and regulations." The motion before the court for authorization for the debtor to conduct of going-out-of-business sales "sought a waiver of most of these restrictions," significantly those aimed at protecting consumers by restricting the sale of consigned goods

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[80] *In re CPJFK, LLC*, 2011 WL 1257208 *11 (Bankr.E.D.N.Y.).

[81] *In re CPJFK, LLC*, 2011 WL 1257208 *7–8, 14.

[82] *In re Crawford Furniture Mfg. Corp.*, 2011 WL 6325859 *2 (Bankr.W.D. N.Y.), citing 28 U.S.C. § 959(b).

obtained from non-debtor parties that might appear to the consumer to be property of the debtor. The court noted that the applicable state statute expressly exempted from its reach any retail sales made pursuant to a court order, but interpreted that provision as requiring it to "refocus on the appropriate exercise of [its] discretion" in crafting its order modifying the state law requirements. The court held, because the "broad waiver" requested by the debtor "would have violated the mandate of 28 U.S.C. § 959(b), [the] court denied the motion in its original form," and entered an order modifying the statutory restrictions on the debtor's going-out-of-business sales that was negotiated by the debtor and the state attorney general.[83]

State law restrictions on the assignment of causes of action and other litigation rights may also affect a debtor's right to assign those assets pursuant to section 363. For an extensive choice of law analysis involving differing Texas and Louisiana state law regarding such assignments, and of the effect of bankruptcy court oversight of the assignments and whether such oversight implicated state public policy by protecting against abuses in connection with such assignments, see *In re East Cameron Partners, L.P.*[84]

Sub Rosa Plans Including for the Use, Sale, or Lease of Substantially All of the Debtor's Assets or Preliminary to a Plan

The bankruptcy court in *In re JER/Jameson Mezz Borrower II, LLC* disagreed with the "blanket assertion" that Chapter 11 is not available to a debtor to conduct an orderly liquidation, as opposed to a piecemeal foreclosure process, noting that "[t]he Code expressly contemplates the use of a bankruptcy case to sell the assets of the estate in such a manner."[85]

Still, a sale of substantially all of a debtor's assets, and even a significant use of a debtor's assets, occasionally is likened to a sub rosa plan, requiring court approval not pursuant to section 363(b), but under the different and arguably heightened standard of section 1129 and the related plan confirmation provisions of the Bankruptcy Code.

In bankruptcy court in *In re GSC Inc.* stated the rule against

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[83] *In re Crawford Furniture Mfg. Corp.*, 2011 WL 6325859 *2–3.

[84] *In re East Cameron Partners, L.P.*, 2011 WL 4625368 *8 (Bankr.W.D. La.).

[85] *In re JER/Jameson Mezz Borrower II, LLC*, 2011 WL 6749058 *8 (Bankr. D.Del.), citing 11 U.S.C. §§ 363 & 1123(a)(5).

sub rosa plans as prohibiting a debtor-in-possession or trustee from entering into a transaction pursuant to section 363 (1) if that transaction would "circumvent the chapter 11 reorganization requirements for plan confirmation,"[86] or (2) "if the sale itself seeks to allocate or dictate the distribution of sale proceeds among different classes of creditors."[87]

The "non-controlling" lenders contended the sale constituted a *sub rosa* plan because it both '(i) attempt[ed] to accomplish something that could not be accomplished in a chapter 11 plan and (ii) [sought] to dictate the distribution of sale proceeds among classes of creditors, thus providing benefits outside of what chapter 11 contemplates.' " The bankruptcy court, after extensive analysis of the terms of sale, found neither of these arguments to be availing and approved the sale.[88]

Most courts have concluded that an asset sale, even of most of the debtor's assets, is not a sub rosa plan unless the sale subverts the priority and distribution requirements of the Bankruptcy Code or contains impermissible provisions such as certain third party releases.

Transactions with Insiders

Transactions with insiders are permissible and may be in good faith, though they typically are subjected to higher scrutiny.[89] See e.g., *In re Flynn* (sale to shareholders) discussed in § XI, "Finality Under § 363(m)," below.

In *WHR Holdings, LLC v. Geoff & Krista Sims Enterprises, Inc.* the debtor had entered into a settlement agreement with Sims, and a dispute arose with respect to whether the settlement agreement was assumed by the buyer. The owner of a substantial minority interest in the buyer also was an insider of the debtor. The bankruptcy court found that the settlement agreement had been assumed pursuant to the sale and purchase documents approved by the sale order. Even if it had not, the court held that, in light of the insider's involvement in the buyer, it would be inequitable to absolve the debtor and the buyer of responsibility for failing to inform Sims of the bankruptcy proceedings. Therefore,

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[86] *In re GSC, Inc.*, 453 B.R. at 175, quoting *In re Iridium Operating LLC*, 478 F.3d 452, 466 (2d Cir.2007); citing *In re Lionel*, 722 F.2d 1063, 1066 (2nd Cir. 1983).

[87] *In re GSC, Inc.*, 453 B.R. at 179–180, quoting *In re Gen. Motors*, 407 B.R. 463, 495 (Bankr.S.D.N.Y.2009).

[88] *In re GSC, Inc.*., 453 B.R. at 174–181.

[89] *In re Dexter Distributing Corp.*, 2011 WL 1979855 *1 (9th Cir.).

the equitable remedy would be to require the parties to arbitrate their dispute under the terms of the settlement agreement. The district court dispensed with the alternative ruling and relief, and concluded simply that the settlement agreement was assumed.[90]

Due Process, Notice, and Opportunity To Be Heard—Fifth Amendment Issues

Bankruptcy Code § 363(b) also requires "notice and a hearing" for the court to authorize transactions other than in the ordinary course of the debtor's business.[91]

The court in *In re Steffen* stated that all of the parties before it were "bound by the Court's prior sale orders regardless of whether they were a party to—or had notice of—the sale proceeding. That is because bankruptcy sales are final as to the entire world."[92] The holder of a lien or other interest must nonetheless receive notice for the sale to free and clear of its lien or interest under section 363(f). See § IV of this update below.

Bankruptcy Rule 2002(a)(2) requires 21-days' notice of the hearing on a section 363(b) sale, which may be shortened by the court for "cause shown" under Bankruptcy Rule 9006(c)(1)[93] or on a showing required under the court's rules.

In *In re Schindler*, the bankruptcy court denied the Chapter 13 debtor's motion to shorten notice. The debtor admitted that she had been seeking to sell the property "for some time," and was seeking approval of the sale on shortened notice "because she purportedly 'did not realize that Court approval was required to consummate the sale.' " The court held that "cause under Rule 9006(c) and under Local Rule 9077-1 'is not shown when the cause for expedited hearing is one of the movant's own making,' " and denied the motion to shorten.[94]

For the requirement of notice for a sale free and clear of interests under Bankruptcy Code § 363(f), see § IV of this update below.

The bankruptcy court in *In re Teleservices Group, Inc.* held that section 363(b) "involves no taking of property, at least if

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[90]*WHR Holdings, LLC v. Geoff & Krista Sims Enterprises, Inc.*, 2011 WL 5838387 *2–4, n. 1 (S.D.Fla.).

[91]11 U.S.C.A. § 363(b).

[92]*In re Steffen*, 464 B.R. 450, 454 (Bankr.M.D.Fla. 2012).

[93]Fed. R. Bankr. Proc. Rules 2002(a)(2) and 9006(c)(1).

[94]*In re Schindler*, 2011 WL 1258531 *2 (Bankr.E.D.N.Y.), quoting *In re Villareal*, 160 B.R. 786, 787 (Bankr.W.D.Tex.1993).

there are not competing interests in what is being sold. After all, the debtor would have long ago acquiesced to the trustee's disposing of his property as part of his decision to file a voluntary petition. And the unsecured creditors' rights in that property would be tangential, at most. Indeed, the fact that unsecured creditors have no interest in the debtor's property is what distinguishes them from their secured counterparts."[95]

By contrast, the court continued, the "estate's sale of both its own interest and another party's interest in the same property" under section 363(h), and "an involuntary bankruptcy proceeding, if opposed, does create constitutional problems" under *Stern v. Marshall* "because it by definition could result in the unwanted transfer of a reluctant debtor's property to the bankruptcy estate. Therefore, it is fair to question whether *Stern* would permit anyone but an Article III judge to effect such an involuntary taking through the entry of a contested order for relief."[96]

Enforceability of the Contract Against the Counterparty; Failure to Obtain Approval of Transactions That Are Out-of-Ordinary Course of the Debtor's Business

The unsecured creditors committee and the court-appointed examiner in *In re Tri-Valley Distributing, Inc*. filed suit to, among other things, avoid postpetition transfers made by the debtor. The bankruptcy court dismissed the claim, reasoning that section 363 does "not create a right of action for a trustee (or here by the examiner with expanded powers) to avoid an unauthorized postpetition transfer. The better place to look for a remedy is in § 549 or possibly other code sections or state law. No authority ha[d] been cited for the use of § 363 to remedy an unauthorized transfer" and the court could "find none." Further, the court was "not prompted to create one in this case—where a Bankruptcy Code section already provides (through § 549) the relief sought by the Plaintiffs under § 105(a), the Court would be unnecessarily overstepping by creating another right of action through § 105(a)." The court granted summary judgment on this count.[97]

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[95] *In re Teleservices Group, Inc.*, 456 B.R. 318, 333–334 (Bankr.W.D.Mich. 2011).

[96] *In re Teleservices Group, Inc.*, 456 B.R. at 333, n. 49–50, citing *Stern v. Marshall*, ___ U.S. ___, 131 S.Ct. 2594, 180 L.Ed.2d 475 (2011).

[97] *In re Tri-Valley Distributing, Inc.*, 452 B.R. 837, 853 (Bankr.D.Utah 2011).

IV. SALES FREE AND CLEAR OF ANY INTEREST IN SUCH PROPERTY—SECTION 363(f)

Bankruptcy jurisdiction is essentially in rem. Bankruptcy Code § 363(f) permits the trustee or other representative of the estate to sell property free and clear of liens and other interests.[98]

"In addition, § 363(f) has been interpreted," most recently by the bankruptcy court in *In re Grumman Olson Industries, Inc.*, "to authorize the bankruptcy court to grant *in personam* relief, similar to the discharge under Bankruptcy Code § 1141(d), that exonerates the buyer from successor liability, including liability for tort claims."[99] "Extending the 'free and clear' provisions in this manner serves two important bankruptcy policies. First, it preserves the priority scheme of the Bankruptcy Code and the principle of equality of distribution by preventing a plaintiff from asserting *in personam* successor liability against the buyer while leaving other creditors to satisfy their claims from the proceeds of the asset sale. Second, it maximizes the value of the assets that are sold. ('[T]o the extent that the 'free and clear' nature of the sale (as provided for in the Asset Purchase Agreement ('APA') and § 363(f) was a crucial inducement in the sale's successful transaction, it is evident that the potential chilling effect of allowing a tort claim subsequent to the sale would run counter to a core aim of the Bankruptcy Code, which is to maximize the value of the assets and thereby maximize potential recovery to the creditors.')."[100]

"A bankruptcy sale under 11 U.S.C. § 363, free and clear of all liens is a judgment that is good as against the world, not merely as against [the] parties to the proceedings."[101] Nonetheless, failure to notify asserted interest holders can limit the reach and effect of the relief, as set forth below.

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[98] *Central Virginia Community College v. Katz*, 546 U.S. 356, 126 S. Ct. 990, 995, 163 L. Ed. 2d 945, 45 Bankr. Ct. Dec. (CRR) 254, 54 Collier Bankr. Cas. 2d (MB) 1233, Bankr. L. Rep. (CCH) P 80443 (2006).

[99] *In re Grumman Olson Industries, Inc.*, 445 B.R. 243, 249 (Bankr.S.D.N.Y. 2011), citing *Campbell v. Motors Liquidation Co. (In re Motors Liquidation Co. f/k/a/ Gen. Motors Corp.)*, 428 B.R. 43, 57–59 (S.D.N.Y.2010).

[100] *In re Grumman Olson Industries, Inc.*, 445 B.R. at 249 (Bankr.S.D.N.Y. 2011), citing and quoting *Douglas v. Stamco*, 363 Fed.Appx. 100, 102–103 (2d Cir.2010); and citing *In re Trans World Airlines, Inc.*, 322 F.3d 283, 292 (3d Cir. 2003).

[101] *In re Farmland Industries, Inc.*, 567 F.3d 1010, 1015, n. 1 (8th Cir. 2009), *Regions Bank v. J.R. Oil Co., LLC*, 387 F.3d 721, 732 (8th Cir.2004).

Notice Under § 363(f)

The holder of a lien or other interest in the property must be given notice of the sale for the sale to be free and clear of the interest,[102] in accordance with Rules 6004(c), 7004 and 9014.[103]

The bankruptcy court's decision in *In re Grumman Olson Industries, Inc.* addresses the limits of a sale order provision purporting to cut off successor liability, when applied against a potential tort claimant who was not given notice of the sale. The bankruptcy court had approved the sale of certain of the debtor's assets to MS Truck Body Corp., a predecessor of Morgan (collectively, "Morgan"). The order approved the sale of the assets free and clear of claims and interests, "including, but not limited to, claims for successor or vicarious liability."[104]

Subsequently, Ms. Federico, a FedEx employee, sustained serious injuries when the FedEx truck she was driving hit a telephone pole. She and her husband commenced a personal injury action against Morgan and others in state court, alleging that the FedEx truck was manufactured, designed and/or sold by Grumman in 1994, and that it was defective for several reasons. The complaint also asserted that Morgan "continued Grumman's product line, and was, therefore, liable to the Fredericos as a successor to Grumman under New Jersey law." Morgan commenced an adversary proceeding in bankruptcy court, alleging that the sale order and the accompanying asset purchase agreement "exonerated it from any liability arising from products manufactured and sold prior to the sale, including liability under state successor liability laws."[105]

The bankruptcy court ruled against Morgan. First, the Fredericos had no claim against Morgan at the time of the bankruptcy sale.

"Equally important, the Fredericos did not receive adequate notice of the bankruptcy. To satisfy due process, a party seeking relief must provide 'notice reasonably calculated, under all the circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity to present their

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[102] *In re Restaurant Associates, L.L.C.*, 2007 WL 951849 at *10 (N.D. W. Va. 2007).

[103] *In re Cone Mills Corp.*, 2009 WL 524716 at *2–3 (3rd Cir. 2009).

[104] *In re Grumman Olson Industries, Inc.*, 445 B.R. at 245–246.

[105] *In re Grumman Olson Industries, Inc.*, 445 B.R. at 247.

objections.' "[106] "A sale order under § 363(f) that purports to free a purchaser from the debtor's liabilities does not bind parties in interest that did not receive appropriate notice of the sale."[107]

"The Fredericos could not have been identified as potential creditors prior to the sale or received adequate notice of the case, the sale, the confirmation or the deadline for filing a proof of claim. Even if the Fredericos knew about the case, the knowledge would be meaningless and there would be nothing for them to do. They could not file a claim based on an accident that occurred years later. In addition, the Fredericos' rights were not protected through the appointment of a future claims representative and the creation of a trust to pay their claims. While such protective measures do not necessarily transform a non-'claim' into a 'claim,' . . . the absence of these protective measures exacerbate[d] the evident unfairness that result[ed] from treating their rights as 'claims' under the Sale Order." Accordingly, the court concluded that the sale order did not affect the Federicos rights to sue Morgan.[108]

In reaching its conclusion, the court expressed its view that Morgan had "misplaced its reliance on *Chrysler* and *General Motors* as examples of the rule that 'a Bankruptcy Court may craft a Rule 363 Order that permits assets to pass to a purchaser free and clear of successor liability claims.' " "As noted, § 363(f) authorizes the Court to absolve the buyer of *in personam* liability for *pre-confirmation* claims in a Chapter 11 case. The rule does not extend to potential future tort claims of the type now asserted by the Fredericos, and the GM sale order did not grant the buyer this relief. To the contrary, the buyer in GM assumed 'all product liability claims arising from accidents or other discrete incidents arising from operation of GM vehicles occurring subsequent to the closing of the 363 Transaction, *regardless of*

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[106] *In re Grumman Olson Industries, Inc.*, 445 B.R. at 254, quoting. *Mullane v. Central Hanover Bank & Trust Co.*, 339 U.S. 306, 314, 70 S.Ct. 652, 94 L.Ed. 865 (1950).

[107] *In re Grumman Olson Industries, Inc.*, 445 B.R. at 254, citing *Western Auto Supply Co. v. Savage Arms, Inc. (In re Savage Indus., Inc.)*, 43 F.3d 714, 721 (1st Cir.1994). quoting *Mullane v. Central Hanover Bank & Trust Co.*, 339 U.S. 306, 314, 70 S.Ct. 652, 94 L.Ed. 865 (1950); *Johns-Manville Corp. v. Chubb Indem. Ins. Co. (In re Johns-Manville Corp.)*, 600 F.3d 135, 158 (2d Cir.2010); and *Travelers Indem. Co. v. Chubb Indem. Ins. Co.*, __ U.S. __, 131 S.Ct. 644, 178 L.Ed.2d 512 (2010).

[108] *In re Grumman Olson Industries, Inc.*, 445 B.R. at 254.

when the product was purchased.' "[109] "Further, although the *Chrysler* sale order purported to extinguish the buyer's liability for potential future tort claims, the Second Circuit questioned its reach," stating that " 'we decline to delineate the scope of the bankruptcy court's authority to extinguish future claims, until such time as we are presented with an actual claim for an injury that is caused by Old Chrysler, that occurs after the Sale, and that is cognizable under state successor liability law.' "[110]

In *In re Agriprocessors, Inc.*, the Chapter 7 trustee filed and served a motion to sell certain assets of the estate free and clear, but did not serve the County of Allamakee, which the debtor had not listed on its schedules, and which had a tax lien against the property. The buyer of the assets, SHF, filed a complaint seeking a declaration that the County's tax liens were void and unenforceable, and the County filed a motion for relief from the sale order.[111] The buyer "failed to provide any evidence that the County had 'very good and specific actual notice' that there would be a sale free and clear of all liens. Accordingly, there [was] no genuine issue of material fact as to whether the County had knowledge of the sale free and clear of its interest," and the court could not grant the buyer's request that the tax lien be declared unenforceable against it.[112]

Some jurisdictions require the movant to plead with particularity the liens proposed to be divested in its notice to the lienholders. In *In re Ray Anthony International, LLC*, the bankruptcy court denied the debtor's emergency motion seeking clarification of the court's approval of the court's free and clear sale, to include all liens and encumbrances against the property. The court observed that, the "requirements of, and consideration for, providing adequate due process to those lien holders directly affected by a sale, has remained constant and paramount . . . Local Rule 9013.2(b)(1)(d) requires a motion to sell property free and clear of all liens to plead 'with particularity' the identity and address of the holder of each and every lien on the property to be sold. Local Rule 6004.1(A)(5) requires that the seller serve a copy of the mo-

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[109] *In re Grumman Olson Industries, Inc.*, 445 B.R. at 255–256, quoting *In re Gen. Motors Corp.*, 407 B.R. 463, 482 (Bankr.S.D.N.Y. 2009) (emphasis in original), aff'd sub nom., Campbell v. Motors Liquidation Co. (In re Motors Liquidation Co. f/k/a/ Gen. Motors Corp.), 428 B.R. 43 (S.D.N.Y. 2010).

[110] *In re Grumman Olson Industries, Inc.*, 445 B.R. at 256, quoting *In re Chrysler LLC*, 576 F.3d 108, 127 (2d Cir.2009).

[111] *In re Agriprocessors, Inc.*, 2012 WL 122570 (Bankr.N.D.Iowa).

[112] *In re Agriprocessors, Inc.*, 2012 WL 122570 *5–9.

tion upon all parties against whom relief is sought and upon their counsel."[113]

Additional recent opinions construing section 363(f) are discussed below.

"Free and Clear" of What?—"Interests" Under § 363(f)

In *In re Skyline Woods Country Club*, the bankruptcy court approved the sale of the debtor-country club's golf course to a purchaser, free and clear. The "free and clear" provision of the sale order was extensive, including express reference to "restrictions" and other interests, and permanently "enjoined all persons and entities . . . holding claims or interests of any kind or nature whatsoever . . . from asserting against the Buyer, its successors or assigns, its property, or the Assets, such persons' or entities' claims or interests."[114]

The buyer ceased operating the golf course at some time after the purchase, and began changing the use of the property. Nearby residents and various homeowner associations sued the buyer in state court in Nebraska, asserting express and implied restrictive covenants requiring that the property be maintained as a golf course. The buyer filed a motion in the bankruptcy court to enforce the sale order, but after the bankruptcy court advised that it must move to reopen and pay a filing fee, the buyer withdrew its motion and defended the state-court action on the merits, arguing the homeowners' claims were precluded by the bankruptcy court's sale order.[115]

The state trial court granted summary judgment to the homeowners, and the buyer appealed. The Nebraska supreme court affirmed, "agreeing that the property was burdened by implied covenants that the property be maintained as a golf course and concluding, after careful analysis, that such implied restrictive covenants running with the land were interests that may not be extinguished under 11 U.S.C. § 363(f)."[116]

The buyer, and the bank which financed its purchase, moved to reopen the bankruptcy case to initiate an adversary proceeding to enforce the bankruptcy court's sale order by enjoining the homeowners from enforcing the state-court decision The bank-

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[113] *In re Ray Anthony Intern., LLC*, 449 B.R. 693, 696–697 (Bankr.W.D.Pa. 2011), citing *In re Marcus Hook Development Park, Inc.*, 143 B.R. 648, 659 (Bankr.W.D.Pa.1992).

[114] *In re Skyline Woods Country Club*, 636 F.3d 467, 469 (8th Cir. 2011).

[115] *In re Skyline Woods Country Club*, 636 F.3d at 469.

[116] *In re Skyline Woods Country Club*, 636 F.3d at 469.

ruptcy court denied the motion, the Eighth Circuit BAP affirmed, and the buyer and the bank further appealed.[117]

The Court of Appeals rejected the movants' contention that the bankruptcy court had exclusive jurisdiction over the homeowners' claims. Though the U.S. district courts have exclusive jurisdiction of property of the estate at the commencement of a Chapter 11 case, that in rem jurisdiction "exists only so long as property is part of the bankruptcy estate. In all other cases 'arising under title 11, or arising in or related to cases under title 11,' the district courts 'shall have original but not exclusive jurisdiction.' Assuming the bankruptcy court had jurisdiction over this post-bankruptcy dispute between the Homeowners and [the buyer] regarding the title conveyed to [the buyer] by the Sales Order (an issue . . . [the court did] not decide), it was *non*-exclusive jurisdiction under § 1334(b), concurrent with that of state courts of general jurisdiction."[118]

The buyer and the bank further argued that section 363(m) "deprived the Supreme Court of Nebraska of authority to modify the free-and-clear title" the buyer "acquired under the Sales Order." But by its plain language, section 363(m) "applies to appeals of sales authorizations or orders . . . To be sure, a bankruptcy court's Sales Order is entitled to full faith and credit if put at issue in subsequent proceedings, and the extent of its preclusive effect is determined 'by virtue of the nature of rights transferred under 11 U.S.C. § 363.' "[119] "But § 363(m) does not expand the *exclusive* jurisdiction of the bankruptcy courts and therefore does not create an exception to 28 U.S.C. § 1738, the Full Faith and Credit statute. Here, the Supreme Court of Nebraska gave full faith and credit to the Sales Order and § 363(f) and ruled against [the buyer] on the merits." The Eighth Circuit concluded that "denial of the motion to reopen was not an abuse of discretion because, in a reopened bankruptcy proceeding, the state-court judgment would be entitled to the full faith and credit mandated by 28 U.S.C. § 1738," and accordingly affirmed.[120]

In *In re Inwood Heights Housing Development Fund Corp.* the debtor owned a low-income apartment building that was subject

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[117] *In re Skyline Woods Country Club*, 636 F.3d at 469–470.

[118] *In re Skyline Woods Country Club*, 636 F.3d at 471, citing *Valley Historic Ltd. P'ship v. Bank of New York*, 486 F.3d 831, 837–38 (4th Cir.2007) and other cases and 28 U.S.C. § 1334(b).

[119] *In re Skyline Woods Country Club*, 636 F.3d at 471, citing *Regions Bank v. J.R. Oil Co., LLC*, 387 F.3d 721, 732 (8th Cir.2004).

[120] In re Skyline Woods Country Club, 636 F.3d at 468, 471–472.

to restrictions that prevented the project from being transferred without the consent of the governmental authority that had initially conveyed the real property to the debtor. On the authority's motion for stay relief under section 363 and to dismiss under section 1112, the court concluded that the debtor could not relieve itself of these restrictions by section 363(f), because the restrictions ran with the land. Thus the debtor could not be rehabilitated. The court granted stay relief to permit the authority's foreclosure proceeding to go forward, and stated that it would hold an order dismissing the case in abeyance pending completion of that action.[121]

The court in *In re Hereford Biofuels, L.P.* held that the sale by the debtor of all of its claims under a builder's risk policy free and clear of any interests under § 363(f) was free of any claim of a third-party beneficiary or co-insured relating to the policy, because it would "either be derivative of the Debtor's as the primary insured (not direct claims) or simply an *interest* in the claims, of which the sale was made free and clear."[122]

The bankruptcy court in *In re Extra Room, Inc.* held that a lessee's interest is an "interest" under section 363(f), entitled to adequate protection under section 363(e) on a sale of the property encumbered by the lease.[123]

"Section 363(p)(2) provides that 'an entity asserting an interest in property has the burden of proof on the issue of the validity, priority, or extent of such interest.' "[124]

The Requirements of § 363(f)(1), (2), (3), (4), or (5)

Bankruptcy Code § 363(f) provides that:

> (f) the trustee may sell property under subsection (b) or (c) of this section free and clear of any interest in such property of an entity other than the estate, only if—
>
> (1) applicable nonbankruptcy law permits sale of such property free and clear of such interest;
>
> (2) such entity consents;
>
> (3) such interest is a lien and the price at which such prop-

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[121] *In re Inwood Heights Housing Development Fund Corp.*, 2011 WL 3793324 *7, 12 (Bankr.S.D.N.Y.).

[122] *In re Hereford Biofuels, L.P.*, 2012 WL 10298 *15–18 (emphasis in original).

[123] *In re Extra Room, Inc.*, 2011 WL 846448 *2 (Bankr.D.Ariz.).

Citing *Precision Indus., Inc. v. Qualitech Steel SBQ, LLC*, 327 F.3d 537, 545 (7th Cir.2003).

[124] *In re Meill*, 2010 WL 5395728 *3, quoting 11 U.S.C. § 363(p)(2).

> erty is to be sold is greater than the aggregate value of all liens on such property;
>
> (4) such interest is in bona fide dispute; or
>
> (5) such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest.[125]

"Because the language of 363(f) is in the disjunctive, courts can approve" a free and clear "sale if any one of the five conditions is satisfied."[126] Generally, the "burden is on the moving party to 'show that one of the provisions of § 363(f)(1)-(5) is applicable to each lien or interest from which the sale is to be free and clear."[127]

In *BAC Home Loans Servicing LP v. Grassi*, the First Circuit BAP noted that the bankruptcy court did not specify the subsection of section 363(f) upon which it relied, nor did it cite a specific subsection in the sale order. The BAP stated that nonetheless it was authorized "to supply the court's intent, when that intent [was] not clear, by combing the record." Since the sale had been properly noticed for over a month without objection, the BAP concluded that the interestholder's implied consent under section 363(f)(2) provided the framework for its decision.[128]

In *In re Mastro*, the Ninth Circuit BAP also appears to have concluded that it is incumbent on the bankruptcy court to consider whether any of section 363(f)(1) to (5) has been satisfied by evidence in the record before it, notwithstanding that the positions of the parties may have focused on some but not all of the five grounds. "While the Trustee primarily relied on § 363(f)(5) in support of the Sale Motion, we note that § 363(f)(4) expressly permits a sale free and clear of an interest in estate property when 'such interest is in bona fide dispute.' Here, the undisputed facts in the record and our holding that the 2006 deed of trust secures an obligation that [the asserted interest holder] could not establish would support a determination that § 363(f)(4) applies.

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[125]11 U.S.C.A. § 363(f).

[126]*BAC Home Loans Servicing LP v. Grassi*, 2011 WL 6096509 *5 (1st Cir. BAP), citing *In re Sumner Regional Health Sys., Inc.*, 2010 WL 2521081 *2 (Bankr.M.D.Tenn.); *Liscinski v. Westgate (In re Westgate)*, 2008 WL 3887607 *2 (Bankr.D.N.J.). See also e.g., *In re Congoleum Corp.*, 2007 WL 1428477 *1 (Bankr.D.N.J. 2007).

[127]*BAC Home Loans Servicing LP v. Grassi*, 2011 WL 6096509 *5, quoting *In re Daufuskie Island Props., LLC*, 431 B.R. 626, 637 (Bankr. D.S.C.2010). See also e.g., *In Matter of Strug-Division, LLC*, 375 B.R. 445, 450, 48 Bankr. Ct. Dec. (CRR) 253 (Bankr. N.D. Ill. 2007); *In re Zeigler*, 320 B.R. 362, 381–82 (Bankr. N.D. Ill. 2005).

[128]*BAC Home Loans Servicing LP v. Grassi*, 2011 WL 6096509 *5.

However, we decline to determine whether this clause applies or whether any of the four other clauses under § 363(f) apply. It suffices for us to say that, in the process of denying the sale motion based on its erroneous construction of the 2006 deed of trust, the bankruptcy court neglected to determine whether authority to sell existed or could have been granted under § 363(b)(1) and § 363(f)." This "constituted an abuse of the court's discretion," and the BAP vacated the bankruptcy court's order denying the sale motion and remanded for further proceedings.[129]

Section 363(f)(1) permits a free and clear sale if applicable nonbankruptcy law permits such sale to be free and clear.

Section 363(f)(2) permits a sale free and clear sale of an interest if the entity holding the interest consents.

The First Circuit BAP in *BAC Home Loans Servicing LP v. Grassi*, also discussed in this section above, held that the interest holder's failure to forward the notice of the sale motion to counsel and object to the sale motion constituted its consent. "This Panel, as well other courts in this circuit and nationally, views silence as implied consent sufficient to satisfy the consent requirement for approving a sale under § 363(f)(2)." The court held that the bankruptcy court had not abused its discretion when it entered the sale order or when it denied the interest holder appellant's motion for reconsideration.[130]

In *In re Blixseth* the bankruptcy court noted that the lienholders had "not filed objections to the sale free and clear, and the Trustee's Motion was served on several of the lienholders listed on Trustee's Ex. 2." The court "deem[ed] the lack of objection by holders of liens and interests, after notice, as their implied consent to the sale free and clear of liens."[131]

In *EQK Bridgeview Plaza, Inc.*, also discussed in § II above, the court considered both whether a land swap constituted a "sale" under section 363 and whether the debtor's real property could be transferred free and clear of interests to the other swap party. "One such scenario is when the interest involved is a lien, and the price at which a property is to be sold is greater than the aggregate liens against the property. 11 U.S.C. § 363(f)(3). Thus, arguably, Section 363 could provide legal authority for the proposed land swap here—but *only* if the court deem[ed] the *swap* (*i.e.,* the land-for-land exchange) to be, in essence, a 'sale,'

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[129]*In re Mastro*, 2011 WL 3300140 *7–8 (9th Cir. BAP).

[130]*BAC Home Loans Servicing LP v. Grassi*, 2011 WL 6096509 *5–7, citing cases.

[131]*re Blixseth*, 2011 WL 1519914 *14.

and only if the value that the Debtor would be obtaining (*i.e.,* the value of the swap land) is greater than the liens on the surplus property." The court considered the swap transaction to be a transfer, but not necessarily a sale.[132] In any event, the court concluded that the lienholder was not adequately protected, as discussed in § IV below, and denied approval of the swap transaction.

In *In re Borders Group, Inc.*, the bankruptcy court approved de minimis sales procedures that included a provision that the "De Minimis Assets may be sold free and clear of Liens if a lienholder receives notice of a sale and fails to object. See 11 U.S.C. § 363(f)(2). Under section 363(f)(2), a lienholder who receives notice of a sale but does not object within the prescribed time period is deemed to consent to the proposed sale, and assets thereafter may be sold free and clear of liens."[133]

The debtor in *In re Pigg* owned a condominium unit that was severely damaged in the Nashville flood of May, 2010. The debtor abandoned the unit, and stated on her schedules her intent to surrender it. The homeowners' association ("HOA") held a lien against the property for unpaid condominium assessments, and the bank held a mortgage lien in the property. The Chapter 7 trustee filed a no asset report, and the debtor obtained her discharge.[134]

The debtor filed an adversary proceeding asking the court to compel the bank to accept a deed in lieu of foreclosure or to compel the bank to foreclose, thereby cutting off any further accumulating liability for HOA fees. The debtor argued that she no longer held a legal, equitable or possessory interest in the condominium, and therefore had no postpetition liability. If however, the court determined that the fees were nondischargeable, the debtor requested equitable relief.[135]

The bankruptcy court fashioned equitable relief, ordering the free and clear sale of the property, and payment of the proceeds first to the costs of sale including the trustee's counsel and taxes, then to the HOA on account of its lien, then to the bank and other lienholders on account of their liens, and finally to the debtor's estate.

The court determined that the HOA and the bank had con-

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[132] *In re EQK Bridgeview Plaza, Inc.*, 447 B.R. 775, 784 (Bankr.N.D.Tex. 2011).

[133] *In re Borders Group, Inc.*, 453 B.R. 477, 484 (Bankr.S.D.N.Y 2011).

[134] *In re Pigg*, 453 B.R. 728, 730–732 (Bankr.M.D.Tenn. 2011).

[135] *In re Pigg*, 453 B.R. at 732.

sented to the free and clear sale under section 363(f)(2) by their inaction. "While in most cases there would be no such inference, in this case, equity demand[ed] that the court fashion a remedy that balance[d] the rights of the lienholders and the right of a debtor to a fresh start. The Bank and HOA's inaction, despite interest by a third party-investor, despite pleas by the debtor for action, and despite the debtor's offer of a deed in lieu of foreclosure," led the court "to deem consent granted by the HOA and Bank for a § 363 sale by the trustee." Pursuant to the court's order, the bank would "receive whatever it would have received had it foreclosed upon the property, but [would] not have any continuing interest in the property unless the Bank" so chose. The HOA's claim would "be paid as a first priority claim behind the trustee's costs of sale." The debtor would "be relieved of any further interest in the flooded property and [would] truly receive a fresh start. The HOA, Bank and the debtor all [would] receive benefit from the trustee's sale of the property. The court fashion[ed] this remedy in order to do complete justice."[136]

Section 363(f)(3) permits a sale free and clear of an interest that is a lien if the price at which such property is to be sold is greater than the aggregate value of all liens on such property.

The bankruptcy court in *In re Lehigh Coal and Nav. Co.* approved a sale of the debtor's property to the first lender. The first lender credit bid its secured claim, free and clear of the second lien of the United States Department of Agriculture (the "USDA"). The bankruptcy court determined that section 363(f)(3) had been satisfied, on the ground that the " 'value of all liens' referenced in § 363(f)(3) meant the value of collateral, rather than the value of all debts against the property," relying on *In re Milford Group, Inc*. The USDA appealed.[137]

The district court reversed and remanded for "adequate findings of fact and conclusions of law showing that the USDA continues to be adequately protected." The district court reasoned that "the 'aggregate value of all liens' " means "the face amount of the lien," citing *Clear Channel Outdoor, Inc. v. Knupfer*. The bankruptcy court observed on remand that, under this interpretation, a free and clear sale under section 363(f)(3) "could not

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[136] *In re Pigg*, 453 B.R. at 735–737.

[137] *In re Lehigh Coal and Nav. Co.*, 2012 WL 27465 *1–2 (Bankr.M.D.Pa.), citing *In re Milford Group, Inc.*, 150 B.R. 904, 906 (Bankr.M.D.Pa.1992).

take place without paying off the liens in full."[138] The bankruptcy court further concluded that the district court's direction for the court to determine adequate protection of the USDA constituted "an implicit finding that rejects *Milford* and accepts the holding of *Clear Channel* that adequate protection, under these circumstances, requires that the USDA be compensated in some fashion, or the free and clear aspect of the sale be rejected." Accordingly, the court reasoned, it could not order the sale free and clear of the USDA's lien under either section 363(f)(3) or section 363(f)(5). The court nonetheless allowed that, while the issue was not before it, "this disposition obviously alter[ed] the equities of the original transfer and potentially subject[ed] the sale order to Federal Rule of Bankruptcy Procedure 9024 [Federal Rule of Civil Procedure 60 relief from judgment or order] consideration."[139]

The bankruptcy court in *In re Nance Properties, Inc.* also followed the "face amount of the lien" interpretation of section 363(f)(3), citing long-standing precedent in its district.[140]

In re Prosser presented to the court one of those rare cases in modern times in which the sales price exceeded the face amount of the liens, and the court approved the sale free and clear without considering whether the "value of all liens" under section 363(f)(3) means the value of the collateral or the face amount of the liens.[141]

Section 363(f)(4) permits a sale free and clear of an interest that is subject to a bona fide dispute.

In *In re Blixseth*, the objector, Blixseth, the former husband and business partner of the debtor, asserted that he held liens against the property proposed to be sold by the Chapter 7 trustee, and was a creditor based on the marital settlement with the debtor. The evidence showed that he did not have a lien or recorded interest against the property. He had not filed a proof of claim, so he did not have an allowed claim. He argued that the debtor's schedules listed him as a creditor, but admitted that his claim was listed as a disputed claim. Therefore, the court found that his interest was in bona fide dispute. He also contended that he was a creditor based on the marital settlement agreement

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[138]*In re Lehigh Coal and Nav. Co.*, 2012 WL 27465 *2, citing *Clear Channel Outdoor, Inc. v. Knupfer (In re PW, LLC)*, 391 B.R. 25, 33 (9th Cir.BAP 2008).

[139]*In re Lehigh Coal and Nav. Co.*, 2012 WL 27465 *4.

[140]*In re Nance Properties, Inc.*, 2011 WL 5509325 *4 (Bankr.E.D.N.C.), citing *Richardson v. Pitt County (In re Stroud Wholesale, Inc.)*, 1986 WL 181749 (4th Cir.1986).

[141]*In re Prosser*, 2011 WL 832945 *8.

with the debtor, but the Chapter 7 trustee testified that under the settlement with other parties in interest in the case, certain rights under the marital settlement agreement had been assigned to the trustee, who intended to pursue litigation against Blixseth regarding the marital settlement agreement. The court held that, thus, "all of Blixseth's conceivable interests" in the property were "subject to bona fide dispute," and the trustee could sell the property under section 363(f)(4) notwithstanding Blixseth's opposition.[142]

Section 363(f)(5) permits a sale to be free and clear of an interest of an entity that could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest.

In *In re Harris*, the Chapter 13 debtor sought to sell his principal residence free and clear under section 363(f)(5), for less than the face amount of the liens against the property, on the ground that a strip down or a cram down of the mortgage could hypothetically take place in a Chapter 11 case. The bankruptcy court held that that debtor's argument failed, if for no other reason than mortgage was on the debtor's principal residence and was not subject to stripping or cram down pursuant to 11 U.S.C. § 1129(b). The hypothetical proceeding contemplated by section 363(f)(5) needs, at the very least, to be legally possible.[143]

The continuing tension between section 363(f)(3) and section 363(f)(5) is considered in the discussion above regarding recent section 363(f)(3) cases.

V. ADEQUATE PROTECTION UNDER § 363(e)

Bankruptcy Code § 363(e) provides that "on the request of an entity that has an interest in property used, sold or leased, or proposed to be used, sold, or leased, by the trustee, the court, with or without a hearing, shall prohibit or condition and use, sale, or lease as is necessary to provide adequate protection of such interest."[144]

Such adequate protection may be provided by: (1) cash payments to such entity to the extent such use, sale or lease results in a decrease in the value of such entity's interest in the property; (2) providing such entity with an additional or replacement lien to the extent of any such decrease in value; or (3) granting

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[142] *In re Blixseth*, 2011 WL 1519914 *14.

[143] *In re Harris*, 2011 WL 5508861 *3–4 (Bankr.W.D.Mich.), citing *Clear Channel Outdoor, Inc. v. Knupfer (In re PW, LLC)*, 391 B.R. 25, 45–46 (B.A.P. 9th Cir.2008).

[144] *In re Pick*, 2008 WL 5392017 at *2 (Bankr. D. Neb. 2008).

such other relief, other than compensation allowable under Bankruptcy Code § 503(b)(1) as an administrative expense, as will result in the realization by such entity of the indubitable equivalent of such entity's interest in such property.[145]

The holder of a first security interest in condominiums in *In re The Lodge at Big Sky, LLC* sought adequate protection payments. The evidence showed that the debtor had no equity in the condominium units, had not made any payments to secured party "for quite some time," and had not paid the real property taxes on the condominium units since 2008. Nevertheless, the related debtor-management company had "amassed in excess of $500,000 in its coffers" and the debtors' principal had "distributed large sums of money to himself." Such facts clearly established that the secured party was entitled to the adequate protection that it requested, which was the debtor's immediate payment of the past due real estate taxes.[146]

The debtors in *In re RadLAX Gateway Hotel, LLC* owned a hotel and parking property. The owner of an adjacent office property, LAX Enterprise, had a parking easement giving it parking rights on a portion of the parking property. Prior to the bankruptcy filing, the debtors with the apparent agreement of LAX Enterprise, demolished the existing parking deck on the parking property and began to build a new one. Construction of the new parking deck stalled, and the debtors filed their Chapter 11 bankruptcy petitions.[147]

LAX Enterprise contended that it was entitled to adequate protection for the loss in value of its interest in the easement under § 363(e). The bankruptcy court denied LAX Enterprise's adequate protection claim on the ground there was "no evidence to show that [LAX] Enterprise's interest ha[d] decreased in value in any way due to the pendency of this bankruptcy." LAX Enterprise appealed, asserting that the bankruptcy court had misstated the standard. It argued that a statutory claim for adequate protection depends not on the effect of the bankruptcy itself on the claimant's interest, but rather on the effect that a debtor's actions regarding the property have on the claimant's interest. The district court agreed.[148]

"Under 11 U.S.C. § 361, adequate protection under section 363

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[145]11 U.S.C.A. § 363(e).

[146]*In re The Lodge at Big Sky, LLC*, 454 B.R. 138, 145 (Bankr.D.Mont. 2011).

[147]*In re RadLAX Gateway Hotel, LLC*, 466 B.R. 453 (N.D.Ill. 2012).

[148]*In re RadLAX Gateway Hotel, LLC*, 466 B.R. 453.

may be granted in the form of monetary compensation 'to the extent that [a debtor's] use [of property] results in a decrease in the value of [a petitioning] entity's interest in such property.' " Under the plain meaning of these words, LAX Enterprise has made allegations that, if true, could show that the value of its interest in the parking easement has decreased due to the debtors' continued use and occupancy of the easement area." LAX had "provided evidence that the failure of a prospective sale of the office building was influenced at least in part by the unavailability of the parking easement area." The district court reversed and remanded, directing the bankruptcy court to consider such evidence with respect to LAX Enterprise's claim for adequate protection.[149]

The Supreme Court's recent decision regarding credit bidding in the *RadLAX Gateway* case is discussed in § VII, "Who Can Credit Bid," below.

In *EQK Bridgeview Plaza, Inc.*, also discussed in § IV, "The Requirements of § 363(f)(1), (2), (3), (4), or (5)," above, the court considered whether a mortgage in land to be acquired by the debtor in a proposed land "swap" was adequate protection for the mortgage on the land proposed to be transferred by the debtor free and clear. The court found the evidence "compelling that the proposed swap land [was] just not as valuable and full of potential as the Debtor's representatives optimistically suggest[ed]," and in fact was worth less than the land proposed to be transferred free and clear. "In all candor," the court believed that the debtor had asked the court and the secured party "to make a big leap of faith here." Accordingly, even if the "swap" could be characterized a "sale" under section 363, the court would deny the motion for the debtor's inability to provide adequate protection.[150]

The debtor's counsel in *In re Fernandez*, who had not been paid his fees, sought to characterize the debtor's postpetition, preconfirmation mortgage payments as adequate protection payments and revoke those payments so that he could be paid his fees instead. The bankruptcy court denied his request. The debtor's counsel on appeal specifically took issue with that court's holding that section 1326(a)(2) requires the Chapter 13 trustee to satisfy all unpaid adequate protection claims, including the contractual mortgage payments on the debtor's home, before pay-

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[149] *In re RadLAX Gateway Hotel, LLC*, 466 B.R. 453.

[150] *EQK Bridgeview Plaza, Inc.*, 447 B.R. at 783–784.

ing approved attorney's fees. The district court agreed with the bankruptcy court's conclusion and affirmed.[151]

The Chapter 13 debtors in *In re Gollnitz* confirmed their plan. Mr. Gollnitz had operated a gasoline service station that he owned prepetition. The plan among other things authorized Mr. Gollnitz to surrender the property to secured creditors. "Otherwise, the plan made no provision with regard to any environmental obligations. Because the debtors did not include the New York State Department of Environmental Conservation on their mailing matrix, that agency received no notice of either the bankruptcy filing or the hearing on confirmation. Consequently, it had no opportunity to object to the debtors' plan."[152] More than a year after plan confirmation, the Department filed its motion to compel the debtors to bring the property into compliance with state environmental laws. The debtors responded that "the plan contemplated a surrender of the property to Chautauqua County on account of outstanding real property taxes," and "as a consequence, any responsibility for environmental compliance now rest[ed] with the county rather than with the debtors."[153]

The court granted the motion, holding that the authorization for surrender did not constitute a transfer of title. Rather, a transfer required both the surrender of an interest and its acceptance, and the County, "perhaps due to a recognition of environmental problems," had chosen not to commence a tax foreclosure. Ownership and the responsibilities of ownership were never accepted by any third party, but remained with Mr. Gollnitz. The same result followed from section 1327(b), "which states: 'Except as otherwise provided in the plan or the order confirming the plan, the confirmation of a plan vests all of the property of the estate in the debtor.' " The debtors' plan made no provision for any retention of ownership by the Chapter 13 trustee. Instead, by operation of section 1327(c), title had revested in Mr. Gollnitz, who retained the obligations of an owner for future environmental compliance.[154]

The court further characterized Mr. Gollnitz's obligations as an adequate protection obligation under section 363(e). "As sovereign," the State of New York held an interest in the property, and had charged the Department of Environmental Conservation with the enforcement of applicable rules and regulations for its

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[151] *In re Fernandez*, 2011 WL 1404891 *3, 8–9, 10–11 (S.D.Tex. 2011).

[152] *In re Gollnitz*, 456 B.R. 733, 735 (Bankr.W.D.N.Y. 2011).

[153] *In re Gollnitz*, 456 B.R. at 735–736.

[154] *In re Gollnitz*, 456 B.R. at 736.

use. The debtors' plan proposed a surrender of the property. "That surrender [was] itself a proposed use or sale within the meaning of section 363(e)." By reason of its interest in the property, the Department could at any time request that the court "impose such conditions on the proposed use or sale as are necessary to protect adequately the state's environmental interests. For purposes of providing this adequate protection, a debtor in Chapter 13 holds the status of a trustee under 11 U.S.C. § 1303. Having the responsibilities of a trustee, a debtor must satisfy the command of 28 U.S.C. § 959(b) for compliance with the valid environmental laws of New York." Accordingly, Mr. Gollnitz remained obligated to satisfy the environmental regulations of New York with regard to the fuel tanks at the property.[155]

See also *In re Extra Room, Inc.* discussed in § IV, " 'Free and Clear' of What?—'Interests' Under § 363(f)," above regarding adequate protection with respect to a free and clear sale of property encumbered by a lease.

See also *In re Lehigh Coal and Nav. Co.* discussed in § IV, "The Requirements of § 363(f)(1), (2), (3), (4), or (5)," above regarding adequate protection with respect to a free and clear sale under § 363(f)(5).

See also § XII, below, regarding adequate protection under section 363(e) in the context of the debtor's use of cash collateral, and § XIII, below, regarding adequate protection under section 363(e) in the context of proposed priming liens under postpetition financings.

VI. INTEREST OF OTHERS—DOWER, CURTESY AND CO-OWNED PROPERTY

Bankruptcy Code subsections 363(g), (h), and (j) contain special provisions with respect to the sale of property subject to dower and curtesy and of co-owned property. Recent cases with respect to these Bankruptcy Code provisions are set forth below.

Dower and Curtesy—§ 363(g)

Bankruptcy Code § 363(g) provides that, "[n]otwithstanding subsection (f) of this section, the trustee may sell property under subsection (b) or (c) of this section free and clear of any vested or contingent right in the nature of dower or curtesy."[156]

The author is not aware of any cases since the 2011 update regarding dower and curtesy under section 363(g).

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[155] *In re Gollnitz*, 456 B.R. at 737.

[156] 11 U.S.C.A. § 363(g).

Co-Owned Property—§ 363(h), (i), and (j)

Bankruptcy Code § 363(h) provides that:

> (h) Notwithstanding subsection (f) of this section, the trustee may sell both the estate's interest . . . and the interest of any co-owner in property in which the debtor had, at the time of the commencement of the case, an undivided interest as a tenant in common, joint tenant, or tenant by the entirety, only if—
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> (1) partition in kind of such property among the estate and such co-owners is impracticable;
>
> (2) sale of the estate's undivided interest in such property would realize significantly less for the estate than sale of such property free of the interests of such co-owners;
>
> (3) the benefit to the estate of a sale of such property free of the interests of co-owners outweighs the detriment, if any, to such co-owners; and
>
> (4) such property is not used in the production, transmission, or distribution, for sale, of electric energy or of natural or synthetic gas for heat, light, or power.[157]

The trustee has the burden of proving that these requirements have been satisfied.[158]

The trustee in *In re Naughton* sought authority to sell real estate belonging to the bankruptcy estate and non-debtor co-owners under section 363(b) and (h). The bankruptcy court determined that—"given the confusion engendered by the Supreme Court's recent decision in *Stern,*" it might "not have the authority under 28 U.S.C. § 157(c) to enter final judgment if, as some believe, this power is reserved exclusively for judges with life tenure and salary protections afforded by Article III of the Constitution. Because the Defendants failed to appear or otherwise participate in this matter," the bankruptcy court was "unwilling to find that they [had] consented to entry of a final judgment by a United States Bankruptcy Judge." The trustee's counsel appears to have shared this concern "that a sale order under 11 U.S.C. § 363(h) might be vulnerable to collateral attack later, under *Stern.* Because the Trustee's buyer's title" would "ultimately depend upon the validity of the order authorizing the

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[157] 11 U.S.C.A. § 363(h).

[158] *In re Beck*, 2011 WL 3902820 *3 (Bankr.E.D.N.Y.); *In re Loy*, 2011 WL 5118458 *7 (Bankr.E.D.Va.); *In re Laurie*, 2011 WL 3879507 *4 (Bankr.N.D. Ohio); *In re Coy*, 2011 WL 3667607 *4 (Bankr.D.Del.); *In re Prosser*, 2011 WL 832945 *7; *In re Youngquist*, 2012 WL 243763 *3 (Bankr.D.Kan.); and *In re Prosser*, 2012 WL 246279 *4 (Bankr.D.Virgin Islands).

sale of the estate's interest and the interests of the co-owners," the court believed it "prudent to ask the District Court to consider entering final judgment authorizing the Trustee to sell not just the estate's interest in the real estate, but also the interests of the Defendants, as 11 U.S.C. § 363(h) allows. In this circumstance, an ounce of prevention may be worth a pound of cure."[159]

Therefore, the court submitted its proposed findings of fact and conclusions of law as contemplated in Fed. R. Bankr. P. 9033, as follows, and recommended that the district court authorize the trustee to sell the real property, free and clear of all interests of the defendants pursuant to 11 U.S.C. §§ 363(b) and (h), and allow her to distribute the sale proceeds pursuant to 11 U.S.C. § 363(i):

> 'Each Defendant's failure to deny the well-pleaded factual allegations constitutes an admission under Fed.R.Civ.P. 8(b)(6). The allegations, which have been admitted, establish[ed] that the Debtor . . . ha[d] an interest in real property with the approximate value of $20,000.00 free and clear of liens; partition of the real property between the estate and the Defendants [was] impracticable; the sale of the estate's undivided interest in the real property would realize significantly less for the estate than the sale of the property free of the interests of the Defendants; and the benefit to the estate of the sale of the real property free of the interests of the Defendants outweighs the detriment, if any, to the Defendants. The admitted allegations also establish[ed] that the real property [was] not used in the production, transmission, or distribution, for sale, of electric energy or of natural or synthetic gas for heat, light, or power. The Trustee's counsel represented on the record that the Defendants [were] neither minors, nor incompetents, as contemplated under Fed.R.Civ.P. 55. Similarly, it appear[ed] from the Trustee's certification in her papers and open court that the Defendants [were] not in active military service.'[160]

In *In re Parker*, the debtor's brother appealed from the bankruptcy court's order determining the proper distribution of the net proceeds to the respective interest holders from the sale of real property.[161] The appellant also complained that the trustee had not made distributions in accordance with the bankruptcy court's order. In response, the trustee showed that he had not distributed the proceeds due to the appellant's appeals. In particular, the trustee argued that the appeal challenged "the very Order under which appellant demands distribution." The court held that, because the appellant's argument related to events occurring after the entry of the order on appeal, the appellant's conten-

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[159] *In re Naughton*, 2011 WL 4479478 *1–2 (W.D.Mich.).

[160] *In re Naughton*, 2011 WL 4479478 *1–2.

[161] *In re Parker*, 2011 WL 3322726 *1 (W.D.N.C.).

tion was not within the scope of the appeal and denied it as non-justiciable.[162]

A recent case in which the trustee sought by adversary proceeding to sell the co-owned property under section 363(h), and the defendant co-owner sought to withdraw the reference, is *Birdsell v. Schneider*. The court denied the defendant's motion, on the ground that there was no good cause, because withdrawal of the matter from the bankruptcy court "would waste judicial resources, increase delay and costs to the parties, jeopardize the uniformity of bankruptcy administration, and promote forum shopping."[163]

The court in *In re Loy* held that, under section 363(h), "[t]here is no requirement that the benefit exceed the detriment significantly."[164]

In *In re Wolk*, the BAP affirmed the bankruptcy court's ruling that the "trustee had not met his burden of proving that the benefit to the bankruptcy estate of the sale outweighed the detriment" to the co-owner. "The bankruptcy court's findings of fact regarding the benefit to the estate and detriment" to the co-owner were "not clearly erroneous. Accordingly, the bankruptcy court did not abuse its discretion in denying the motion to sell."[165]

Other cases addressing whether the benefit to the estate outweighs the detriment to the co-owners include: *In re Beck*;[166] *In re Laurie*;[167] *In re Coy*;[168] *In re Prosser*;[169] and *In re Youngquist*.[170]

Other recent section 363(h) cases involving tenants in common, joint tenants, or tenancies by the entireties include: *In re Kasparek*;[171] *In re Hereford Biofuels, L.P.* (claim of a third-party beneficiary or co-insured relating to insurance policy may be characterized as an interest in the policies that can be sold free

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[162]*In re Parker*, 2011 WL 3322726 *7.

[163]*Birdsell v. Schneider*, 2011 WL 1540145 *3 (D.Ariz.).

[164]*In re Loy*, 2011 WL 5118458 *7 (Bankr.E.D.Va.).

[165]*In re Wolk*, 451 B.R. 468, 473 (8th Cir. BAP 2011).

[166]*In re Beck*, 2011 WL 3902820 *3.

[167]*In re Laurie*, 2011 WL 3879507 *4–5.

[168]*In re Coy*, 2011 WL 3667607 *4–8.

[169]*In re Prosser*, 2011 WL 832945 *9; *In re Prosser*, 2012 WL 246279 *4.

[170]*In re Youngquist*, 2012 WL 243763 *3.

[171]*In re Kasparek*, 2011 WL 2646552 (10th Cir.BAP).

and clear under sections 363(f) and 363(h)) (also discussed in § IV, above).[172]

A recent case involving the bankruptcy court's denying a motion filed by the debtor's estranged wife for stay relief to allow her to pursue an equitable distribution of the marital assets in a pending divorce case is *In re Secrest*. The court reasoned that judicial economy would be enhanced by its administering the co-owned property by a free and clear sale under section 363(f) and (h), and that the debtor's wife's interests were fully protected by her right to purchase the property under section 363(i).[173]

In *In re Dorsey*, the bankruptcy court avoided certain prepetition fraudulent transfers made by the debtor to his wife of his interest in their co-owned property, and ordered the sale of the property pursuant to section 363(h).[174]

Another recent case involving the distribution of section 363(h) proceeds to co-owners is *In re Milford*.[175]

Bankruptcy Code § 363(i) provided that: "[p]rior to the commencement of the sale of the property, the debtor's spouse, or a co-owner of such property, is permitted to purchase such property 'at a price at which such sale is to be consummated.' "[176]

In *In re Prosser*, the bidding procedures for the auction sale of the co-owned property required the co-owner, who was the debtor's non-debtor wife, to exercise her statutory right of first refusal to purchase the co-owned property and submit all required bid documents and a good faith deposit by a date certain, prior to the closing date. The co-owner wife took "issue with the process set forth requiring her to reserve her right of first refusal." She contended that section 363(i) gave her a right of first refusal until the time of consummation of the sale. The court overruled this objection, noting that the approved bidding procedures did not "wrongfully impair Mrs. Prosser's rights. They simply place[d] a reasonable condition upon the exercise of her right of first refusal." The condition was "warranted" so that the parties would know prior to closing whether the sale would go forward to a co-owner or to the successful bidder. "Nothing in § 363(i) prohibits reasonable conditions and the condition [would] be enforced." If Mrs. Prosser reserved her right of first refusal by complying with

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[172]*In re Hereford Biofuels, L.P.*, 2012 WL 10298 *15.

[173]*In re Secrest*, 453 B.R. 623, 625, 631–631 (Bankr.E.D.Va. 2011).

[174]*In re Dorsey*, 2011 WL 2313158 *16 (Bankr.M.D.Ala.).

[175]*In re Milford*, 2011 WL 6140852 (Bankr.M.D.Tenn.).

[176]11 U.S.C.A. § 363(i).

the approved bidding procedures, she would "be permitted to close" on the property.[177]

Bankruptcy Code § 363(j) provides that, after a sale of co-owned property, the trustee shall distribute to the debtor's spouse or co-owners of the property, "the proceeds of such sale, less the costs and expenses, including any compensation of the trustee, of such sale, according to the interests of such spouse or co-owners, and of the estate."[178]

In the case of property held by tenants by the entireties, or two tenants in common having equal ownership interests, the co-owner is entitled to "one-half of the benefits, less costs and expenses associated with the generation of the benefits, not including any compensation to the trustee."[179]

VII. THE BIDDING PROCESS—BIDDING PROCEDURES, BREAKUP FEES, CREDIT BIDDING, AND COLLUSIVE BIDDING

Bidding Procedures and Break-up Fees

It is not uncommon for a debtor to establish bidding procedures, including a break-up fee payable to the initial, stalking-horse bidder if it is outbid, and to seek court approval of those procedures prior to completing the marketing and sale process and selecting the highest or best bidder of the property to be sold. Generally, the business judgment standard applies,[180] through several jurisdictions (notably the Third Circuit) have applied the section 503(b), actual and necessary administrative expense standard to the court's approval of a break-up fee. In those latter jurisdictions, it is essential to the stalking-horse bidder that the court approve any break-up fee or due diligence expense reimbursement prior to the auction at which the stalking horse is proposed to bid the floor price. Otherwise the break-up fee and expense reimbursement may be disallowed on the ground that they were not a necessary incentive to the stalking-horse bid.

The Fifth Circuit affirmed the lower court in *In re ASARCO, L.L.C.*, discussed in last year's update. The Court of Appeals ruled that the business judgment standard—and not the "actual and necessary" administrative expense standard of section 503(b)—applied to a debtor's request for authority to reimburse

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[177] *In re Prosser*, 2011 WL 832945 *5–6.

[178] 11 U.S.C.A. § 363(j).

[179] *In re Kaye*, 2012 WL 364092 *4 (Bankr.E.D.La.),

[180] *In re Innkeepers USA Trust*, 448 B.R. at 146.

qualified bidders for their due diligence expenses in connection with their possible purchase of the debtor's property.[181]

The standing of certain parties to object to a motion for approval of bidding procedures was considered recently in *Wallach v. Kirschenbaum*, and the standing of an unsuccessful, disgruntled bidder to object to the sale was considered recently in *In re Innkeepers USA Trust*, both of which are discussed in § III, "Standing to Object," above

For a case in which the court established bidding procedures that also applied to a co-owner's right to purchase co-owned property subjected to sale under section 363(h) and (i), see *In re Prosser* discussed in § VI above.

Credit Bids

Credit bidding at a section 363(b) sale of property "that is subject to a lien that secures an allowed claim" is expressly permitted by Bankruptcy Code § 363(k), "unless the court for cause orders otherwise." If the holder of the lien purchases the property, "such holder may offset such claim against the purchase price of such property."[182]

The district court in *In re Barbel* noted that it is " 'well settled among district and bankruptcy courts that creditors can bid the full face value of their secured claims under 363(k),' " and that "[t]he existence of credit bids without more does not taint the sale."[183]

The secured creditor nonetheless is not obligated to credit bid its secured claim, and may bid that claim in full or in part. The district court in *In re Barbel* was unimpressed by the debtor's argument that the secured lender's credit bids totaled only "approximately half of the estimated value of the subject properties" and as such did "adequately reflect the value of the estate." Equally unavailing was the debtor's assertion that the bankruptcy court had "erred in failing to obtain an appraisal of the properties." The court was "unaware of any authority establishing that an appraisal is a necessary prerequisite to a valid sale under § 363(k)." Instead, the "highest and best offer," whether by credit bid in whole or in part, or otherwise, serves "as a relevant

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[181] *In re ASARCO, L.L.C.*, 650 F.3d 593, 602 (5th Cir. 2011).

[182] 11 U.S.C.A. § 363(k).

[183] *In re Barbel*, 2011 WL 3290207 *3 (D. Virgin Islands), quoting *In re SubMicron Sys. Corp.*, 432 F.3d 448, 460 (3d Cir.2006).

indicator of an asset's value."[184] In *Barbel*, the secured lender's credit bids were the highest and best offers, and "were advanced in the course of a public auction, that was publicized in a newspaper regularly issued and of general circulation in the U.S. Virgin Islands which uses newsprint. The fact that the credit bids were the only offers [did] not render them inherently deficient." Further, the debtor Barbel had failed to demonstrate that fraud or mistake encroached on the conduct of the sale. Without such a showing, the Court would be ill-advised to disturb the sale." As such, the district court affirmed the bankruptcy court's approval of the sale procedures, the form of notice of sale, and the sales themselves.[185]

Who Can Credit Bid

Section 363(k) gives the right to credit bid to the holder of a lien, against the property proposed to be sold, that secures an "*allowed* claim."[186]

The Supreme Court in *Radlax Hotel, LLC v. Amalgamated Bank* has put to rest the question of a whether a secured creditor has a right to credit bid in a sale under a plan pursuant to section 1129(b)(2)(A), ruling that it does. To satisfy section 1129(b)(2)(A), a Chapter 11 plan confirmed over the objection of a class of secured claims must provide either: (i) the the secured creditor will retain its liens to the extent of the allowed secured claim, and will be paid the value of the claim in accordance with section 1129(b)(2)(A)(i); (ii) for the sale of the collateral subject to credit bidding under section 363(k), free and clear of the liens, and with the liens to attach to proceeds; or (iii) for the realization of the holders of such secured claims of "the indubitable equivalent of such claims."[187] The debtors' bidding procedures for the sale of the property did not permit the bank to credit bid. Instead, the debtors proposed to confirm their plan under section 1129(b)(2)(A)(iii), rather than section § 1129(b)(2)(A)(ii), and give the bank the " 'indubitable equivalent' of its secured claim, in the form of cash generated by the auction." The Supreme Court found the debtors' reading of the statute to be "hyperliteral and con-

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[184] *In re Barbel*, 2011 WL 3290207 *3, citing *In re Moore*, 608 F.3d 253, 263 (5th Cir. 2010); *In re Boston Generating, LLC*, 440 B.R. 304, 323 (Bankr.S.D.N. Y.2010).

[185] *In re Barbel*, 2011 WL 3290207 *3–4, citing *In re Food Barn Stores Inc.*, 107 F.3d 558, 564 (8th Cir.1997); *In re Webcor, Inc.*, 392 F.2d 893, 899 (9th Cir. 1968); *Hayes v. Sullivan*, 1992 WL 486914, *at 4 (D.Mass.1993).

[186] 11 U.S.C. § 363(k) (emphasis supplied).

[187] 11 U.S.C. § 1129(b)(2)(A)(i), (ii) and (iii).

trary to common sense." The court interpreted (i) as the rule for plans under which the secured creditor retains its lien, (ii) as the rule under which the debtor sells the secured property free and clear, and (iii) as the residual rule covering all other dispositions under a plan, "for example, one under which the creditor receives the property itself, the 'indubitable equivalent' of its secured claim. Thus," the court concluded, "debtors may not sell their property free of liens under § 1129(b)(2)(A) without allowing lienholders to credit-bid, as required by clause (ii)."[188]

In *In re Merit Group, Inc.,* the bankruptcy court held that the secured lender held an allowed claim because debtors had "scheduled the claim without condition or challenge and ha[d] not objected to the claim."[189] The creditors' committee opposed credit bidding by the holder of the secured claim against the sale property, asserting that it might seek to recharacterize that claim as equity, and arguing that its ability to officially challenge the claim was "hampered by the speed of the case."[190] The secured claimant asserted that any section 363(k) limitation was premature. The court concluded that both arguments had "some merit; therefore, after the auction [was] held and the selected bidder and final sales terms [were] presented to the Court for approval, the Court reserve[d] the right to revisit the appropriateness of any credit bid and to consider any conditions or safeguards requested by the Committee or any other party that may be in the best interest of the estate."[191]

Limitations on Credit Bidding

As noted the right of a lienor to credit bid is circumscribed by the court's power to "for cause" order otherwise.[192]

In *In re Olde Prairie Block Owner, LLC*, the debtor's plan provided that the plan funders would make cash and non-cash equity contributions "in exchange for 50% ownership interests in what is referred to here as the 'Reorganized Debtor.' " As a result, the funders would "each be 50% owners of a new joint venture, in exchange for equity contributions made to the Joint Venture including Cash and Non-Cash Equity Contributions." Neither joint venture party was related to the debtor. The court held that "[t]his would thus be a transfer of ownership of rights in the

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[188] *Radlax Hotel, LLC v. Amalgamated Bank*, 566 U.S. ___ (2012).

[189] *In re Merit Group, Inc.*, 2011 WL 2746340 *10 (Bankr.D.S.C.).

[190] *In re Merit Group, Inc.*, 2011 WL 2746340 *12, 15.

[191] *In re Merit Group, Inc.*, 2011 WL 2746340 *15.

[192] 11 U.S.C.A. § 363(k).

Debtor and its assets to new owners of those rights in exchange for cash and property, a transaction normally defined as a sale. Title to the real estate held by the LLC would not change but control of the Debtor itself would be transferred to entirely new entities" and, pursuant to another provision of the plan, the debtor's secured lender "would lose lien rights in one parcel. Since this would effectively constitute a sale," the court held that the debtor was required to provide the secured lender with a right to credit bid its claim under section 363(k).[193]

The debtor suggested that the secured lender should be denied its right to credit bid for cause, "because it ha[d] behaved in a way designed 'geared solely to disrupt Debtor's confirmation.' " The debtor complained of "earlier battles" by the lender "opposing efforts to reorganize," and presenting objections that the debtor considered "spurious." The court recognized that a secured creditor's "ability to credit bid is within the discretion of the court and is not absolute," but nonetheless rejected the debtor's argument that such acts constituted "cause." The court denied confirmation pending modifications giving the secured creditor the right to credit bid and addressing certain other issues.[194]

Effect of Bid

In *In re GSC Inc.* the winning bidder and the debtors entered into an asset purchase agreement ("APA") that the debtors later terminated, giving notice to the bidder. The bidder "rejected" the termination notice, responding that the APA did not allow for such termination and that it intended to leave the APA open. A Chapter 11 trustee was subsequently appointed, and he determined to sell the property to the bidder. The court held that it was "irrelevant whether the Initial APA was validly terminated because the Initial APA [was] separate from the bid itself. The Initial APA was an embodiment of the winning bid at the auction." It was this bid by the winning bidder "that constituted the relevant offer." The bidder "did not assert that it ever revoked the joint bid made at the Auction." To the contrary, it "argued the bid remained open. The Winning Bid remained outstanding, and the Trustee had the authority to accept it."[195]

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[193] *In re Olde Prairie Block Owner, LLC*, 2011 WL 6755930 *3, 10 (Bankr.N. D.Ill.).

[194] *In re Olde Prairie Block Owner, LLC*, 2011 WL 6755930 *10, citing cases, including *In re Daufuskie Island Properties, LLC*, 441 B.R. 60 (Bankr.D.S.C. 2010), discussed in last year's Annual Survey.

[195] *In re GSC, Inc.*, 453 B.R. at 153.

Collusive Bidding—§ 363(n)

Pursuant to section 363(n), "[t]he trustee may avoid a sale . . . if the sale was controlled by an agreement among potential bidders at the sale" and in addition may recover from any such party the value of the property in excess of the sale price, costs, attorney's fees, or expenses incurred in avoiding the sale or recovering such amount, plus punitive damages if the agreement was entered into in willful disregard of section 363(n).[196]

The debtors in *In re GSC Inc.* obtained court approval of their auction bidding procedures for the sale of substantially all of their assets. Late in the second day of the auction, the debtors' financial advisor approached representatives of the debtors' "non-controlling" lenders and their counsel, and "advised that it was his belief that certain of the third-party qualified bidders at the Auction would provide more competitive bids if they were permitted to submit joint bids." The financial advisor also indicated "that he would not permit joint bidding unless the Non-Controlling Lenders agreed. After several hours of discussions with the representatives of the Non-Controlling Lenders, including their counsel and financial advisors, the Non-Controlling Lenders agreed with the approach. The Non-Controlling Lenders provided written consent to the modification of the auction process."[197]

"Thereafter, the auction procedures were modified as follows: (i) all bidders received information on the highest bids for every lot and combination, (ii) all bidders were allowed to speak with other bidders and combine bids to maximize value, (iii) all bidders were allowed in the auction room," and (iv) the debtors' financial advisor and counsel "provided suggested bid configurations." After four rounds under the modified bidding procedures, the financial advisor "determined that in the fifth and final round, bids would be submitted in closed envelopes and the highest qualified bid would be declared the winner."[198]

The non-controlling lenders opposed the sale, on the grounds among others that they did not consent to the winning joint bid "because they did not consent to a collusive bid."[199] The court disagreed. The joint bidders did not collude in submitting their bid, because collusion requires "an intention or an objective to

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[196] 11 U.S.C.A. § 363(n).

[197] *In re GSC, Inc.*, 453 B.R. at 143.

[198] *In re GSC, Inc.*, 453 B.R. at 143–144.

[199] *In re GSC, Inc.*, 453 B.R. at 153–154.

influence the price."[200] An agreement between two bidders resulting in a single bid in exchange for consideration does not, without more, constitute collusion. Although two bidders acting together to lower the sale price constitutes collusion, here the parties combined their bids to *raise* the sale price rather than to lower it."[201] The joint bid had resulted in a "$75–$90 million *increase* in the final purchase price."[202] Since there was no collusion between the bidders, the non-controlling lenders' consent to the modification of the bidding procedures and the joint bid was valid.[203]

VIII. EXEMPTION FROM TRANSFER TAX UNDER § 1146(a)

Related to section 363 sales, Bankruptcy Code § 1146(a), provides that "the making or delivery of an instrument of transfer under a plan confirmed under section 1129 of this title, may not be taxed under any law imposing a stamp tax or similar tax."[204]

The Supreme Court in the *Florida Dept. of Revenue v. Piccadilly Cafeterias, Inc.*, reported in the 2009 Annual survey, put to rest any issue of whether the exemption applies to sales outside of a plan. "The most natural reading of § 1146(a)'s text, the provision's placement within the Code, and applicable substantive canons all lead to the same conclusion: Section 1146(a) affords a stamp-tax exemption only to transfers made pursuant to a Chapter 11 plan that has been confirmed."[205]

The author is not aware of any opinions since the 2011 Annual Survey regarding exemptions from transfer tax.

IX. BANKRUPTCY RULE 9019 AND § 363(b)

A settlement under Rule 9019 is often likened, quite rightly, to a sale of estate property under section 363.

"Under § 363 of the Bankruptcy Code, after notice and a hearing, the trustee may 'use, sell, or lease, other than in the ordinary course of business, property of the estate.' 11 U.S.C. § 363(b)(1).

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[200] *In re GSC, Inc.*, 453 B.R. at 154, quoting *Lone Star Indus., Inc. v. Compania Naviera Perez Companc, S.A.C.F.I.M.F.A., Sudacia, S.A. (In re N.Y. Trap Rock Corp.)*, 42 F.3d 747, 752 (2d Cir.1994).

[201] *In re GSC, Inc.*, 453 B.R. at 154, citing cases.

[202] *In re GSC, Inc.*, 453 B.R. at 154, emphasis in original.

[203] *In re GSC, Inc.*, 453 B.R. at 154.

[204] 11 U.S.C.A. § 1146(c).

[205] *Florida Dept. of Revenue v. Piccadilly Cafeterias, Inc.*, 128 S. Ct. 2326, 171 L. Ed. 2d 203, 50 Bankr. Ct. Dec. (CRR) 34, 59 Collier Bankr. Cas. 2d (MB) 1316, Bankr. L. Rep. (CCH) P 81257 (2008).

The Federal Rules of Bankruptcy Procedure provide that 'on motion by the trustee and after notice and a hearing, the court may approve a compromise or settlement.' Fed. R.Bankr.P. 9019(a). Generally, the court may approve a compromise if it is 'fair and equitable' and in the best interests of the estate."[206]

The Eighth Circuit BAP in *In re Petters Co., Inc.* framed the standard for approval of a proposed settlement as follows:

> "to be approved, a settlement need not be perfect, it must merely 'not fall below the lowest point in the range of reasonableness.' The reasonableness of a settlement is determined by reference to what are known as the *Flight Transportation* or *Drexel* (or *Drexel v. Loomis)* factors. Although these refer to different cases, the factors are the same; *Flight Transportation* simply quotes *Drexel*. Under *Flight Transportation,* a bankruptcy court evaluating a proposed settlement must consider 'all of the factors bearing on the fairness of the settlement including: (a) the probability of success in the litigation; (b) the difficulties, if any, to be encountered in the matter of collection; (c) the complexity of the litigation involved, and the expense, inconvenience and delay necessarily attending it; (d) the paramount interest of the creditors and a proper deference to their reasonable views in the premises.' These findings are reviewed for clear error."[207]

Based on the record before it, the district court held that the bankruptcy court's determination that these factors weighed in favor of approving the settlement was not clearly erroneous.[208]

The bankruptcy court in *In re Blixseth* stated virtually identical standard prevailing in the Ninth Circuit.[209] The court noted in addition that, though "the bankruptcy court has great latitude in authorizing a compromise, it may only approve a proposal that is 'fair and equitable.' "[210] Further, the law favors a compromise,

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[206]*In re Babb*, 2009 WL 1076814 at *1 (Bankr.E.D.N.C. 2009); *In re Babb*, 2009 WL 212568 at *3 (Bankr.E.D.N.C. 2009).

[207]*In re Petters Co., Inc.*, 455 B.R. 166, 175 (8th Cir. BAP 2011), quoting *Drexel Burnham Lambert Corp. v. Flight Transp. Corp. (In re Flight Transp. Sec. Litigation)*, 730 F.2d 1128 (8th Cir.1984) and *Drexel v. Loomis*, 35 F.2d 800 (8th Cir.1929) (internal quotations omitted).

[208]In re Petters Co., Inc., 455 B.R. at 175.

[209]*In re Blixseth*, 2011 WL 1519914 *18 (Bankr.D.Mont.), citing *In re A & C Properties), 784 F.2d1377, 1381 (9th Cir.) cert. denied sub nom. Martin v. Robinson*, 479 U.S. 854, 107 S.Ct. 189, 93 L.Ed.2d 122 (1986).

[210]*In re Blixseth*, 2011 WL 1519914 *18, quoting *Woodson v. Fireman's Fund Ins. Co.*, 839 F.2d 610, 620 (9th Cir.1988) (Citing *Martin v. Kane (In re A & C Properties), 784 F.2d1377, 1380–81 (9th Cir.) cert. denied sub nom. Martin v. Robinson*, 479 U.S. 854, 107 S.Ct. 189, 93 L.Ed.2d 122 (1986).

and the court in its sound discretion has broad authority to approve it.[211]

The Chapter 7 trustee in *In re Milazzo* negotiated an agreement to settle an avoidance action against the debtor and her husband in return for a payment to the bankruptcy estate of $20,000. The trustee filed a motion with the bankruptcy court for approval under Rule 9019, and CadleRock, "a creditor holding almost 99% of the unsecured claims against the bankruptcy estate, then sent the Trustee a letter seeking to 'purchase' the right to pursue the Avoidance Action for $22,500." After the trustee declined to accept the offer, CadleRock objected to the proposed settlement, urging the court to deny the motion and compel the trustee to either accept CadleRock's offer, or "file a notice of intent to sell the relevant cause of action at a sale subject to opportunity to make higher and better offers pursuant to Section 363(b)."[212]

The bankruptcy court overruled the objection and approved the motion to settle for the lower price of $20,000, and CadleRock appealed. The district court remanded for further proceedings to provide an opportunity for the bankruptcy court "to articulate (1) its reasons for not requiring an auction and (2) to expand upon its basis for approving the Settlement."[213]

CadleRock on remand contended that, because it had offered to "purchase" the avoidance action for $2,500 more than the settlement amount, the trustee's settlement motion must be denied and treated as a sale of estate property pursuant to section 363(b), and that the trustee must be ordered to (i) sell the avoidance action to CadleRock at its higher monetary offer, or (ii) conduct an auction and "sell" the avoidance action to the highest bidder.[214]

The court determined that, generally, only a trustee is authorized to bring an action to avoid an allegedly fraudulent or preferential transfer, and that "[t]he sale or assignment of avoidance claims to an objecting creditor is not permitted if the creditor intends to pursue the claims on its own behalf."[215]

The court then applied the somewhat different standard that

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[211] *In re Blixseth*, 2011 WL 1519914 *18 (citing cases).

[212] *In re Milazzo*, 450 B.R. 363, 366 (Bankr.D.Conn. 2011).

[213] *In re Milazzo*, 450 B.R. at 366.

[214] *In re Milazzo*, 450 B.R. at 369.

[215] *In re Milazzo, 450 B.R. at 369, quoting In re Boyer*, 372 B.R. 102, 105 (D.Conn.2007), aff'd 328 Fed. Appx. 711 (2d Cir.2009).

prevails in the Second Circuit for approval of a compromise under Rule 9019:

> (1) the balance between the litigation's possibility of success and the settlement's future benefits; (2) the likelihood of complex and protracted litigation, with its attendant expense, inconvenience, and delay . . .; (3) the paramount interests of the creditors . . .; (4) whether other parties in interest support the settlement; (5) the competency and experience of counsel supporting . . . the settlement; (6)[any] releases to be obtained by officers and directors; and (7) the extent to which the settlement is the product of arm's length bargaining.[216]

Applying these factors, the *Milazzo* court emphasized the delay in closing the case that likely would result from protracted litigation, and its deference to the informed judgment of an experienced trustee—who had been elected by CadleRock, the 99% creditor—and approved the settlement.[217]

Similar deference was shown by the bankruptcy court in *In re ISE Corp.* In that case, Maxwell submitted a bid at the auction of substantially all of the debtor's assets that included a release of claims in exchange for a $250,000 payment. The debtor accepted the bid and the settlement was included as part of the order authorizing the sale, subject however to the requirement that the debtor obtain court approval of the settlement in a motion to be brought pursuant to Bankruptcy Rule 9019. Before bringing the 9019 motion, both the debtor and the creditors' committee "claim to have learned new facts that changed their minds as to whether the Settlement was in the best interests of the estate. The Debtor declined to bring the 9019 Motion, causing Maxwell to bring a motion to enforce the Sale Order by compelling the Debtor to bring the 9019 Motion."[218]

The court noted that, without the support of the committee or the debtor, it would be difficult to justify approval of the settlement. A "court generally gives deference to a trustee's busi-

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[216] *In re Milazzo*, 450 B.R. at 375–376, quoting *TMT Trailer Ferry. 390 U.S. 414, 424*, 88 S.Ct. 1157, 20 L.Ed.2d 1(1968) and *In re Iridium Operating LLC*, 478 F.3d 452, 455, 462 (2d Cir.2007).

[217] *In re Milazzo*, 450 B.R. at 379–381. *Compare In re Moore*, 608 F.3d 253 (5th Cir. 2010) (overbid required the court to consider the appropriateness of an auction and section 363 sale procedures), *and* In re McDonald, 430 B.R. at 12 (in which the court considered a competing settlement offer, in the same manner that it could have considered competing bids in a sale of assets), both of which are discussed in last year's Annual Survey.

[218] *In re ISE Corp.*, 2011 WL 5330058 *1 (Bankr.S.D.Cal.).

ness judgment in deciding whether to settle a matter."[219] The court found that both the debtor and the committee had reasonably investigated the claims, and noted that it "must give proper deference to their views as to what is in the best interests of the estate."[220]

The bankruptcy court, following a "full review of the merits" of the settlement, ruled that "requiring a formal 9019 Motion at this time would be a pointless act that the Court need not mandate . . . No bankruptcy settlement can be enforced without the approval of the Court." The court, having considered settlement on two occasions, determined that "it could not make the necessary findings to approve it," and there was "no reason for a formal motion to be brought." The merits of the settlement were lacking, and "there [was] no reason to review them a third time."[221]

The court's deference to the judgment of the debtor-in-possession or trustee is not without limit. In *In re SK Foods, L.P.* the bankruptcy court gave the debtor's secured lenders a superpriority claim as adequate protection in connection with the debtor's use of cash collateral. Later, the trustee and the secured lenders submitted a proposed compromise to the bankruptcy court for approval, and the court was required to consider the probability that the secured lenders would be able to establish that their superpriority claim was worth $22 to $59 million, if it had to litigate the issue. The bankruptcy court determined that this factor weighed "in favor of the compromise." In reaching its conclusion, the bankruptcy court considered the value placed on the claim by the secured lenders and the trustee, noting that the lenders contended that the superpriority claim was "somewhere between $22 million and $59 million," and that "the compromise reflect[ed] a highly beneficial outcome for the estate. Implicitly then, the bankruptcy court found that the lenders were likely to prevail in litigation on the claim, "at least at the low end of its estimate." But in reaching this conclusion, the bankruptcy court did not consider the objecting parties' position. While noting that the objecting parties had a different valuation, the bankruptcy court simply declined the objecting parties' invitation to resolve these disputes. The district court on appeal held that "this misconceive[d] the Bankruptcy Court role in ruling on a Rule

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[219] *In re ISE Corp.*, 2011 WL 5330058 *3, quoting *Goodwin v. Mickey Thompson Entm't Group, Inc. (In re Mickey Thompson Entm't Group, Inc.)*, 292 B.R. 415, 420 (B.A.P. 9th Cir.2003).

[220] *In re ISE Corp.*, 2011 WL 5330058 *4.

[221] *In re ISE Corp.*, 2011 WL 5330058 *4.

9019 motion. Under the proper standard, the Bankruptcy Court was not called upon to *resolve* the dispute about the proper valuation of the claim, but it was required to *consider the likelihood*" that the secured lenders would succeed in the litigation over the amount of the superpriority claim. The court "could not give the issue proper consideration by relying only on the evidence presented by one side of the litigation. To illustrate, the Bankruptcy Court considered whether a settlement was fair and equitable if the range of super-priority claim possibilities was from $22 million on the low end, and $59 million on the high end. Given this range, it determined that it was reasonable to accept [the secured lenders'] generous offer to value its own claim at the 'lowest end of its own range of values, such that the compromise reflects a highly beneficial outcome for the estate.' But it cannot be determined whether a settlement is fair and equitable by looking only at the range of outcomes asserted by one side of that litigation. The only evidence of the other side's range of outcomes, however, is contained in the Brincko Declaration, which was erroneously excluded from consideration." This was "highlighted by the fact that, according to the evidence offered by Objecting Parties, the low end of the range of litigation outcomes [was] $0.00, not $22 million." The district court remanded for further proceedings consistent with its order.[222]

Notwithstanding that Rule 9019 derives its authority from section 363, the statutory mootness provisions of section 363(m) refer only to a "sale or lease," and thus do not apply to many Rule 9019 orders. See *In re SK Foods, L.P.* also discussed in § XI, "Finality Under § 363(m)" below.

X. USE OF PROPERTY

Most courts have applied the same standard for section 363(b) approval for the use of property out of the ordinary course of business as for sales of property out of the ordinary course—the good business justification standard.

Equity Interests and Voting Rights

A threshold question is whether the property that the debtor would use is property of the estate, a question that often arises in connection with voting rights that the debtor has in another, non-debtor entity.

The debtor in *In re Dixie Management & Inv., Ltd. Partners* was a member in a limited liability company ("LLC"). The LLC's operating agreement and the state law applicable to the LLC

[222] *In re SK Foods, L.P.*, 2011 WL 2709648 *7–8, n. 23 (E.D.Cal.).

provided that, when the debtor filed its bankruptcy petition, "an event of disassociation occurred" and the debtor ceased to be a member of the LLC. The court held that the purported disassociation was ineffective, (1) pursuant to section 363(l), which gives the debtor the power to continue to use, sell or lease its property notwithstanding any provision in a contract, lease or law that is conditioned on the insolvency or financial condition of the debtor, (2) because it was in contravention of section 541(c)(1), which provides that a debtor's property becomes property of the estate notwithstanding an ipso facto clause in an agreement, and (3) under the Supremacy Clause of the United States Constitution.[223]

XI. POSTAPPROVAL AND POSTCLOSING MATTERS—RETENTION OF JURISDICTION, APPEALS AND THE FINALITY OF ORDERS

This section considers decisions of the courts of appeals and the BAPs as well as selected decisions of the district courts and the bankruptcy courts since the 2011 update.

Generally, the appeals court "review[s] *de novo* the legal conclusions of the bankruptcy court and examine[s] its factual findings for clear error."[224]

A court of appeals, in an appeal from a decision of a BAP, sits as a second court of review, and independently reviews the bankruptcy court's decision, applying the same standard of review as the BAP. Thus, even in the case of an intervening appeal to the BAP, the court of appeals reviews the bankruptcy court's conclusions of law de novo.[225]

Retention of Jurisdiction to Interpret and Enforce § 363(b) Orders and Sale Transactions

The bankruptcy court retains jurisdiction under Bankruptcy Code § 105(a) to interpret and enforce its sale order, which is a "core" proceeding under 28 U.S.C.A. § 157(b)(2)(N), or its order authorizing the use or lease of property, which is a core proceeding under 28 U.S.C.A. § 157(b)(2)(M).[226] Such jurisdiction is, however, non-exclusive. See *In re Skyline Woods Country Club* discussed in § IV above. See also *Severstal Sparrows Point, LLC*

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[223]*In re Dixie Management & Inv., Ltd. Partners*, 2011 WL 1753971 *2 (Bankr.W.D.Ark.).

[224]*In re MacNeal*, 2009 WL 97559 at *3 (11th Cir. 2009).

[225]*In re Farmland Industries, Inc.*, 639 F.3d 402, 405 (8th Cir. 2011).

[226]11 U.S.C.A. § 105(a); 28 U.S.C.A. § 157(b)(2)(M) and (N).

v. U.S. E.P.A. regarding a Maryland district court's retention of jurisdiction to interpret release provisions of sale order entered by bankruptcy court for the Southern District of New York, and a subsequently entered Maryland district court consent decree.[227]

In *WHR Holdings, LLC v. Geoff & Krista Sims Enterprises, Inc.* the purchaser of the debtor's assets sought to obtain from the bankruptcy court a favorable interpretation of the sale order, by filing a motion to enforce the sale order some five years after the sale order was entered. The bankruptcy court disagreed with the purchaser's interpretation, and denied the motion. On appeal, the district court affirmed.[228]

The bankruptcy court may enforce its sale order by imposing sanctions on a party who improperly and collaterally attacks it.

Finality of § 363(b) Orders—Section 363(m), Equitable Mootness, Res Judicata and Rule 9024 (Fed.R.Civ.Proc. 60(b))

The finality of an order entered pursuant to Bankruptcy Code § 363(b) is protected by Bankruptcy Code § 363(m) (which expressly refers only to sale or lease), the doctrine of equitable mootness, and the principle of res judicata. The order may nonetheless be challenged under Rule 60. These are discussed in turn below.

Appeals—Section 363(m)—Rules 6004 and 8005

Bankruptcy Code § 363(m) provides that:

> The reversal or modification on appeal of an authorization under subsection (b) or (c) of this section 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.[229]

Bankruptcy Rule 6004(h) provides that "[a]n order authorizing the use, sale or lease of property other than cash collateral is stayed until the expiration of 10 days after entry of the order, unless the court orders otherwise."[230] Bankruptcy Rule 8005 sets the

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[227] *Severstal Sparrows Point, LLC v. U.S. E.P.A.*, 794 F.Supp.2d 624, 626 (D. Md.,2011).

[228] *WHR Holdings, LLC v. Geoff & Krista Sims Enterprises, Inc.*, 2011 WL 5838387 *2–4.

[229] 11 U.S.C.A. § 363(m).

[230] Fed. R. Bankr. P. 6004(h).

rule for obtaining a stay pending appeal from an order of the bankruptcy court.[231]

A bankruptcy court's decision to "order otherwise" under Rule 6004(h) and lift the 10-day stay normally imposed by that Rule is reviewed for abuse of discretion.[232]

See also § III, "Standing to Object," above.

Finality Under § 363(m)

The Court of Appeals reviews the district court's finding of mootness de novo.[233]

The Third Circuit in *In re Flynn* appears to have shifted toward the per se rule for statutory mootness. The *Flynn* court stated that, if the appellant does not obtain a stay, the only issue is whether the appeal is moot because vacation or modification of the order would affect the validity of the sale. In *Flynn*, the remedy sought by the appellant, "voidance of the sale, would affect the validity of the sale and [was] therefore impermissible under § 363(m)."[234] Flynn argued that the sale order "was invalid because there was no good-faith purchaser and Flynn was not given the opportunity to entertain third-party offers of sale. He also contend[ed] that the sale was made in bad faith, without proper accounting. There [was] no evidence in the record to support the contention" that the shareholders that purchased the debtor's assets were not good-faith purchasers, or that they or the Chapter 7 trustee had acted in bad faith. In short, there was no evidence of bad faith on the part of the trustee or the shareholders in connection with the sale or the sale order.[235]

The Third Circuit held that, "[b]ecause Flynn did not receive a stay of the sale pending appeal, the sale has since been closed, and the relief" he sought "would impact the validity of that sale, the District Court correctly dismissed Flynn's appeal as moot under § 363(m).[236]

The district court in *In re Alabama Aircraft Industries, Inc.*, another case within the Third Circuit, considered an appeal from an order authorizing the sale of substantially all of the debtor's

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[231]Fed. R. Bankr. P. 8005.

[232]See e.g., *Hower v. Molding Systems Engineering Corp.*, 445 F.3d 935, 938, 46 Bankr. Ct. Dec. (CRR) 102, Bankr. L. Rep. (CCH) P 80512 (7th Cir. 2006).

[233]*In re River West Plaza-Chicago, LLC*, 2011 WL 6645693 *2 (7th Cir.).

[234]*In re Flynn*, 2011 WL 873457 *2 (3rd Cir.).

[235]*In re Flynn*, 2011 WL 873457 *3.

[236]*In re Flynn*, 2011 WL 873457 *3.

assets. The sale transaction included the vesting of claims of the debtor in a litigation trust, the costs of which would be funded by the purchaser of the debtor's assets, and the recoveries from which would be split 90/10 between the purchaser and the debtor. Boeing, a defendant with respect to one of the debtor's claims vested in the litigation trust, objected to the sale. The bankruptcy court overruled the objection, and ordered the sale, and Boeing appealed. Boeing orally asked for a stay from the bankruptcy court at the close of the sale hearing, which request was denied. Boeing did not further pursue obtaining a stay.[237]

Boeing asserted on appeal that the debtors' creation of the trust was "not a sale deserving of § 363(m) protection because the bankruptcy court, in its Sale Order, ruled that it was a 'use of the Debtors' property.' " Boeing further argued that the ruling prevented the district court "from affording the creation of the Trust § 363(m) protection because only sales, and not uses, are afforded such protection." The district court found Boeing's argument unconvincing.

First, the bankruptcy court had expressly given the establishment of the trust section 363(m) protection. Second, the transaction documents identified 90% of the trust's beneficial interest as "a 'Purchased Asset' and specifically condition[ed] the closing of the asset sale upon the creation of the Trust and the bankruptcy court's corresponding approval." "Even more convincingly, the totality of the transaction strongly indicate[d] that the establishment of the Trust was part and parcel of the Debtors' sale to [the purchaser]. The Debtors were quickly running out of capital. They faced the option of selling all major assets or being forced to liquidate. To receive the highest possible purchase price from [the [purchaser], they included in the asset sale the creation of the Trust and a 90% stake in its beneficial interest. Neither the complexity of the transaction, nor the Debtors' retention of 10% of the Trust's beneficial interest, dictate[d] finding otherwise."[238]

Finally, even if the court "were to describe the Trust as a use of estate property rather than an outright sale," Third Circuit case law supported the holding that "transactions integral to a sale deserve § 363(m) protection whether they themselves are properly

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[237] *In re Alabama Aircraft Industries, Inc.*, 464 B.R. 120, 122–123 (D.Del. 2012).

[238] *In re Alabama Aircraft Industries, Inc.*, 464 B.R. at 124.

referred to as sales under § 363(b)."[239] In reaching its conclusion, the district court referred to the *Clear Channel* court's "attempt to limit such protection to only instances of 'changes of title,' " as having "been summarily rejected."[240]

Having concluded that the debtors' formation of the trust was deserving of section 363(m) protection, and recognizing that its execution was not stayed, the district turned to "whether granting Boeing its requested relief, vacating the Trust, would 'affect the validity of the sale.' " The court found it "clear that vacating the Trust would affect the validity of the sale. Because the Agreement [was] conditioned upon the creation of the Trust, its vacation would nullify the sale and return all assets to the Debtors. Such unraveling is exactly the type of affront to finality that § 363(m) seeks to prevent."[241]

Lastly, excising the trust would put in jeopardy the monetary investments the purchaser and its parent company had subsequently made in the business it had acquired from the debtors. Moreover, as the trust had already commenced its litigation in Alabama state court, vacating the sale would put the proper resolution of those claims at risk." The relief Boeing requested could "only be granted at the cost of the deal's validity," and the court affirmed the sale order.[242]

The question of "use" as opposed to "sale" or "lease" also arose in *In re SK Foods, L.P.* The district court in that case addressed the trustee's mootness argument first, "because equitable mootness is considered to be jurisdictional in the Ninth Circuit."[243] "Section 363(m) mootness presents similar issues."[244] At issue in *In re SK Foods, L.P.* was an appeal from a Rule 9019 settlement, and the court held that, since section 363(m) by its terms language applies only to appeals from an order approving a sale

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[239]*In re Alabama Aircraft Industries, Inc.*, 464 B.R. at 124, citing *Cinicola v. Scharffenberger*, 248 F.3d 110, 125–26 (3d Cir.2001) (providing the assumption and assignment of employment contracts § 363(m) protection because they were "inextricably intertwined" with the Debtor's sale of assets); *Official Comm. of Unsecured Creditors v. Chase Manhattan Bank (In re Charter Behavioral Health Sys., LLC)*, 45 Fed.Appx. 150, 151 n. 2 (3d Cir.2002).

[240]*In re Alabama Aircraft Industries, Inc.*, 464 B.R. at 125, citing *Clear Channel Outdoor, Inc. v. Nancy Knupfer (In re PW, LLC)*, 391 B.R. 25, 35 (9th Cir. BAP 2008).

[241]*In re Alabama Aircraft Industries, Inc.*, 464 B.R. at 125.

[242]*In re Alabama Aircraft Industries, Inc.*, 464 B.R. at 125.

[243]*In re SK Foods, L.P.*, 2011 WL 2709648 *3, n. 13 (E.D.Cal.), citing *Sherman v. SEC (In re Sherman)*, 491 F.3d 948, 965 n. 20 (9th Cir.2007).

[244]*In re SK Foods, L.P.*, 2011 WL 2709648 *3, n. 13.

or lease, section 363(m) statutory mootness did not apply to moot the appeal from a Rule 9019 order that was before the court.[245]

Several other recent opinions addressed the issue of what constitutes a "sale" for purposes of section 363(m) statutory mootness, in the wake of the Ninth Circuit BAP's *Clear Channel* decision, which held among other things that a lien "stripped" by a sale order could be reinstated on appeal, notwithstanding the provisions of section 363(m), since the lien stripping was not a "sale" referred to in and protected by section 363(m).

In *In re Namco Capital Group, Inc.* the district court found "the reasoning of *Clear Channel* unpersuasive. A sale that involves lien-stripping under § 363(f) is still by its terms a sale under subsection (b) or (c). A reversal of the bankruptcy court's authorization to sell free and clear amounts to 'a modification on appeal' of the authorization to sell." In the *Namco* court's view, such a reversal would be "plainly contrary to the mandate of § 363(m), which insulates § 363(b) and (c) sales from judicial review."[246]

A California district court *In re Thorpe Insulation Co.* also rejected *Clear Channel* citing extensive authority.[247]

But see *In re Lehigh Coal and Nav. Co.* discussed in § IV above.

The Seventh Circuit in *In re River West Plaza-Chicago, LLC* explained that the rule of noted that the rule of section 363(m) mootness is based on a central purpose of bankruptcy—to maximize creditor recovery. Because purchasers are likely to demand a steep discount if the sale estate property can later be disturbed, Congress has decided that bankruptcy sales are usually final.[248]

The appellant in *River West Plaza* had brought suit against the debtor prepetition, alleging that he was entitled to a percentage of the profits of the debtor's shopping center, and also filed a lis pendens against the shopping center. The debtor commenced its bankruptcy case, and the litigation was stayed. The bankruptcy court disallowed the appellant's claim, and the appellant appealed. The debtor's plan, providing for a sale free and clear pursuant to section 363(f), was confirmed, and the sale was ap-

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[245] *In re SK Foods, L.P.*, 2011 WL 2709648 *4–5.

[246] *In re Namco Capital Group, Inc.*, 2011 WL 2312090 *3 (C.D.Cal.).

[247] *In re Thorpe Insulation Co.*, 2011 WL 1378537 *1–2 (C.D.Cal.) (citing authority).

[248] *In re River West Plaza-Chicago, LLC*, 2011 WL 6645693 *3, citing *Corporate Assets, Inc. v. Paloian*, 368 F.3d 761, 767 (7th Cir.2004); *In re Sax*, 796 F.2d 994, 998 (7th Cir.1986).

proved by the court. The appellant's motions to stay the sale were denied, the sale closed, and the bankruptcy case was closed. Later, the district court affirmed the disallowance of the appellant's claim as moot. The appellant appealed to the Seventh Circuit.[249]

The appellant in *River West Plaza* did not obtain a stay, and did not contest the purchaser's status as a good-faith purchaser, which the court stated was "the sole ground § 363(m) provides for modifying the terms of a sale completed in the absence of a stay." The court held that, despite the appellant's "suggestion to the contrary," it could not ignore section 363(m) just because the purchaser was not a party to the appeal and had not, therefore, raised section 363(m) itself.[250]

Still, under the Seventh Circuit's formulation, the per se rule does not apply, and a "case must be declared moot where 'there is no possible relief which the court could order that would benefit the party seeking it.' "[251] The appellant argued that he could "avoid a challenge to the 'validity' of the sale for the purposes of § 363(m), and thus its stay requirement," by asking the court to "simply rearrange the distribution of the sale proceeds," by paying his claim out of the proceeds of the sale that were paid to the holder of the mortgage against the shopping center.[252] The court held that the appellant's alternative argument also faltered, for two reasons: the effect of his notice of appeal to the district court and, again, section 363(m). First, though the appellant had appealed from the order disallowing his claim, he never appealed from the plan confirmation order, which had established the mortgage lender's share of the proceeds. Second, just as section 363(m) prevented the court from letting the appellant "challenge the sale of the property if he could succeed in reviving his disallowed claim on appeal," it also prevented the court "from letting him upset the expectations from the sale that River West's other creditors had when deciding to support the sale." Characterizing the appellant's request for a redistribution of the proceeds as an "end run," and reemphasizing the appellant's failure to appeal

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[249]*In re River West Plaza-Chicago, LLC*, 2011 WL 6645693 *2.

[250]*In re River West Plaza-Chicago, LLC*, 2011 WL 6645693 *3.

[251]*In re River West Plaza-Chicago, LLC*, 2011 WL 6645693 *3, quoting *In re Envirodyne Indus.*, 29 F.3d 301, 303 (7th Cir.1994).

[252]*In re River West Plaza-Chicago, LLC*, 2011 WL 6645693 *4.

from the bankruptcy court's approval of the section 363 sale or obtain a stay of the sale, the Seventh Circuit affirmed.[253]

In *In re Golf 255, Inc.*, another Seventh Circuit opinion, the court held that the relief available to the appellants "*would* be to rescind the bankruptcy sale, and that would be improper" unless the purchaser were a party to the "alleged (but unproved and probably nonexistent) fraud. And of that there [was] no evidence."[254]

The Tenth Circuit in *In re C.W. Mining Company* enunciated a similar rule. The bankruptcy court in that case had determined that a coal mining agreement had not been terminated and remained property of the debtor's estate, and the counterparty to the agreement appealed. While the appeal was pending, the trustee sold the agreement. The trustee filed a motion to dismiss the appeal, arguing that the appeal was statutorily and equitably moot, because the agreement had been sold from the estate.[255] The Tenth Circuit ruled that, because the trustee had not affirmatively foreclosed the possibility that the counterparty might be entitled to alternative relief that would not affect the validity of the sale, the trustee had not established that the appeal was moot under section 363(m).[256]

Stay

In *In re Viola*, the district court noted that the rule that an appellant must obtain a stay exists to protect the interests of good faith purchasers of property,[257] and that "the trend is towards an absolute rule that requires appellant to obtain a stay before appealing a sale of assets."[258] The debtor, Viola, was notified of the sale, the sale order was entered, and the sale closed. The debtor then filed an emergency motion seeking a stay of the sale. The district court held that the debtor lacked standing to appeal, as discussed in § III above, and in addition noted that he had not previously sought or obtained a stay or filed a notice of appeal, and that the vehicles had been sold. Thus, the mootness rule

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[253] *In re River West Plaza-Chicago, LLC*, 2011 WL 6645693 *4–5.

[254] *In re Golf 255, Inc.*, 652 F.3d 806, 811 (7th Cir. 2011), citing 11 U.S.C. § 363(m) and cases.

[255] *In re C.W. Mining Co.*, 641 F.3d 1235, 1236 (10th Cir. 2011).

[256] In re C.W. Mining Co., 641 F.3d at 1239.

[257] *In re Viola*, 2011 WL 4831200 *3 (N.D.Cal.), citing *Thrift & Loan v. Suchy*, 786 F.2d 900, 901–02 (9th Cir.1985).

[258] *In re Viola*, 2011 WL 4831200 *3 (N.D.Cal.), quoting *Onouli-Kona Land Co. v. Estate Richards*, 846 F.2d 1170, 1172 (9th Cir.1988).

provided an additional basis for the court to deny his motion for a stay.[259]

In *In re Friwat* the appellant was the assignee of a judgment lien against certain real property in which the debtor held an equitable interest at the time he filed his Chapter 7 petition. The Chapter 7 trustee sought and obtained the bankruptcy court's approval of the sale of the property to a third party, free and clear of liens and encumbrances, including the judgment lien. The judgment lienor did not appeal from the sale order, and the property was sold to the third party, "as a bona-fide purchaser."[260]

The assignee of the judgment lien filed suit to quiet title in state court, and the action was removed and transferred to the bankruptcy court. The bankruptcy court dismissed the complaint, and the assignee appealed.[261] The district court began its analysis by stating that a "party wishing to challenge a bankruptcy court's order authorizing sale of estate property to a good faith purchaser must obtain a stay pending appeal, or the appeal becomes moot once the sale is completed. Failure to seek a stay bars an appeal from the sale." The district court's analysis focused on the bankruptcy court's findings of fact relating to whether the property sold was property of the estate, and whether the judgment lienor had notice of the sale.[262] The district court concluded that none of those findings were clearly erroneous, and that the bankruptcy court had subject matter jurisdiction over the free and clear sale of the property, and affirmed.[263]

In *In re Kutrubis*, the bankruptcy court approved a sale of the debtor's interest (or former interest) in a partnership over the objection of another partner. The partner, who was acting pro se, appealed but did not obtain a stay from the sale order, and the sale closed.[264] The Chapter 7 trustee maintained that the pro se appellant's failure to obtain a stay of the partnership sale rendered her appeal moot. The district court for the Northern District of Illinois noted that, without a doubt, the appellant's pro se status had complicated the proceedings; "however, the Rules of Bankruptcy Procedure apply equally to pro se litigants." The appellant "was obligated to comply with the same rules of proce-

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[259]*In re Viola*, 2011 WL 4831200 *3.

[260]*In re Friwat*, 2011 WL 5217826 *1.

[261]*In re Friwat*, 2011 WL 5217826 *1.

[262]*In re Friwat*, 2011 WL 5217826 *2–3.

[263]*In re Friwat*, 2011 WL 5217826 *3.

[264]*In re Kutrubis*, 2011 WL 5118864 *2–3 (N.D.Ill.).

dure required of litigants that are represented by attorneys." She failed to do so and the court, applying the per se rule to the pro se appellant, dismissed her appeal.[265]

The district court in *In re Coastline East Corp.* reached the same result under Fifth Circuit precedent. Because section 363(m) "prevents an appellate court from granting effective relief if a sale is not stayed, *the failure to obtain a stay renders the appeal moot.*"[266] Appellant failed to obtain a stay as required under section 363(m). The bankruptcy court's approval was issued, the assets were transferred, and the sale was completed. Thus, under section 363(m), the validity of the sale" could not "be altered on appeal," and was moot. An appellant's pro se status did not change this result, and a motion to dismiss was granted.[267]

In *Knight v. Bank of America, N.A.*, another judge from the Northern District of Illinois affirmed the bankruptcy court's approval of an assignment of claims pursuant to section 363(b) on the merits, without any mention of whether a stay had or had not been obtained.[268]

In *Olslund v. Bellinger* the district court for the District of Maryland ruled that "as a result of the Appellant's failure to obtain a stay from the Bankruptcy Court, that Court authorized the transfer of the deed of subject property pursuant to the $10,000 sale." Accordingly, the appeal was "MOOT pursuant to 11 U.S.C. § 363(m)."[269]

See also *In re Shoemaker* regarding the statutory mootness of an appeal under section 363(m) if a stay has not been obtained.[270]

Good Faith

Several recent decisions have addressed what constitutes "good faith" under section 363(m) and whether the court's finding of good faith can be considered on appeal if a stay has not been obtained.

In *In re CPJFK, LLC* the bankruptcy court made a good faith finding over an objection that the broker "was not a disinterested

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[265] *In re Kutrubis*, 2011 WL 5118864 *4–6.

[266] *In re Coastline East Corp.*, 2011 WL 3475535 *2 (M.D.Fla.) (emphasis in original), citing *In re Bleaufontaine*, 634 F.2d 1383, 1389–90 (5th Cir. 1981); *In re Vetter Corp.*, 724 F.2d 52, 55–56 (7th Cir.1983).

[267] *In re Coastline East Corp.*, 2011 WL 3475535 *2.

[268] *Knight v. Bank of America, N.A.*, 2011 WL 5008528 *6 (N.D.Ill.).

[269] *Olslund v. Bellinger*, 2012 WL 246440 *2 (D.Md.).

[270] *In re Shoemaker*, 2011 WL 1750239 (N.D.Fla.).

broker" and had loyalty to the successful bidder for the property "based upon prior business dealings." The court ruled that the "testimony established that there was no interference or involvement" by the buyer "or any other party in the marketing process, nor any evidence of any 'fraudulent, collusive actions specifically intended to affect the sale price or control the outcome of the sale.' " Accordingly, a good-faith finding pursuant to section 363(m) was "appropriate."[271]

In *In re Dexter Distributing Corp.* the bankruptcy court determined that the buyer was " 'the only possible buyer and that his purchase price [was] above the fair market value of the business.' Thus, the bankruptcy court's conclusion that [the buyer] was a good faith purchaser was not 'illogical, implausible, or without support in the record.' "[272]

In *Sheehan v. Dobin*, the district court rejected the appellants' argument that the bankruptcy court had made no determination as to whether or not the purchaser acted in good faith, because the trustee at the hearing only provided a proffer and not live testimony regarding the "good faith" of the purchaser. The district court rejected this argument. First, the principals of the purchaser were in court and available to testify at the hearing, yet the appellants chose not to cross-examine them. Moreover, the bankruptcy judge on the record of the hearing had specifically rejected the appellants' argument that the purchaser was not a good faith purchaser because one of the principals of the purchaser was an adjacent landowner whose homeowner's association was in litigation with the debtor.[273]

In *In re Reynolds*, the district court suggested that even in the absence of a stay, it could consider the bankruptcy court's good faith finding. On the record before it, however, the trustee "was authorized to sell the property by § 363 and by the bankruptcy court's order of approval . . . The sale was completed . . . No evidence suggest[ed] that the buyers of the property were not good-faith purchasers. As the sale was consummated and no stay pend-

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[271] *In re CPJFK, LLC*, 2011 WL 1257208 *9, 14, quoting *Licensing By Paolo, Inc. v. Sinatra (In re Gucci)*, 126 F.3d 380, 390 (2d Cir.1997)

[272] *In re Dexter Distributing Corp.*, 2011 WL 1979855 *1 (9th Cir.), citing *Retz v. Samson (In re Retz)*, 606 F.3d 1189, 1196 (9th Cir.2010).

[273] *Sheehan v. Dobin*, 2011 WL 1627051 *4 (D.N.J.).

ing appeal was entered," the court was "powerless to order reversal of the sale."[274]

The district court in *Official Committee of Unsecured Creditors v. Interforum Holding LLC* stated the Seventh Circuit's view similarly: "it is also true that a stay is not necessary when an appeal challenges whether the purchaser is a good faith purchaser pursuant to § 363(m)." Under this rule, a challenge to the purchaser's good faith is not automatically grounds for dismissal, even if the appellant has failed to obtain a stay.[275] However, since the bankruptcy court's good faith finding was not clearly erroneous, and the committee-appellant had not obtained a stay, the appeal was moot under section 363(m) and the district court dismissed it.[276]

Equitable and Constitutional Mootness

Closely related to section 363(m) are the nonstatutory doctrines of equitable and constitutional mootness.

The district court in *Save Al-Huda School Foundation v. Islamic Society of San Francisco* characterized these doctrines as follows: "Constitutional mootness requires the impossibility of the court's granting relief for lack of a live case and controversy."[277] "Equitable mootness inquires beyond the impossibility of a remedy and considers the consequences of a reversal on third parties who acted in reliance on an order authorizing a sale."[278]

The debtor, Islamic Society of San Franscisco (the "ISSF"), sought to sell property used by the Al-Huda School, free and clear. The Save Al-Huda School Foundation ("SAHSF"), a group formed of parents of potential students, donors, and members of ISSF, opposed the sale, arguing that the property could not be

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[274]*In re Reynolds*, 455 B.R. 312, 319 (D.Mass. 2011), citing *Aja v. Fitzgerald (In re Aja)*, 441 B.R. 173, 177, 179 (1st Cir. BAP 2011).

[275]*Official Committee of Unsecured Creditors v. Interforum Holding LLC*, 2011 WL 2671254 *4 (E.D.Wis.).

[276]*Official Committee of Unsecured Creditors v. Interforum Holding LLC*, 2011 WL 2671254 *7.

[277]*Save Al-Huda School Foundation v. Islamic Society of San Francisco*, 2011 WL 672658 *3 (N.D.Cal.), citing *DeFunis v. Odegaard*, 416 U.S. 312, 316, 94 S.Ct. 1704, 40 L.Ed.2d 164 (1974); *Luckie v. EPA*, 752 F.2d 454, 457 (9th Cir. 1985); *Church of Scientology of Cal. v. United States*, 506 U.S. 9, 12, 113 S.Ct. 447, 121 L.Ed.2d 313 (1992).

[278]*Save Al-Huda School Foundation v. Islamic Society of San Francisco*, 2011 WL 672658 *3 (N.D.Cal.), citing *In re PW, LLC*, 391 B.R. 25, 33 (9th Cir.BAP 2008).

sold because it was subject to a charitable trust obligation, alleging its right to enforce the trust and prevent the ISSF from selling the school property. The bankruptcy court ruled against the SAHSF, holding that the SAHSF lacked standing to enforce a trust both statutorily and at common law, and could not enjoin ISSF from selling the property.[279]

The Save Al-Huda School Foundation ("SAHSF") appealed seeking to reverse the bankruptcy court's judgment and a new trial on the substantive issue of the SAHSF's standing to enforce the "purported charitable trust." The district court held that, since the appeal did not appeal from the bankruptcy court's sale order, section 363(m), "by its terms," did not apply.[280]

The court nonetheless held that the appeal was constitutionally moot. The property, which the SAHSF contended was subject to a charitable trust restricting its use as an Islamic school, had been sold to a non-party to the appeal. "Even if the SAHSF were to prevail at a new trial, it would be impossible for the court to fashion "any effectual relief." A ruling that the SAHSF possesse[d] a beneficiary interest in the Al-Huda School [would] not effect a return of the Property to the ISSF." The court was therefore "powerless to undo what has already been done," and the SAHSF's appeal was constitutionally moot.[281]

The court also held that the appeal was equitably moot for reasons that parallel those for statutory mootness. In the absence of a stay, the purchasers had "relied on the finality of the order authorizing the sale in good faith. Allowing the SAHSF's appeal to proceed create[d] a threat of invalidating a consummated sale," which would directly contradict "the vibrant policy of finality embodied in the equitable mootness doctrine." It was therefore "inequitable to consider the merits of the SAHSF's appeal."[282]

In *In re Dexter Distributing Corp.* the Seventh Circuit held that the appeal also was constitutionally moot, since there had been " 'intricate and involved transactions' in reliance on the

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[279]*Save Al-Huda School Foundation v. Islamic Society of San Francisco*, 2011 WL 672658 *1–2.

[280]*Save Al-Huda School Foundation v. Islamic Society of San Francisco*, 2011 WL 672658 *4.

[281]*Save Al-Huda School Foundation v. Islamic Society of San Francisco*, 2011 WL 672658 *5, quoting *In re Focus Media, Inc.*, 378 F.3d 916, 923 (9th Cir. 2004).

[282]*Save Al-Huda School Foundation v. Islamic Society of San Francisco*, 2011 WL 672658 *5.

bankruptcy court's order confirming the reorganization plan, and reversal would affect the rights of numerous third parties."[283]

The Tenth Circuit in *In re C. W. Mining Company* stated that the "equitable mootness doctrine allows a court to decline to hear a bankruptcy appeal, even when relief could be granted, if implementing the relief would be inequitable." The court noted that it had "adopted this doctrine in the context of Chapter 11 reorganization plans, but [had] not applied it in the Chapter 7 setting." Even if it did apply, however, the court was not required to do so "as it is discretionary with the court." The court decided that, rather than consider whether the doctrine of equitable mootness could be applied, and, if so, "weigh the doctrine's six factors in this case in the face of an underdeveloped record on this issue," the better and more appropriate course was to resolve the appeal on the merits,[284] and did so as discussed in this § XI, "Finality Under § 363(m)," above.

The district court in *In re SK Foods, L.P.* stated the Ninth Circuit's formulation, that "[b]ankruptcy appeals may become equitably moot when events occur 'that make it impossible for the appellate court to fashion effective relief.' "[285] "This includes cases where the settlement transaction is too 'complex or difficult to unwind.' "[286] "Moreover, if appellants did not diligently pursue a stay of the objected-to order in the bankruptcy court, thus permitting 'a comprehensive change of circumstances to occur,' it may be 'inequitable' to consider the appeal. The 'heavy' burden of establishing mootness is on the party advocating its application.' "[287]

The district court acknowledged that, though the appellants had not sought a stay pending appeal—a key factor in considering equitable mootness—such factor only arises if the failure to obtain a stay has led to "such a comprehensive change of circumstances" that considering the appeal would be inequitable. Since

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[283]*In re Dexter Distributing Corp.*, 2011 WL 1979855 *1, citing *Trone v. Roberts Farms, Inc. (In re Roberts Farms, Inc.)*, 652 F.2d 793, 797 (9th Cir. 1981); *Southwest Prods., Inc. v. Durkin (In re Southwest Prods., Inc.)*, 144 B.R. 100, 105 (9th Cir. B.A.P. 1992).

[284]*In re C.W. Mining Co.*, 641 F.3d at 1239–1240.

[285]*In re SK Foods, L.P.*, 2011 WL 2709648 *3, quoting *Focus Media, Inc. v. NBC Inc. (In re Focus Media, Inc.)*, 378 F.3d 916, 922 (9th Cir.2004).

[286]*In re SK Foods, L.P.*, 2011 WL 2709648 *3, quoting *Lowenschuss v. Selnick (In re Lowenschuss)*, 170 F.3d 923, 933 (9th Cir.1999).

[287]*In re SK Foods, L.P.*, 2011 WL 2709648 *3, quoting *Focus Media, Inc. v. NBC Inc. (In re Focus Media, Inc.)*, 378 F.3d 916, 923 (9th Cir.2004).

the trustee had not established the predicate "comprehensive change," the court held that the appeal was not equitably moot.[288] *In re SK Foods, L.P.* is also discussed in § IX and this § XI, "Finality Under § 363(m)," above.

Res Judicata (Claim Preclusion) and Issue Preclusion (Collateral Estoppel)

Res judicata, or claim preclusion, "is a judicially made doctrine with the purpose of both giving finality to parties who have already litigated a claim and promoting judicial economy; it bars claims that could have been litigated as well."[289] To establish that a case is barred under the doctrine of res judicata, the Eleventh Circuit has held that the following elements must be present:

(1) the prior judgment must be valid by having been rendered by a court of competent jurisdiction and in accordance with requirements of due process;
(2) the judgment must be final and on the merits;
(3) there must be identity of both parties or their privies; and
(4) the later proceeding must involve the same cause of action as involved in the earlier proceeding.[290]

In *Matrix IV, Inc. v. American Nat. Bank and Trust Co. of Chicago*, Matrix was a supplier of the debtor Stylemaster, and filed a $7 million claim against Stylemaster in its bankruptcy case. Matrix "lodged a strenuous objection to the proposed sale of Stylemaster's assets" and was also party "to an adversary proceeding to resolve a lien-priority dispute with ANB," Stylemaster's primary lender." Matrix also "had a lien on certain Stylemaster inventory in its possession." "In opposing the proposed asset sale, Matrix alleged that Stylemaster (and by extension Gateway, a related company) had fraudulently induced it to produce plastic storage containers without any intention of paying for them. The object of this scheme, according to Matrix, was to build up Stylemaster's inventory so that a successor company led by Stylemaster insiders could purchase the company's assets at a firesale price in the bankruptcy. The lien-priority adversary proceeding centered on similar allegations; Matrix

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[288] *In re SK Foods, L.P.*, 2011 WL 2709648 *4, n. 17.

[289] *In re Atlanta Retail, Inc.*, 456 F.3d 1277, 1284, 46 Bankr. Ct. Dec. (CRR) 223 (11th Cir. 2006) (citing *Parklane Hosiery Co., Inc. v. Shore*, 439 U.S. 322, 326, 99 S. Ct. 645, 58 L. Ed. 2d 552, Fed. Sec. L. Rep. (CCH) P 96713, 26 Fed. R. Serv. 2d 669 (1979)).

[290] *Atlanta Retail*, 456 F.3d at 1285 (citing *In re Justice Oaks II, Ltd.*, 898 F.2d 1544, 1550, 22 Collier Bankr. Cas. 2d (MB) 1304, Bankr. L. Rep. (CCH) P 73353 (11th Cir. 1990)).

claimed that ANB's lien should be equitably subordinated to its own because ANB participated in the fraud by lending Stylemaster money and conspiring to destroy Matrix's lien."[291]

"Matrix's fraud allegations failed at all levels of the bankruptcy proceeding—in the bankruptcy court, the district court, and on appeal" to the Seventh Circuit. Matrix "repackaged those failed allegations into [a] RICO and common-law fraud action. The district court dismissed the suit on grounds of res judicata and collateral estoppel, concluding that Matrix had litigated and lost the very same fraud claims in the bankruptcy proceeding. Gateway then moved for Rule 11 sanctions; the district court denied this motion. Matrix appealed the dismissal order, and Gateway . . . cross-appealed from the denial of its Rule motion."[292]

The Seventh Circuit began its consideration of the issues on appeal by noting its "general agreement" with the district court that the claims Matrix advanced were "based on the same core of operative facts as the claims it litigated and lost in the bankruptcy proceedings."[293] It made "no difference that the earlier claims took a different form—that is, an equitable-subordination defense in the lien-priority adversary proceeding and an objection to the bankruptcy asset sale" on the ground that the purchaser of the debtor's assets was not a good-faith purchaser. It was "quite clear that the allegations of fraud Matrix asserted in the Stylemaster bankruptcy [were] the same basic allegations" it made on appeal: "(1) Stylemaster built up its inventory with goods from Matrix that it had no intention of paying for; (2) its principals formed a new corporate entity, J.R. Plastics, to buy Stylemaster's assets at a reduced price in a bankruptcy sale; (3) Stylemaster arranged a line of credit with ANB secured by Stylemaster's unpaid-for inventory; and (4) Stylemaster and ANB conspired to establish the priority of ANB's lien over Matrix's. Under well-established claim-preclusion doctrine, this common nucleus of operative facts" meant the claims were "the same even though they involve[d] different legal theories."[294]

Matrix insisted that the claims were not the same because the

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[291] *Matrix IV, Inc. v. American Nat. Bank and Trust Co. of Chicago*, 649 F.3d 539, 542 (7th Cir. 2011).

[292] *Matrix IV, Inc. v. American Nat. Bank and Trust Co. of Chicago*, 649 F.3d at 542.

[293] *Matrix IV, Inc. v. American Nat. Bank and Trust Co. of Chicago*, 649 F.3d at 547–548.

[294] *Matrix IV, Inc. v. American Nat. Bank and Trust Co. of Chicago*, 649 F.3d at 548.

alleged RICO conspiracy included events subsequent to Stylemaster's bankruptcy filing. "More specifically, Matrix assert[ed] that ANB committed a fraud on the bankruptcy court by pursuing a claim for which it did not have standing." A question relating to ANB's standing in the bankruptcy proceeding could not form the basis for an otherwise impermissible collateral attack on the judgments rendered by the bankruptcy court. "Moreover, only a few of the allegations in the amended complaint pertain[ed] to events that occurred during the bankruptcy proceeding; they [did] not suffice to destroy the essential factual commonality of these claims. Nearly all the facts comprising the alleged fraudulent scheme predate[d] Stylemaster's bankruptcy filing; without the alleged prebankruptcy scheme, Matrix ha[d] no RICO or common-law fraud claim."

Matrix also contended, "quite implausibly, that it never actually pleaded fraud in its opposition to the bankruptcy sale or in the adversary proceeding. Matrix claim[ed] that because it withdrew its motion to dismiss the bankruptcy case and removed the mention of 'fraud' from its supplemental statement of facts in support of equitable subordination, the present allegations of conspiracy to defraud were never put before the bankruptcy court." The appeals court considered this "hardly an accurate representation of the bankruptcy proceedings. Even accepting the proposition that the withdrawal of the motion to dismiss and the recharacterization of the equitable-subordination defense took some of the fraud allegations off the table, it [was] abundantly clear that Matrix doggedly pursued its claim of fraud throughout the bankruptcy proceedings. Matrix's objection to the asset sale and its equitable-subordination defense in the lien-priority proceeding turned entirely on allegations that a fraudulent scheme was afoot." More fundamentally, Matrix's argument on appeal ignored the issue "that identity of claims for res judicata purposes has nothing to do with legal theories; the key is that the claims [arose] from the same core of operative facts. Matrix's equitable-subordination defense in the lien priority proceeding rested on the same fraud allegations Matrix raised and lost in its objection to the section 363 sale; in turn, these same allegations form[ed] the basis of the RICO and fraud claims asserted" on appeal. "Finally, there [could] be little doubt that the bankruptcy court rendered final judgments on the merits. The bankruptcy orders confirming the asset sale under § 363 and dismissing the equitable-subordination defense in the lien-priority adversary proceeding—'orders affirmed by the district court and the Seventh Circuit'—were final orders. Matrix maintain[ed] that these orders did not dispose of its fraud claim on the merits." The Seventh

Circuit disagreed, observing that "the heart of Matrix's request that the bankruptcy court reconsider its approval of the asset sale was a contention that Stylemaster and J.R. Plastics participated in an inventory-buildup fraud, the purpose of which was to permit J.R. Plastics to purchase Stylemaster's assets for a fraction of their value. The bankruptcy court held a hearing on the motion, rejected Matrix's allegations of fraud, held that J.R. Plastics was a good-faith purchaser, and permitted the sale to proceed. That was a merits determination."[295]

The Seventh Circuit further noted that Matrix "had another full airing of its fraud claim when it raised—and lost—its equitable-subordination defense in the lien-priority adversary proceeding. The bankruptcy court, first orally and in a later written opinion, held that ANB had not engaged in any inequitable or unfair conduct . . .. The district court affirmed this ruling after scouring the record for evidence of collusive or unfair dealings and finding none. The lack of evidence of fraud mean[t] that the defense was meritless, not that it was never litigated on the merits."[296]

In sum, "the elements of claim preclusion were established." The court cited *In re Met-L-Wood Corp.,* in which the trustee "was barred from filing a RICO suit against the debtor and others involved in a bankruptcy asset sale after the sale had been confirmed; res judicata applied because the suit was a 'thinly disguised collateral attack on the [bankruptcy court's] judgment confirming the sale.' 'RICO is many things, . . . but it is not an exception to res judicata.' "[297] Similarly, in *Crop-Maker Soil Services v. Fairmount State Bank,* the Seventh Circuit had "concluded that a fraud claim brought in district court in connection with a lien over a tomato crop was barred by res judicata because the plaintiff had failed to raise the issue in earlier lien-priority proceedings in the bankruptcy court." In that case, the Seventh Circuit had "held that the plaintiff's failure to raise the fraud arguments in bankruptcy court, 'whether strategic or inadver-

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[295] *Matrix IV, Inc. v. American Nat. Bank and Trust Co. of Chicago*, 649 F.3d at 548–549.

[296] *Matrix IV, Inc. v. American Nat. Bank and Trust Co. of Chicago*, 649 F.3d at 549.

[297] *Matrix IV, Inc. v. American Nat. Bank and Trust Co. of Chicago*, 649 F.3d at 549, quoting *In re Met-L-Wood Corp.*, 861 F.2d 1012, 1016, 1018 (7th Cir. 1988).

tent, [would] will not enable Crop-Maker to escape the res judicata net.' "[298]

Strangely, following this lengthy exegesis, the Seventh Circuit then stated that normally it would conclude its opinion and "affirm the district court without further ado." The elements of claim preclusion were established, and there was circuit precedent for applying it in the case before it. But a pronounced conflict in the case law on this issue gave the court "reason to pause" and "suggest[ed] that resolving the conflict may be a bit more complicated than the caselaw presently admits."[299] Accordingly, the Seventh Circuit "affirm[ed] the district court's order of dismissal, although on narrower grounds . . . Because collateral estoppel—issue preclusion—block[ed] this new suit in its entirety," the court affirmed "on this narrower ground of decision" and left "the resolution of the conflict for a future case in which it [would] actually matter." In sum, the fraud allegations at issue were "the same as those that were *actually litigated* in the section 363 hearing and in the lien-priority adversary proceeding. The bankruptcy court was required to and did address them before entering its orders in those proceedings. Finally, Matrix was fully represented in the bankruptcy proceedings. Accordingly, Matrix [was] collaterally estopped from relitigating the very same issues" on appeal.[300]

Bankruptcy Rules 9023 (Fed.R.Civ.Proc. 59(e)) and 9024 (Fed.R.Civ.Proc. 60(b))

Post-judgment, non-appellate motions for reconsideration may also be sought. The First Circuit BAP in *BAC Home Loans Servicing LP v. Grassi* characterized such relief as follows. " 'While a motion for reconsideration is not one that is recognized by the Federal Rules of Civil Procedure, it is well-settled policy that courts can treat a motion which asks the trial court to modify a prior ruling as a motion to alter or amend the judgment under Fed.R.Civ.P. 59(e), made applicable by Fed. R. Bankr.P. 9023, or as a motion for relief from judgment under Fed.R.Civ.P. 60, made

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[298] *Matrix IV, Inc. v. American Nat. Bank and Trust Co. of Chicago*, 649 F.3d at 549, citing *Crop-Maker Soil Services v. Fairmount State Bank*, 881 F.2d 436, 439–440 (7th Cir.1989).

[299] *Matrix IV, Inc. v. American Nat. Bank and Trust Co. of Chicago*, 649 F.3d at 549, citing *Barnett v. Stern*, 909 F.2d 973 (7th Cir.1990) and *Stern v. Marshall*, __ U.S. __, 131 S.Ct. 2594, 180 L.Ed.2d 475 (2011).

[300] *Matrix IV, Inc. v. American Nat. Bank and Trust Co. of Chicago*, 649 F.3d at 551–552.

applicable by Fed. R. Bankr.P. 9024.' "[301] " 'Which rule applies depends essentially on the time a motion is served.' "[302] " 'Regardless of how it is characterized, a post-judgment motion made within [fourteen] days of the entry of judgment that questions the correctness of a judgment is properly construed as a motion to alter or amend judgment under Fed.R.Civ.P. 59(e).' "[303] Though the movant, BAC, did not label the motion to reconsider as one under Rule 59(e), it was filed within fourteen days of the sale order, and thus the BAP construed it as a motion under Rule 59(e).[304]

The BAP continued: " 'The federal courts have consistently stated that a motion for reconsideration of a previous order is an extraordinary remedy that must be used sparingly because of interest in finality and conservation of scarce judicial resources. In practice, [R]ule 59(e) motions are typically denied because of the narrow purposes for which they are intended.' "[305] " 'In order to be successful on a Rule 59(e) motion, the moving party must establish a manifest error of law or fact or must present newly discovered evidence.' "[306] "In order to prevail on a Rule 59(e) motion made on the grounds of 'newly discovered evidence,' 'the evidence must have become available only after judgment (with the exercise of reasonable diligence), and be both admissible and probative.' "[307] " 'The moving party cannot use a Rule 59(e) motion to cure its procedural defects or to offer new evidence or raise arguments that could and should have been presented originally to the court.' "[308]

The movant, BAC, had failed to present a manifest error of

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[301]*BAC Home Loans Servicing LP v. Grassi*, 2011 WL 6096509 *6, quoting Nesbit v. Rowbotham (In re Rowbotham), 2007 WL 878499 *3–4 (1st Cir. BAP).

[302]*BAC Home Loans Servicing LP v. Grassi*, 2011 WL 6096509 *6, quoting *In re Dodson*, 2003 WL 22056650 * 2 (Bankr.D.N.H.).

[303]*BAC Home Loans Servicing LP v. Grassi*, 2011 WL 6096509 *6, quoting *Aybar v. Crispin-Reyes*, 118 F.3d 10, 14 n. 3 (1st Cir.1997).

[304]*BAC Home Loans Servicing LP v. Grassi*, 2011 WL 6096509 *6.

[305]*BAC Home Loans Servicing LP v. Grassi*, 2011 WL 6096509 *6, quoting *Jimenez v. Pabon Rodriguez (In re Pabon Rodriguez)*, 233 B.R. 212, 219 (Bankr. D.P.R.1999).

[306]*BAC Home Loans Servicing LP v. Grassi*, 2011 WL 6096509 *6, quoting *Schwartz v. Schwartz (In re Schwartz)*, 409 B.R. 240, 250 (B.A.P. 1st Cir.2008).

[307]*BAC Home Loans Servicing LP v. Grassi*, 2011 WL 6096509 *6, quoting In re Pabon Rodriguez, 233 B.R. at 222.

[308]*BAC Home Loans Servicing LP v. Grassi*, 2011 WL 6096509 *6, quoting In re Schwartz, 409 B.R. at 250.

law, the record amply supported the approval of the proposed sale under the provisions of section 363(f)(2), BAC failed to demonstrate the existence of newly discovered evidence or otherwise sustain its burden under Rule 59(e). The BAP held that the bankruptcy court did not abuse its discretion when it entered the sale order and denied BAC's motion for reconsideration, and affirmed.[309]

See also *In re Lehman Brothers Holdings Inc.* in § III, "Court Approval Required—Business Justification," above, and *In re Lehigh Coal and Nav. Co.* in § IV, "The Requirements of § 363(f)(1), (2), (3), (4), or (5)," above.

XII. CASH COLLATERAL

Few debtors in the present day have significant unencumbered assets. Accordingly, a debtor-in-possession's use of cash collateral is essential to its ability to continue to operate or liquidate its assets postpetition, and is a component of most postpetition financing transactions (discussed in § XIII, below).

A Chapter 7 or Chapter 11 trustee may also need to use cash collateral, whether or not it is operating the business, to pay the costs of operations, of liquidating estate assets and of litigating claims. In *In re Polaroid Corporation*, for example, the bankruptcy court approved the Chapter 7 trustee's use of cash collateral for liquidation expenses and to prosecute avoidance actions, and the Eighth Circuit BAP affirmed.[310]

"Cash collateral" is essentially cash or cash equivalents whenever acquired in which the estate and an entity other than the estate (such as a secured lender) have an interest.

The threshold question is whether the estate has an interest in the property at issue or its cash proceeds. If it does not, then the debtor-in-possession or the trustee has no right to use the funds.

If the debtor has an interest in the property, and the creditor does not, e.g., the creditor does not have a lien in the property or its proceeds, then the cash is not cash collateral and the debtor, without court approval, may use the cash in the ordinary course

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[309] *BAC Home Loans Servicing LP v. Grassi*, 2011 WL 6096509 *7.

[310] *In re Polaroid Corp.*, 2011 WL 6221952 *1 (8th Cir.BAP). The trustee also argued that the Chapter 7 estate had a sufficient equity cushion to protect the objector's interest in the cash collateral. The BAP acknowledged that an equity cushion can afford adequate protection, but since the bankruptcy court did not premise its finding of adequate protection on the presence of an equity cushion, the BAP did reach the question of whether the objector was adequately protected by such an equity cushion. 2011 WL 6221952 *3, n. 9.

of its business.[311] That same freedom does not apply to cash collateral, in which both the debtor and a third party have an interest, and which the debtor-in-possession or the trustee may use only with court approval or if the third party (e.g., the secured creditor) consents.[312]

The objectors in *In re MF Global Holdings Ltd.* argued that certain of the funds that the debtors proposed to use were customer funds, which had been unlawfully converted from segregated customer accounts, and thus remained customer funds in which the debtor held, "as of the commencement of case, only legal title and not an equitable interest" under Bankruptcy Code §§ 541(d) and 761(10)(A)(viii) (regarding unlawfully converted customer accounts in connection with commodity brokers' liquidations).[313] The Chapter 11 trustee persuasively argued that "funds on deposit in an account in the name of the Debtors are presumed to be property of the Debtors' estate."[314] The court found that in "light of public disclosures concerning MF Global, including those of the SIPA Trustee, the customers' speculation may (or may not) turn out to have some basis in fact," but it had "not been established so far and certainly" did not "overcome the legally recognized presumption" that the funds were property of the debtors. The court made no determination of the "ultimate property rights to the funds," and noted that the proposed cash collateral order included "a very broad and appropriate reservation of rights," including whether the funds were property of the estate or were subject to a constructive trust or equitable lien in favor of any former customer of the debtor.[315]

In such circumstances, however, the debtor's customers were "entitled to know whether segregated customer property" was on deposit, and the court directed the Chapter 11 trustee to "undertake a limited investigation and thereafter report to the Court on the narrow issue whether the funds on deposit" in the account at issue, "as of the petition date, included 'customer property,' and if so, how much," to be filed with the court within sixty

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[311] 11 U.S.C. § 363(c)(1).

[312] 11 U.S.C. § 363(c)(2).

[313] *In re MF Global Holdings Ltd.*, 2011 WL 6210374 *2 (Bankr.S.D.N.Y.).

[314] *In re MF Global Holdings Ltd.*, 2011 WL 6210374 *1, *McHale v. Boulder Capital LLC (In re 1031 Tax Group, LLC)*, 439 B.R. 47, 70–71 (Bankr.S.D.N.Y. 2010); *L.F.D. Operating Inc. v. Ames Dep't Stores, Inc. (In re Ames Dep't Stores, Inc.)*, 274 B.R. 600 (Bankr.S.D.N.Y.2002).

[315] *In re MF Global Holdings Ltd.*, 2011 WL 6210374 *2.

days from the date of the order granting the use of cash collateral on a final basis.[316]

Issues regarding the effect of an assignment of rents or hotel revenues provision in mortgage loan documents continued to arise in recent cases.

The stage to which a foreclosure or execution action has proceeding at the time the bankruptcy petition is filed may also be determinative of whether the property is property of the estate that the debtor may use postpetition. In *In re Biedermann Mfg. Industries, Inc.* the parties agreed that BB & T held a valid security interest in the accounts of the debtor, and that BB & T had levied on the accounts prepetition pursuant to state law by sending notices to the debtor's customers, directing the customers to make payment to BB & T. The parties disagreed as to the effect of that levy. BB & T argued that the prepetition levy "transferred ownership of the accounts to it." The debtor maintained that it still held an interest in the accounts on the petition date, which entitled it to use those accounts pursuant to § 363.[317]

BB & T relied on the 1981 decision in *Cross Elec. Co., Inc. v. U.S.*, in which the Fourth Circuit reversed the bankruptcy court's "dissolution" of the IRS's prepetition levy, and held that though the debtor retained a right of redemption in certain of its property, the trustee was " 'in no position to exercise any of the limited rights it may have to redeem the property levied upon.' " Therefore "the bankruptcy court had no authority to dissolve the levy and the IRS was entitled to collect the account." The *Biedermann* court considered it "noteworthy that the Fourth Circuit was careful to limit its ruling to 'the facts of this case,' " and that the United States Supreme Court decided *United States v. Whiting Pools, Inc*. two years later.[318]

The *Biedermann* court disagreed, emphasizing that *Whiting Pools* had reasoned that the turnover provisions of section 542 "brings into the estate" property in which a debtor does not have a possessory interest on the petition date, including property repossessed by a secured creditor, and that the protections afforded to a secured creditor by possession "are replaced upon the

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[316] *In re MF Global Holdings Ltd.*, 2011 WL 6210374 *3.

[317] *In re Biedermann Mfg. Industries, Inc.*, 453 B.R. 802, 804 (Bankr.E.D. N.C. 2011).

[318] *In re Biedermann Mfg. Industries, Inc.*, 453 B.R. 802, 804–805 (Bankr.E. D.N.C. 2011), *Cross Elec. Co., Inc. v. U.S.*, 664 F.2d 1218, 1219, 1221 (4th Cir.1981), abrogated by U.S. v. Whiting Pools, Inc., 462 U.S. 198, 103 S.Ct. 2309, 76 L.Ed.2d 515 (1983).

filing of a bankruptcy by the right of adequate protection."[319] The decision in *Cross Electric* was "abrogated or, at a minimum, effectively modified" by *Whiting Pools*, the court continued, and the Supreme Court in the latter had "held that the interest a creditor has in property levied upon is still just a lien. Levy is a provisional remedy that does not determine a creditor's rights in property, but merely brings it into the creditor's possession. In the case of tangible personal property, ownership is transferred only upon sale to a bona fide purchaser."[320]

The court found that BB & T was "adequately protected by the equity cushion it enjoy[ed] in the aggregate value of its collateral," directed the debtor's account payors to make their payments to the debtor, and granted the debtor's motion for use of cash collateral.[321]

Interest in Cash Collateral and Burden of Proof

Bankruptcy Code § 363(p)(2) provides that, at the cash collateral hearing, the entity asserting an interest in cash collateral has the burden of proof on the issue of the validity, priority and extent of such interest.[322]

A spate of cases involving a lender's asserted interest in rents, hotel revenues, golf course receipts, and other revenues arising in connection with real estate were decided in the past year.

In *In re McCombs* the bankruptcy court held that under Alabama state law, which applied, "the assignment of rents clause effectuated an absolute assignment of rents rather than a collateral assignment," and that, as a consequence, the rental proceeds from the debtor's rental properties were not property of the bankruptcy estate. "Under the terms of the assignment of rents clause, [the lender] was entitled to the rents from the day the assignment was executed. Therefore, the Debtor retained no proprietary interest in the rents that would have passed to the bankruptcy estate, pursuant to 11 U.S.C. § 541, on the day the Debtor filed his petition." This result was not altered by the fact that the debtor "was allowed, pursuant to the assignment of rents clause, to collect the rents. The terms of the clause merely gave the

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[319] *In re Biedermann Mfg. Industries, Inc.*, 453 B.R. at 806, quoting *U.S. v. Whiting Pools, Inc.*, 462 U.S. 198, 207, 103 S.Ct. 2309, 76 L.Ed.2d 515 (1983)

[320] *In re Biedermann Mfg. Industries, Inc.*, 453 B.R. at 806, citing *U.S. v. Whiting Pools, Inc.*, 462 U.S. 198, 211, 103 S.Ct. 2309, 76 L.Ed.2d 515 (1983).

[321] *In re Biedermann Mfg. Industries, Inc.*, 453 B.R. at 807.

[322] 11 U.S.C.A. § 363(p)(2); *In re Harbour East Development, Ltd.*, 2011 WL 6097063 *3 (Bankr.S.D.Fla.).

debtor the right to collect rents on behalf of the lender "so long as the Debtor acted in line with the terms of the mortgage. However, once a default occurred and was communicated" to the debtor by the lender, the lender "had the right to instruct the Debtor's tenants to deliver the rents directly to it, or its agent, going forward."[323] Accordingly, the court, having found that there was no cash collateral, denied the lender's motion to prohibit the use of cash collateral.[324]

The court in *In re Murray* concluded otherwise, regarding a North Carolina property. In that case the debtor moved for authority to use "cash collateral—*i.e.,* the rents—to pay for operational and other expenses, including management fees to the debtors, insurance, supplies, utilities, and taxes." The debtor proposed to use the rents generated by the properties only for maintenance and operational costs, and to adequately protect the deed of trust lender, BB & T, by making monthly cash payments to it and granting it a replacement lien in the rents. BB & T objected on several grounds. Its main argument was that "due to the assignments of rents and BB & T's actions to take possession of them," the rents were not property of the estate.[325]

The assignment of rents clause at issue did not use the word "absolute." It made the lender attorney-of-fact to collect the rents, provided that the debtor was entitled to collect the rents prior to a default. The bankruptcy court found that it was "patently clear from the language of these provisions that the assignment [was] not absolute. Assignments of rent often do include specific references to 'absolute' assignments in hopes of establishing the assignment as 'absolute,' even though the assignment is 'in reality an assignment meant to secure the underlying obligation to [the mortgagor].' "[326] In this case, "refreshingly," the assignment purported to be only what it was: "additional security for the payment of the debt." Further, the North Carolina statute enabling a mortgagee to take an assignment of rents to secure its loan did

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[323]*In re McCombs*, 2011 WL 4458893 *4 (Bankr.S.D.Ala.).

[324]*In re McCombs*, 2011 WL 4458893 *5.

[325]*In re Murray*, 2011 WL 5902623 *1–2 (Bankr.E.D.N.C.).

[326]*In re Murray*, 2011 WL 5902623 *3, citing In re Harvest Oaks Drive Assocs., LLC, Case No. 10-03145-8-SWH at 14 (Bankr. E.D.N.C. March 23, 2011) (quoting *In re Senior Housing Alternatives, Inc.*, 444 B.R. 386, 54 Bankr. Ct. Dec. (CRR) 75, 64 Collier Bankr. Cas. 2d (MB) 1706 (Bankr. E.D. Tenn. 2011)).

not support the lender's argument that the assignment was absolute.[327]

The *Murray* court held that the debtor did not need to provide adequate protection for its use of the rents to pay maintenance and operational costs. It was telling to the court that in the Sixth Circuit BAP's *Buttermilk* case, cited by BB & T, "the lender maintained, and the court determined, that the debtor was required to provide adequate protection *in order to use the 'net' rents*—those rents being the funds that remain *after* paying operating expenses."[328] "The *Buttermilk* court permitted, without discussion, the use of cash collateral for the benefit of the real property collateral (through maintenance and operations) as if that use constituted adequate protection in and of itself. Because the debtor also proposed to adequately protect BB & T by making cash payments in an amount that BB & T did not contest, the court found that BB & T was adequately protected and authorize the debtor's use of cash collateral.[329]

In *In re 400 Walnut Associates LP* the debtor sought to use cash collateral consisting primarily of real property rents, and the secured creditor asserted that the rents had been absolutely assigned to it. The debtor argued that the assignment clause was ambiguous regarding whether the assignment was absolute or was for security. The bankruptcy court determined that the debtor was "correct that the characterization of the rents contradicts itself within the very same subsection." Subsection (a) of the assignment began "by stating that the rents are to be assigned absolutely and that rents are *not* among the Mortgaged Property notwithstanding the *express in*clusion of rents in the definition of that term." Then the subsection addressed the effect of a finding that rents *had not been assigned* to the lender: should that occur, then the rents *were included* in the mortgaged property. It appeared to the court that "the lender ha[d] covered all of its bases. However, in so doing, the question of what the Debtor's interest . . . in the rents [was] remain[ed] unclear. By its terms, the subsection would support either reading. If that [were] the case, deciding which reading control[led] require[d] resort to contract principles. It is a well settled principle of contract construction that terms are construed *contra proferen-*

[327] *In re Murray*, 2011 WL 5902623 *3.

[328] *In re Murray*, 2011 WL 5902623 *6 (emphasis in original), citing *Buttermilk Towne Center, LLC*, 442 B.R. 558, 565–566 (6th Cir.BAP2010).

[329] *In re Murray*, 2011 WL 5902623 *6.

tum, that is against the drafter."[330] Construing the ambiguity against the drafter the court found that the secured lender had "a security interest in the rents and, as a corollary, that the rents [were] cash collateral the use of which [was] subject to the strictures of Code § 363."[331]

The debtor and the secured creditor further disputed whether the prior holder of the loan had "perfected" its interest in the rents, and thus deprived the estate of those rents. The debtor argued—and the secured creditor disputed—"that the parties reached a forbearance agreement whereby the rents would go back to the Debtor who would pay expenses associated with the real estate and remit the remainder to [the secured creditor]. Whether an agreement was reached or not, letters" of the date of a meeting between the parties "were hand-delivered to the Debtors subtenants instructing them to resume making their monthly rental payments to the Debtor." These letters were signed by the prior holder's counsel and a representative of the Debtor. The letters had their "intended effect: subtenants resumed paying their rent to the Debtor's management company." On this basis, the court further found that, as of the bankruptcy filing, the secured creditor "had not enforced its right to attach those rents. For that reason, the rents constitute[d] cash collateral which the Debtor may use on the condition that it provide adequate protection" of the secured creditor's interest in the rents.[332]

In *In re City Loft Hotel, LLC*, the debtor City Loft owned the hotel property and CLH operated the hotel and received all revenue generated by the hotel, though there was no agreement with City Loft for that operation. The bank had a lien on the property and an assignment of rents, and the court held with minimal analysis that "the revenue generated by the property" was the bank's cash collateral. This result could not "be circumvented by the formation of an additional entity and the diversion of income from City Loft [to CLH] without any agreement." The bank had "not consented to any use of cash collateral, and neither City Loft nor CLH ha[d] requested that the Court authorize use of cash collateral." Because neither of the requirements of section 363(c)(2) had been met, the court prohibited the debtors from any further use of the bank's cash collateral.[333]

In *In re SI Grand Traverse LLC* the debtor operated a hotel.

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[330] *In re 400 Walnut Associates LP*, 454 B.R. 601, 606 (Bankr.E.D.Pa. 2011).

[331] *In re 400 Walnut Associates LP*, 454 B.R. at 607–608.

[332] *In re 400 Walnut Associates LP*, 454 B.R. at 609–610.

[333] *In re City Loft Hotel, LLC*, 465 B.R. 428, 434 (Bankr.D.S.C. 2012).

The debtor's largest creditor, CB 2010, asserted claims against the debtor secured by a first lien on the hotel and related rents, and a third lien on the same collateral. The debtor sought to use cash collateral. The bankruptcy court noted that CB 2010 had "expressed considerable lack of confidence in the Debtor's management," and had "so far been unwilling to consent to the use of its cash collateral."[334]

The court characterized CB 2010 as having "two distinct types of collateral. First, of course, the creditor ha[d] a mortgage lien on the Hotel, which is to say the real estate—bricks and mortar—and personal property used in the operation. Second, CB 2010 assert[ed] a lien on the rents or revenues derived from the property. According to the Debtor's Schedule D, CB 2010 ha[d] the first and third mortgages on the Hotel and an 'all asset lien via UCC1.' In addition, from the court's prior review of the mortgage documents, CB 2010 also benefit[ted] from an assignment of rents. Moreover, to the extent that the rents take the form of personal property, by its admissions in Schedule D, the Debtor concede[d] that CB 2010 ha[d] an interest in the rents. Were that insufficient," the court continued, "the Bankruptcy Code itself presumptively protects a lender's interest in hotel revenues. *See* 11 U.S.C. § 552(b)(2) . . . Because CB 2010 ha[d] an interest in rents, and because rents constitute 'cash collateral,' and because the Debtor proposes to operate its business using this cash collateral, the Debtor must adequately protect CB 2010's interest in the rents."[335]

The debtor asserted that CB 2010 was adequately protected by an equity cushion, and by a partial guaranty of its loan by the second lender, but the court did not find sufficient evidence of either.[336]

At "the suggestion that the court made at a prior hearing," the debtor's counsel also argued "that the court should eliminate or liberate post-petition rents from the lender's liens as contemplated in the last sentence of 11 U.S.C. § 552(b)(2)," which provides that a prepetition lien in rents and hotel revenues does *not* extend postpetition "to any extent that the court, after notice and a hearing and based on the equities of the case, orders otherwise."[337] But the debtor's counsel "offered no evidence in support of any equitable reason (other than the Debtor's desire to

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[334]*In re SI Grand Traverse LLC*, 450 B.R. 703, 704 (Bankr.W.D.Mich.,2011).

[335]*In re SI Grand Traverse LLC*, 450 B.R. at 706.

[336]*In re SI Grand Traverse LLC*, 450 B.R. at 708.

[337]*In re SI Grand Traverse LLC*, 450 B.R. at 708, citing 11 U.S.C. § 552(b).

reorganize) to depart from the presumptive extension of prepetition liens to post-petition rents. Having considered the record as a whole," and acknowledging that the case was "in its infancy," the court was "not prepared to disengage the rents from CB 2010's security interest," for a number of reasons, "including concerns about the Debtor's prepetition management, "especially the grossly underfunded allocation" for the property improvement plan, or "PIP," which the court regarded "as a substantial threat not just to the cash collateral, but to the business as a going concern."[338]

The court, have concluded that the debtor had not carried its burden of demonstrating adequate protection under section 363(p), denied the debtor's motion for use of cash collateral.[339]

In *In re Ocean Place Development, LLC*, the bankruptcy court found that hotel revenues were personal property in which the secured lender, AFP, held a perfected security interest and properly considered property of the debtor's estate.[340] The court distinguished the decision of its Court of Appeals, the Third Circuit, in *Jason Realty*, in which the court held that the debtor had absolutely assigned rents to its secured lender, and thus the rents were not property of the estate. First, *Jason Realty* "did *not* involve the debtor's assignment of receipts from non-leasehold interests, such as receipts realized from the debtor's operation of a hotel, restaurant, or spa. In fact, AFP . . . failed to show that the Debtor [was] a party to any leases that generate[d] substantial rents from leases of its real property." Second, and more significantly to the *Ocean Place* court, the *Jason Realty* court "was assigned with an inapposite task" of determining "whether the assignment of an undeniable interest in real property conveyed title to the lender or, instead, pledged the rents as security. As such, the *Jason Realty* court's discussion was limited to the treatment of an assignment under New Jersey property law and the ensuing rights of an assignee arising under an absolute assignment of rents." The *Ocean Place* case tasked the court "with determining whether hotel room revenues should be treated as interests in real property. Having determined that the interests in hotel room revenues should be characterized as 'accounts' or 'payment intangibles,' as defined under Article 9," the court determined that it did not need to address "whether the as-

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[338] *In re SI Grand Traverse LLC*, 450 B.R. at 708–709.

[339] *In re SI Grand Traverse LLC*, 450 B.R. at 709.

[340] *In re Ocean Place Development, LLC*, 447 B.R. 726, 735 (Bankr.D.N.J. 2011).

signment of rents absolutely vested title in AFP. In so holding, the Court respectfully submit[ted] that the Third Circuit did not intend to include non-leasehold interests"—such as hotel revenues—"within the purview" of it of its *Jason Realty* decision.[341]

The court acknowledged "that absolute assignments may divest a debtor of any legal right to use rents," but that it was also "true that there is no Third Circuit case law or supplemental evidence to suggest that this holding extends beyond assignments of interests in *real property*." In sum, *Jason Realty,* and the cases extending *Jason Realty* outside of the real property realm," were inapplicable to the case before the court, "because the revenues at issue are interests in personal property, not real property." The court reasoned that to rule otherwise "would countenance the ability of lenders to take security interests in personal property in a manner to evade the protections afforded to obligors under Article 9," and that the *Jason Realty* court "did not intend such a result. To use the oft-quoted idiomatic *Jason Realty* language, the Lender confused hotel revenue apples" with "leasehold proceed oranges.' "[342]

Accordingly, the hotel revenues were "available for use as cash collateral in the Debtor's reorganization efforts so long as AFP remains adequately protected." "For the reasons expressed in the Court's oral decision, the Court deem[ed] AFP's collateral position to be adequately protected," and granted the debtor's motion for a final order approving the use of cash collateral.[343]

In *In re HT Pueblo Properties, LLC* the secured lender in the debtor's hotel property brought a motion seeking to prohibit the debtor's use of the hotel room revenues. The lender, Zions, had a lien against the "rents" and "revenues" from the hotel. But the language of the security documents did not include a reference to "fees, charges, accounts, or other payments for the use or occupancy of rooms and other public facilities in hotels, motels, or other lodging properties," the language used in section 552(b)(2) to extend the prepetition lender's security interest in hotel room revenues to postpetition revenues from the same source.[344]

The security agreement granted to Zions a security interest in, among other things, "[a]ll accounts, general intangibles, instru-

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[341]*In re Ocean Place Development, LLC*, 447 B.R. at 738.

[342]*In re Ocean Place Development, LLC*, 447 B.R. at 738, quoting *In re Jason Realty, L.P.*, 59 F.3d 423 (3d Cir.1995).

[343]*In re Ocean Place Development, LLC*, 447 B.R. at 738.

[344]*In re HT Pueblo Properties, LLC*, 2011 WL 5041767 *5 (Bankr.D.Colo.).

ments, rents, monies, payments, and all other rights, arising out of a sale, lease, consignm[unreadable] or other disposition of any of the property described in this Collateral section," and Zions filed a UCC-1 financing statement with respect to the security agreement.[345] Of great significance to the court, "a careful reading of § 552(b) indicates a *security agreement* is the critical instrument that must contain the key language creating the lien interest. Such an interest may not be established in ancillary documents. The Security Agreement in this case link[ed] the collateral described to the *disposition* of the Property, not to the *operation* of the property." In the court's opinion, revenue derived from operating a hotel does not constitute the "disposition" of property and therefore did not fall within this collateral description. Accordingly, the court found that Zions did "not have an enforceable security agreement in the room revenues. Therefore, section 552(b)(2) did not apply, and the court returned to the question of "whether the room revenues may be considered rents, which may be assigned, or personal property, which is subject to the Colorado Uniform Commercial Code."[346]

The court found, based on the analysis of the loan documents, that the room revenues constituted personal property, subject to the Uniform Commercial Code, not real property, which could be assigned. Presumably, because the security agreement, and the financing statement filed with respect to it, related to the disposition and not the operation of the hotel property, it was ineffective to grant to Zions a perfected security interest in the room rents derived from operations.[347] The court denied Zions' motion,[348] though it noted that its finding was "specific to the facts of this case and the documents involved."[349]

Similarly, the bankruptcy court in *In re Premier Golf Properties, LP* construed section 552(b) to not extend to greens and driving fees at a golf course. The bank argued that the greens fees and driving range fees were "either real property or personal property," and that it had a security interest in both. "[T]hat may have been accurate prepetition. But it beg[ged] the question of the effect of § 552(a), and it [did] not help resolve what Congress intended by the 'narrow' exception of 'proceeds, products, offspring or profits' of property secured prepetition." The "Bank's

[345] *In re HT Pueblo Properties, LLC*, 2011 WL 5041767 *2–3.

[346] *In re HT Pueblo Properties, LLC*, 2011 WL 5041767 *6.

[347] *In re HT Pueblo Properties, LLC*, 2011 WL 5041767 *7.

[348] *In re HT Pueblo Properties, LLC*, 2011 WL 5041767 *9.

[349] *In re HT Pueblo Properties, LLC*, 2011 WL 5041767 *7.

approach would write the general rule of section 552(a) out of existence. Congress was looking to protect the secured creditor's interest in its prepetition collateral, and to the extent it was consumed, dissipated, transformed or transmuted, the value received postpetition for that prepetition interest should acquire protected status as cash collateral to the extent applicable state law otherwise would provide." The court found and concluded that postpetition revenues generated by the debtor from greens fees and driving range fees were not encumbered by any security interest of the bank because of the operation of section 552(a). Further, the court found and concluded that the bank's claimed security interest did "not fit any of the 'narrow' exceptions to the general rule of § 552(a)." Accordingly, the bank's motion to prohibit the debtor from using its "alleged cash collateral" was denied "because postpetition greens fees and driving range fees are not its cash collateral within the meaning of 11 U.S.C. § 363."[350]

In *In re The Wright Group, Inc.*, the bankruptcy court observed that "the ball was advanced down the fairway with respect to Wright's use of acknowledged cash collateral of Fifth Third Bank ('Fifth Third') by the entry of a series of interim cash collateral orders which avoided the issue raised" by Wright's motion for authority to use cash collateral that was before the court. "However, by the time the hearing was held . . . with respect to extended use of cash collateral, it became apparent that the issue raised . . . could no longer be left in the rough. By order entered . . ., the court initiated a procedure for determination of that issue . . ., a procedure which was further implemented by a telephonic conference . . . Pursuant to that order, a final evidentiary hearing on the foregoing issue was held . . . At that hearing, the court stated its provisional conclusions concerning certain issues, but reserved its decision as a whole. The general issue before the court [was] a narrow one," and could "be stated as follows: Do the receipts derived by Wright from operation of its miniature golf course facility constitute 'cash collateral' as defined by 11 U.S.C. § 363(a), so that Wright's use of those receipts is subject to 11 U.S.C. § 363(c)(2)?"[351]

The court expounded: "Given that the nature of the transaction between Wright and its miniature golf course patrons is a license to use the miniature golf course, how are the receipts from the patrons' payment for this license to be characterized? A transac-

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[350] *In re Premier Golf Properties, LP*, 2011 WL 4352003 *3 (Bankr.S.D.Cal.).

[351] *In re Wright Group, Inc.*, 443 B.R. 795, 797–798, 73 U.C.C. Rep. Serv. 2d 582 (Bankr. N.D. Ind. 2011).

tion goes like this. The patron approaches a counter at the miniature golf course and expresses his/her desire to play miniature golf, or to otherwise use the miniature golf course. The fee set for this privilege is uniform, and it is paid in cash before the patron is allowed to enter the miniature golf course: there are no promissory notes, there are no open accounts, there are no IOUs—if you don't pay, you don't play. This transaction involves either an account, or simply money."[352]

The court determined that: (1) the receipts obtained by Wright from payment from its miniature golf course patrons were received in consideration of the patrons' privilege to use the miniature golf course, i.e., the provision of a license for the use of real estate by Wright; (2) the receipts obtained by Wright of the patrons of the miniature golf course were "money" under Article 9 of the Uniform Commercial Code, and by virtue of its security agreement with Wright, Fifth Third had a security interest in Wright's money in existence on the date prior to filing of the debtor's bankruptcy petition; (3) security interests in money can only be perfected by possession; Fifth Third did not have possession of Wright's money, and therefore it had no perfected security interest in the receipts; (4) because it had no perfected security interest in the receipts. Fifth Third's security interest in the receipts was avoidable by the debtor pursuant to 11 U.S.C. § 544(a)(2); (5) 11 U.S.C. § 363(a) was premised on the basis that a creditor has an enforceable, perfected, and unavoidable security interest in property which might otherwise constitute "cash collateral" under that section; because Fifth Third did not have possession of receipts, Fifth Third's interest in those receipts was not perfected, resulting in the determination that those receipts did not constitute "cash collateral" subject to the provisions of 11 U.S.C. § 363(c)(2); (6) any security interests of Fifth Third, whether or not perfected, did not attach to any receipts of miniature golf course patrons obtained by Wright on or after the date of the filing of the petition, pursuant to 11 U.S.C. § 552(a), and Wright is entitled to use those proceeds without recourse to 11 U.S.C. § 363(c)(2); and (7) because receipts obtained by Wright from miniature golf course patrons prior to the filing of the petition did not generate "proceeds" within the scope of 11 U.S.C. § 552(b), there was no "cash collateral" derived from proceeds with respect to the prepetition receipts.[353]

Accordingly, the court held that the cash receipts derived by

[352] *In re Wright Group, Inc.*, 443 B.R. at 800–801.

[353] *In re Wright Group, Inc.*, 443 B.R. at 808–809.

Wright from patrons of its miniature golf course facility did not constitute "cash collateral" as defined by 11 U.S.C. § 363(a), and Wright was free to use all such proceeds without consideration of 11 U.S.C. § 363(c)(2).[354]

The debtors in *In re Young* were the sole members of a limited liability company, Laguna LLC, which was in the business of operating a fitness club. The debtors also owned the real estate and fitness club facilities, and rented them to Laguna, LLC. The debtors had taken a loan from Bank'34, which was secured by the real estate and fitness club facilities.[355] Bank'34 filed a motion for stay relief and to prohibit the debtors' use of cash collateral resulting from the operation of the fitness club, "including member payments for use of the facilities, cash, cash equivalents, deposit accounts, and rents."[356]

The bankruptcy court found that the bank had a security interest "in rents paid to the Debtors by Laguna LLC for its use of the Real Property, and in the Debtors' cash, rights to receive payments, and general intangibles." The bank asserted that its security interest in general intangibles attached to the debtors' "discretionary post petition member withdrawals from Laguna LLC. The Court disagree[d]. Regardless of whether Bank'34's security interest in general intangibles attache[d] to the Debtors' member interests in Laguna LLC, the security interest [did] not extend to post-petition member withdrawals."[357] The court reasoned that, except as provided in section 506(b)(2), "which is inapplicable to member withdrawals, Bank'34's prepetition liens [did] not extend to property in which the Debtors had no interest on the date they commenced their chapter 11 case" unless the property was "proceeds, products, offspring, or profits of property in which the Debtors had an interest on that date."[358]

The court further held that, under 11 U.S.C. § 552(b)(2), the bank *did* "have a lien against rents the Debtors receive[d] from Laguna LLC post-petition for its lease of the Real Property," and ordered payment to the bank of amounts that the debtors had received as rent from Laguna LLC, as adequate protection, and

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[354]*In re Wright Group, Inc.*, 443 B.R. at 809.

[355]*In re Young*, 2011 WL 3799245 *2 (Bankr.D.N.M.).

[356]*In re Young*, 2011 WL 3799245 *11.

[357]*In re Young*, 2011 WL 3799245 *11.

[358]*In re Young*, 2011 WL 3799245 *12.

denied the bank's motion to prohibit the debtors' use of cash collateral.[359]

Authorized Use—Consent or Court Authorization after Notice and Hearing

Bankruptcy Code § 363(c)(2) provides that:

> (2) The trustee [or debtor] may not use, sell, or lease cash collateral under paragraph (1) of this subsection unless—
>
> (A) each entity that has an interest in such cash collateral consents; or
>
> (B) the court, after notice and a hearing, authorizes such use, sale, or lease in accordance with the provisions of this section.[360]

Notice and a hearing is *not* required, as set forth in section 363(c)(2)(A) for a trustee's or debtor-in-possession's use of cash collateral on the consent of entities with an interest in it. As a practical matter, however, the consent of a secured creditor to the use of cash collateral typically is conditioned the secured creditor's being granted replacement liens, superpriority claims, and other forms of adequate protection, and other lender-friendly terms that do require court approval for them to be effective.

Court authorized use of cash collateral pursuant to section 363(c)(2)(B) *does* require notice a hearing.

In *In re Reitter Corp.*, the IRS filed a motion to prohibit the use of cash collateral requesting: (i) the court to enter an order prohibiting the debtor's use of cash collateral because the IRS was a secured creditor status; (ii) the court to vacate the prior cash collateral orders due to insufficient service of process of the three (3) joint motions; and (iii) the court to order the debtor's secured lender, BPPR, to disgorge any payments of cash collateral it has received from debtor. On the same date, the debtor and the secured lender filed an urgent motion for an order extending the cash collateral stipulation.[361] Following the hearing on the IRS's motion, the court ruled that: (1) the IRS was a secured creditor "over Debtor's cash collateral pursuant to 26 U.S.C. § 6321, irrespective of which party [was] the senior lien holder of Debtor's accounts receivables;" and (2) the IRS was not given due notice of the stipulation in conformity with Fed. R. Bankr. P.

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[359] *In re Young*, 2011 WL 3799245 *12.

[360] 11 U.S.C.A. § 363(c)(2).

[361] *In re Reitter Corp.*, 449 B.R. 641, 643–64 (Bankr.D.Puerto Rico 2011).

9014, 4001(b) and 7004(b)(5). Thus, the IRS was not bound by the stipulation.[362] Consequently, any motion or agreement entered into by BPPR and the debtor could "not affect the rights of the IRS over the cash collateral."[363]

Debtors in possession and others involved in the unauthorized use of cash collateral may be subject to sanction by the court.[364]

In *In re Moon Thai & Japanese, Inc*., the failure of the debtor's counsel to review the documents necessary to determine whether third parties had an interest in cash collateral, which failure led to an unauthorized use of cash collateral by the debtor, was among the factors cited by the court in prohibiting the debtor's counsel from filing future bankruptcy cases under any chapter of the Bankruptcy Code.[365]

The court in addition may grant retroactive superpriority claims in amounts already spent by the debtor-in-possession, including for amounts expended to preserve the lender's collateral.[366] The unauthorized use cash collateral also is a ground for conversion of a Chapter 11 case to Chapter 7, and the resulting appointment of a trustee to act for the estate.[367]

Adequate Protection

Bankruptcy Code § 363(e) provides that "the court, with or without a hearing, shall prohibit or condition such use, sale, or lease as is necessary to provide adequate protection of such interest . . .."[368]

Cash payments may be inadequate in amount. In *In re Grand Island Liquor Mart* the debtors' representative testified that the debtors had "nothing additional to offer as 'backup' collateral. All

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[362]*In re Reitter Corp.*, 449 B.R. at 644.

[363]*In re Reitter Corp.*, 449 B.R. at 645.

[364]*In re Moon Thai & Japanese, Inc.*, 2010 WL 3211981 *2 (Bankr.S.D.Fla. 2010).

[365]*In re Moon Thai & Japanese, Inc.*, 448 B.R. 576, 578–579, 590–592 (Bankr.S.D.Fla. 2011).

[366]*In re Hefty*, 2011 WL 4850659 *4–5 (Bankr.D.Mont.).

[367]*In re Gow Ming Chao*, 2011 WL 5855276 *6 (Bankr.S.D.Tex.) {"The Debtor used the cash collateral from their rental properties without first obtaining permission from this Court or the Bank, thereby violating 11 U.S.C. § 363(c)(2); Bankruptcy Rule 4001(b); Local Rule 4002-1(b), (i); and U.S. Trustee Guideline 6.2.", citing *In re Aerosmith Denton*, 36 B.R. 116, 119 (Bankr.N.D.Tex.1983) (holding that debtor's unauthorized use of "proceeds collected post-petition from pre-petition receivables constitutes use of 'cash collateral' ").

[368]11 U.S.C.A. § 363(e).

they can offer is $6,000 a month and hope that business gets better." The bankruptcy court considered the debtors' projections and financial conditions, found the payment to be inadequate, and denied the debtors' motion to use cash collateral.[369]

Adequate protection that may be required for debtor's use of rents and other revenues of real property was the focus of several decisions in the past year.

The bankruptcy court in *In re Smithville Crossing, LLC* stated that, "[g]enerally, a debtor may use cash collateral to reasonably maintain the property . . . '[W]here a secured creditor is undersecured and the debtor cannot otherwise provide the adequate protection required under § 363, the cash collateral can be used pursuant to § 506(c). This approach has been interpreted as an 'exception' to the adequate protection requirement of § [363].' "[370]

By contrast, for the debtor "to use the net rental proceeds for expenses beyond § 506(c) of the Bankruptcy Code," including the lender's cash collateral held by the debtor's counsel as a retainer, the debtor must provide the lender with adequate protection. A replacement lien on the postpetition rents was not adequate protection, the court reasoned, because lender already had a postpetition lien in the rents pursuant to section 552(b) of the Bankruptcy Code. Because the lender had a security interest in both prepetition and postpetition rents, the debtor was prohibited from using the cash collateral to pay expenses beyond section 506(c) of the Bankruptcy Code unless the debtor could provide the lender with adequate protection for its interest in the rental income, and the court required the debtor to "find another way" to adequately protect the lender's security interest in the rents.[371]

The rule against using rents in which the secured creditor has a lien to pay costs beyond section 506(c) costs is not absolute in all jurisdictions. In *In re Bucktown Station, LLC*, the debtor sought to pay 1/2 its counsel's fees from cash on hand generated by rents in which the lender had a lien. Pursuant to orders previ-

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[369] *In re Grand Island Liquor Mart*, 2011 WL 739593 *3 (Bankr.D.Neb.).

[370] *In re Smithville Crossing, LLC*, 2011 WL 5909527 *9 (Bankr.E.D.N.C.), quoting *Travelers Insurance Company v. River Oaks Limited Partnership*, 166 B.R. 94, 98 (E.D.Mich.1994). Pursuant to § 506(c) of the Bankruptcy Code, the debtor-in-possession "may recover from property securing an allowed secured claim the reasonable, necessary costs and expenses of preserving, or disposing of, such property to the extent of any benefit to the holder of such claim, including the payment of all ad valorem property taxes with respect to the property." 11 U.S.C. § 506(c).

[371] *In re Smithville Crossing, LLC*, 2011 WL 5909527 *11.

ously entered allowing the debtor to use cash collateral to pay for operations, the lender had been granted replacement liens and postpetition interest payments from the debtor. The debtor had sufficient cash on hand to pay the requested proposed fees and other postpetition administrative expenses. It had not been shown that the real property was declining in value, or that cash on hand would diminish "below the amount on hand when the case was filed, and the payments sought [would] be replenished out of rent collections."[372] The bankruptcy court noted that, under *Timbers*, "adequate protection may be shown even if creditor is undersecured, and for reasons earlier stated that has been shown here."[373] The debtor's motion to pay one-half of the requested fees out of the lender's cash collateral was allowed, "conditional on and provided Debtor amends its Plan to provide the clarity and changes as earlier required to afford necessary additional protection" to the lender.[374]

In *In re Harbour East Development, Ltd*. the debtor sought to use $119,000 of cash collateral to pay non-operating expenses for capital improvements, in addition to a smaller amount that the secured lender, NVB, had authorized pursuant to a prior interim order authorizing the use of cash collateral. The debtor proposed to use these funds to build out unsold condominium units to prepare them for rental, and to purchase furniture and appliances for the units. The budget included a projection for 2012 operating results that reflected $983,880 in rental revenues and positive cash flow of $258,182 (without payment of any debt service). The motion suggested that the "projected future rental stream, along with a replacement lien on furniture and appliances installed in the units (depreciating assets that are of little value once used)" adequately provided the lender NVB with adequately protected for the use of its cash collateral.[375]

The court noted that the "viability of the projections in the Budget has not been proven, but even if the Budget were proven to be reasonable, the Court cannot allow the Debtor to fund capital improvements from cash collateral without NBV's consent or a replacement lien on previously unencumbered assets that affords NBV dollar-for-dollar protection for the diminishment in its

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[372] *In re Bucktown Station, LLC*, 2011 WL 3889239 *1 (Bankr.N.D.Ill.).

[373] *In re Bucktown Station, LLC*, 2011 WL 3889239 *2, citing *United States Ass'n v. Timbers, etc.*, 484 U.S. 365 (1988).

[374] *In re Bucktown Station, LLC*, 2011 WL 3889239 *2.

[375] *In re Harbour East Development, Ltd.*, 2011 WL 6097063 *3–4.

cash collateral projected during the last quarter of 2011."[376] The debtor had not demonstrated that the property would "be enhanced, dollar-for-dollar, by the expenditures proposed by the Debtor. The possibility that the debtor's rental program *might* perform as projected did not justify "shifting the risk of success or failure from the Debtor to NBV," if in actuality the debtor did not perform as projected in the budget.[377]

The bankruptcy court in *In re Lilo Properties, LLC* referred to the split in the case law with respect to whether adequate protection payments derived from real estate rent and being held by a secured creditor "should be considered an addition to the creditor's collateral or subtracted from the collateral."[378] "The 'subtraction' cases hold that post-petition rent payments to the undersecured creditor should be subtracted from the secured portion of the creditor's claim as measured by the value of the real estate. Conversely, the 'addition' cases hold that the amount of post-petition rents not reinvested into real estate should be added to the size of the creditor's secured claim, and that payment of those rents decreases the total amount of the creditor's claim but not the secured portion of its claim as measured by the value of its real estate."[379] The *Lilo* court adopted the "addition" case, concluding that they were better reasoned.[380]

In *In re Samshi Homes, LLC*, the debtor's evidence did not support a conclusion that the mortgage lender, TCB, was adequately protected. The debtor's representative's testimony indicated that, "despite prior orders of this court constraining Debtor's use of cash collateral, Debtor has used TCB's cash collateral for whatever purpose [the debtor's representative] decided, without seeking court authority or the consent of TCB." TCB's "uncontroverted testimony" was that the real property market was declining, such that continued delay in the bankruptcy case was eroding the potential recovery for TCB. The court concluded that the debtor had not sustained its burden of proof regarding adequate protec-

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[376] *In re Harbour East Development, Ltd.*, 2011 WL 6097063 *4, citing *Desert Fire Protection v. Fontainebleau Las Vegas Holdings, LLC (In re Fontainebleau Las Vegas Holdings, LLC)*, 434 B.R. 716, 727 (S.D.Fla.2010).

[377] *In re Harbour East Development, Ltd.*, 2011 WL 6097063 *4, citing *Resolution Trust Corp. v. Swedeland Development Group, Inc. (In re Swedeland Development Group, Inc.)*, 16 F.3d 552, 557 (3d Cir.1994) (en banc).

[378] *In re Lilo Properties, LLC*, 2011 WL 5509401 *5 (Bankr.D.Vt.).

[379] *In re Lilo Properties, LLC*, 2011 WL 5509401 *5, citing *Beal Bank, S.S.B. v. Waters Edge Ltd. Pshp.*, 248 B.R. 668, 685–86 (D.Mass.2000).

[380] *In re Lilo Properties, LLC*, 2011 WL 5509401 *6.

tion, and denied its third emergency motion for use of cash collateral.[381]

In *Bank of New York Mellon Trust Co. NA v. Humboldt Redwood Co.* the bankruptcy court ordered the debtor, in connection with its use of cash collateral, to make "adequate protection" cash payments for the indenture trustee's professionals' fees, and found that the indenture trustee was entitled to a replacement lien on assets acquired postpetition "of the same class or category of the pre-petition collateral assets," and an administrative superpriority claim, as authorized by section 507, "for any loss or diminution in the petition-date value of encumbered assets caused by the debtor's use during the bankruptcy case."[382]

The bankruptcy court, in connection with plan confirmation, then needed to determine the amount payable to the indenture trustee on account of the secured claim. The bankruptcy court made its determination, and appeals were taken by the indenture trustee, who argued that it was entitled to a higher secured claim value and plan payment. The district court affirmed the bankruptcy court's determination, stating that the "Bankruptcy Court's analysis ensured that the Indenture Trustee received the full value of its secured claim, valued as of the date of the petition. While it is possible to say that the confirmation-date *secured claim* under 11 U.S.C. § 1129 might have been a lesser amount, the result would simply be that the *administrative claim* under 11 U.S.C. § 507(b) would then have to be higher in order to bring the Indenture Trustee's claim to its petition-date value as guaranteed by the cash collateral order. Likewise, a higher secured claim would mean a lower administrative claim. That is because, under the terms of the plan of reorganization, the Indenture Trustee would have to be paid the petition-date value of its collateral as the higher value, regardless of the name given to the claim."[383]

In *In re Polaroid Corporation*, the Eighth Circuit BAP affirmed the trustee's authority to use cash collateral in which a creditor asserted a security interest to fund litigation. The trustee presented evidence that the recoveries would exceed the expenditures, and "reminded the bankruptcy court his previous forecasts had been accurate." In affirming, the BAP noted that though the

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[381]*In re Samshi Homes, LLC*, 2011 WL 2837640 *2–3 (Bankr.S.D.Tex.).

[382]*Bank of New York Mellon Trust Co. NA v. Humboldt Redwood Co.*, 2012 WL 43650 *2 (S.D.Tex.).

[383]*Bank of New York Mellon Trust Co. NA v. Humboldt Redwood Co.*, 2012 WL 43650 *4.

objector had argued that the trustee's "figures represented nothing more than his expectation that he could recover those funds," it had "offered no evidence to suggest [the trustee's] projection was unreasonable or his figures were inflated or otherwise inaccurate."[384]

The Chapter 12 debtors in *In re Walker* filed a motion for use of cash collateral, and proposed to give the secured lender a lien in crops to be grown as adequate protection, among other protections. The bankruptcy court observed that "[c]ase law does not generally support finding that a lien on crops to be grown in the future constitutes adequate protection for the use of cash collateral in either Chapter 11 or Chapter 12 cases. Because cash collateral is consumed, or used up, the standard for determining adequate protection is strict. The risks of farming are generally considered too great to establish that liens on crops not yet planted can provide adequate protection for the use or consumption of creditors' cash. Courts that have allowed the use of cash collateral and found that such use is adequately protected by a lien on future crops have done so cautiously and only when the lien is first in priority and superior to all production and input provider liens."[385]

The bankruptcy court considered the debtors' financial projections, and the additional adequate protection of crop insurance and a third lien in vehicles that the debtors proposed, and found that the secured creditor would not be adequately protected. With respect to crop insurance, the court emphasized that crop insurance only "guarantees revenue in the event yields or prices fall below set minimums. Crop insurance does not guarantee profit," and the debtors' budget had no flexibility and no margin whatsoever for any increases in costs. The court denied the debtors' cash collateral motion.[386]

In *In re SK Foods, L.P.* discussed in § IX above, the district court remanded the bankruptcy court's approval of a settlement between the trustee and the secured lenders regarding the amount of the secured lenders' superpriority claim, ruling that the bankruptcy court should have considered a lower amount.[387]

Terms of Cash Collateral Order

In *In re Amerigraph, LLC* the Chapter 7 trustee filed a com-

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[384] *In re Polaroid Corp.*, 2011 WL 6221952 *2.

[385] *In re Walker*, 2011 WL 839508 *3 (Bankr.C.D.Ill.), citing cases.

[386] *In re Walker*, 2011 WL 839508 *4.

[387] *In re SK Foods, L.P.*, 2011 WL 2709648, *7–8 (E.D. Cal. 2011).

plaint alleging that the defendant—a bank and secured creditor—had received fraudulent transfers from the debtor prior to the commencement of the Chapter 7 case. The defendant moved for summary judgment, contending that the debtor—"acting in its capacity as debtor-in-possession—waived and released the fraudulent transfer claims (as well as the other claims asserted in the Complaint) pursuant to an agreed cash collateral order entered during its Chapter 11 case," and that the waiver and release were binding on the trustee. The trustee took the position that he was not bound by the waiver and release "because the Cash Collateral Order did not expressly state that it would be binding on a Chapter 7 Trustee and did not state that it would survive conversion." The court noted that "the Cash Collateral Order, while not expressly stating that it would be binding on a Chapter 7 Trustee, did state that it would survive conversion to Chapter 7. And, in general, a Chapter 7 Trustee is bound by a waiver and release effectuated by a debtor-in-possession pursuant to an order approved after adequate notice to parties in interest." However, since there was "a genuine issue of material fact as to whether parties in interest received adequate notice of the Cash Collateral Order, that order "provide[d] no basis for granting summary judgment in favor of the Defendant."[388]

XIII. SECTION 364—OBTAINING CREDIT

Section 364(a) permits a debtor-in-possession or a Chapter 7 trustee that has been authorized to operate the business to "obtain unsecured credit and incur unsecured debt in the ordinary course of business allowable under 503(b)(1) of this title as an administrative expense."[389]

Section 364(b) provides that the court, "after notice and a hearing, may authorize" the debtor or trustee to incur unsecured debt as an administrative expense out of the ordinary course of business.[390]

Section 364(c) provides that if the trustee or debtor is unable to obtain unsecured credit, then the court "after notice and a hearing, may authorize" the debtor or trustee to obtain credit or incur debt (1) with priority or all other administrative expenses, or (2)

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[388] *In re Amerigraph, LLC*, 456 B.R. 349, 353–354 (Bankr.S.D.Ohio 2011).

[389] 11 U.S.C.A. § 364(a).

[390] 11 U.S.C.A. § 364(b).

secured by property that is not otherwise subject to a lien, or (3) secured by a junior lien on property that is subject to a lien.[391]

Section 364(d) provides that the court, "after notice and a hearing," may authorize the debtor to obtain credit or incur debt "secured by a senior or equal lien on property of the estate that is subject to a lien only if—(A) the trustee is unable to obtain such credit otherwise; and (B) there is adequate protection of the interest of the holder of the lien on the property of the estate on which such senior or equal lien is proposed to the granted." Section 364(d) further provides that the debtor or trustee has the burden on the issue of adequate protection.[392]

In *In re Living Hope Southwest Medical SVCS, LLC*, the Chapter 7 trustee brought an adversary proceeding against the lender and its president, seeking to avoid postpetition transfers made by the debtor while it was operating as Chapter 11 debtor-in-possession. The defendants filed counterclaims, asserting that they were entitled to administrative expense claims and a claim for turnover of certain equipment.[393]

The evidence showed that the debtor transferred from its bank accounts $86,200 by check and $25,000 by debit to the lender, Pillar, during the pendency of the Chapter 11 case. The defendants argued that Pillar had extended unsecured credit to the debtor and was reimbursed in the ordinary course of the debtor's business. Pursuant to section 364(a), if extensions of credit are in the ordinary course of the debtor's business, then court approval is unnecessary.

The court applied the horizontal and vertical tests to determine if the advances were "made in the 'ordinary course of business,' a term not defined by the Bankruptcy Code . . . The creditor asserting the ordinary-course-of-business defense has the burden of production under both inquiries."[394]

The court characterized the horizontal test as requiring the court to "determine whether it is accepted practice for a business such as this privately-owned hospital to permit a potential investor to extend *ad hoc* bridge loans defrayed, not by a note with stated repayment terms, but by a blank-check repayment scheme. The Defendants failed to provide any evidence showing that the

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[391] 11 U.S.C.A. § 364(c).

[392] 11 U.S.C.A. § 364(d).

[393] *In re Living Hope Southwest Medical SVCS, LLC*, 450 B.R. 139 (Bankr. W.D.Ark. 2011).

[394] *In re Living Hope Southwest Medical SVCS, LLC*, 450 B.R. at 149.

transactions at issue fell within a range of accepted practice in the Debtor's particular industry." Accordingly, the horizontal test had not been satisfied.[395]

Under the vertical test, the court "must examine whether the transaction subjects other creditors to economic risks that differ from those they expected when they originally extended credit," and whether a reasonable creditor would view the transaction as "deviating from the debtor's day-to-day operations." The defendants, to bolster their case, might have provided some evidence of the debtor's pre- and postpetition practice with regard to short-term financing. "Here, the evidence [did] not point to any past measures the Debtor ever resorted to in order to deal with its cash flow problems, other than writing bad checks and, on one occasion, persuading a creditor to hold his check for payment for services." To the contrary, the facts in evidence convinced the court that "the transactions between the Defendants and the Debtor subjected other creditors to risks that differed markedly from those they would reasonably have expected."[396]

The defendants argued that the debtor used the funds the defendants advanced to pay ordinary and necessary operating expenses such as utilities and payroll, and, therefore, "Section 364(a) permitted their credit extensions without court approval." The trustee did not dispute the defendants' explanation of how the advances were used, nor did she seek to avoid the debtor's disbursement of those funds to employees, trade creditors, and the like. Her "targets" were the defendants' extensions of credit and their repayment by the debtor. The "source and manner of the transfers appear[ed] to be anything but ordinary, and the Defendants failed to produce evidence that would prove otherwise. Therefore, Court approval was necessary prior to the Defendants' extensions of credit."[397]

The court acknowledged that some courts have approved postpetition financing nunc pro tunc, but observed at the outset that "extraordinary circumstances must be found to exist in order to authorize a loan on a *nunc pro tunc* basis." In addition, "creditors seeking *nunc pro tunc* approval of extensions of credit must show that approval would have been granted if a timely application had been made, that other creditors have not been harmed by the continuation of business made possible by the loans, and that the parties entered into the credit transaction in good faith

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[395] *In re Living Hope Southwest Medical SVCS, LLC*, 450 B.R. at 150.

[396] *In re Living Hope Southwest Medical SVCS, LLC*, 450 B.R. at 150.

[397] *In re Living Hope Southwest Medical SVCS, LLC*, 450 B.R. at 151.

and with the honest belief that the transactions were authorized without court approval."[398] The *Living Hope* court found that these factors did not exist and declined to retroactively approve the defendants' advances and the debtor's payments to the defendants as a postpetition loan transaction.[399]

Consent to Priming Lien

In *In re Sargent Ranch, LLC* the Chapter 11 trustee sought court approval of postpetition financing having priority over a prepetition credit. The trustee argued "that the senior secured creditors should be held to have consented by virtue of a majority not having timely filed opposition, and recognizing that under applicable California law and the applicable Operating Agreement a majority ha[d] the authority to act for the group. Since the majority ha[d] been silent, they should be deemed to have consented under the Court's Local Rules." The bankruptcy court was "loathe to so hold" on the circumstances before it.[400]

Court Approval Required; Notice and Hearing; Effect of Approval

Generally, for the court to approve the financing, a debtor-in-possession or trustee must show that financing could not be obtained on less onerous terms.[401]

A postpetition financing agreement once approved may be treated as a contract, subject to ordinary contract law. In *Arlington Hospitality, Inc. v. Arlington LF, LLC* the Seventh Circuit held that the DIP lender, LF, committed an anticipatory breach of its obligation to lend under the DIP loan agreement when: (1) "LF's general counsel told Arlington's [the debtor's] investment banker that LF was unwilling to 'fund any more money under the DIP,' " and (2) "outside counsel for LF told counsel for Arlington's creditor committee that LF was 'not willing to proceed further with the DIP loan; in other words, we will make no further loans to the Debtors. . . . We think the Debtor should find a new DIP lender to pay out our loan and fund the options that expire at the end of this month.' " "These statements," the court reasoned, "demonstrated LF's intent not to perform any more of its lending obligations under the Interim Order," and the court

[398] *In re Living Hope Southwest Medical SVCS, LLC*, 450 B.R. at 151–152.

[399] *In re Living Hope Southwest Medical SVCS, LLC*, 450 B.R. at 151–153.

[400] *In re Sargent Ranch, LLC*, 2011 WL 1884149 *2 (Bankr.S.D.Cal.).

[401] *In re Olde Prairie Block Owner, LLC*, 2011 WL 1692145 *7.

affirmed the bankruptcy court's findings as not clearly erroneous.[402]

The Seventh Circuit acknowledged that the debtor had failed "to pay fees that were due immediately" following approval of the financing, "per the parties' agreement," but concluded that by the time the lender LF had "properly informed Arlington of the potential breach by using the notice procedures in the Interim Order, LF had already breached the agreement. Having walked away from the agreement before Arlington's breach ever became effective," the lender LF could not later invoke the interim order to obtain the payment of fees and default interest that it sought.[403]

In *In re Briarwood Capital, LLC* the trustee sought approval of a loan from American Lawyers Funding ("ALF") to fund an appeal against the estate's largest creditor, which had prevailed at the trial court level. The interest rate was 25% per annum, and the loan was unsecured, nonrecourse, and was granted administrative expense priority under section 364(b), but was repayable only to the extent that the estate was able to make distributions to administrative expense creditors. The court was satisfied that the estate had exercised due diligence, including by engaging an independent appellate law firm, in assessing the merits of an appeal. The trustee further had preserved the estate's autonomy in all matters concerning the appeal by the express terms of the loan agreement, so to the theoretical extent that ALF had some other objective in mind which induced it to fund the loan, ALF would not have any control over the estate's decisions regarding the litigation. The court found the loan to be in the best interests of the bankruptcy estate, and authorized the trustee to take the loan.[404]

In *In re Avery*, a debtor, Security Aviation, engaged a law firm prior to commencing its bankruptcy case to represent it a criminal proceeding, and paid the law firm a $400,000 retainer. A second law firm, IMF, was then engaged to represent a related individual in the same criminal proceeding, and was paid a $50,000 retainer from the first law firm's retainer. Security Aviation filed for bankruptcy, brought an action alleging conversion by IMF, and sought to recover the retainer.[405] The law firm asserted an attorney's lien in the retainer for its fees under Alaska

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[402] *Arlington LF, LLC v. Arlington Hospitality, Inc.*, 637 F.3d 706, 713, 717 (7th Cir. 2011).

[403] *Arlington LF, LLC v. Arlington Hospitality, Inc.*, 637 F.3d at 713.

[404] *In re Briarwood Capital, LLC*, 2011 WL 997689 (Bankr.S.D.Cal.).

[405] *In re Avery*, 461 B.R. 798, 802, 816–817 (Bankr.D.Alaska 2011).

law. The court found that, with respect to the prepetition transfers made to pay IMF's fees and expenses, IMF had a valid, existing attorney's lien for the fees it had earned or the expenses it had incurred.[406] The postpetition transfers to IMF, however, presented a different picture. After Security Aviation filed bankruptcy, the balance of IMF's retainer become property of the bankruptcy estate and IMF could not assert a postpetition lien for such services against the retainer in its trust account because it did not obtain prior approval from the bankruptcy court. Nor did IMF seek court approval of its employment as counsel for Security Aviation or the related party, which also required approval by the Court.[407]

Administrative Claims, Liens and Priming Liens Under § 364(b), (c) and (d)

Several cases in the last year considered issues in connection with motions seeking administrative claim status or liens under section 364(b), (c) and/or (d).

In *In re Sargent Ranch, LLC*, also discussed in this § XIII, "Consent to Priming Lien," above, the trustee's second argument in support of his request that the court approve a priming loan was that his intended expenditure in "obtaining expert analysis of remunerative uses to which the real property may be put" would enhance its value "in virtually any direction" because it would move the property closer to some sort of use, even if it ruled out other theoretically possible uses. Indeed, it was "interesting to note that the proposed loan agreement describe[d] as collateral not just the superpriority secured lien on the real property, but also the reports and analyses performed on the property." The court believed that there was support for and merit in the trustee's second argument. However, the record was "silent" on the extent to which, if at all, the value of the property would be increased quantitatively "by borrowing to fund the analyses." Nor did the record show that the value of the property would be increased sufficiently to afford the senior secured creditors the adequate protection that section 364 required. The court denied approval of the financing, while chiding the parties for not cooperating with the Chapter 11 trustee, "who was appointed at the request of many of the parties who now handcuff him financially from being able to do anything to advance the case." On this note, the court gave "notice that unless a borrowing

[406] *In re Avery*, 461 B.R. at 804.

[407] *In re Avery*, 461 B.R. at 818.

agreement [was] reached in the interim, on June 20, 2011 at 4 p.m." the court would hear argument on its own motion to convert the case to one under Chapter 7.[408]

In *In re DB Capital Holdings, LLC* the debtors sought approval of secured postpetition financing that would prime the lien of its prepetition lender, West LB. The bankruptcy court noted that granting postpetition financing on a priming basis "is extraordinary and is allowed only as a last resort," and "is impermissible unless there is adequate protection to existing lien holders."[409] The existence of an equity cushion is one test for determining whether priming is appropriate, though there are also courts "that have adopted a more 'holistic approach' by analyzing all relevant facts 'with a particular focus upon the value of the collateral, the likelihood that it will depreciate or appreciate over time, the prospects for successful reorganization of the Debtor's affairs by means of the Plan, and the Debtor's performance in accordance with the Plan."[410]

The court found that the debtors had not shown that they would be able "to provide an indubitable equivalent of West LB's current lien. The debtors proposed to make periodic payments to West LB, but those payments would not come from any assets owned by the debtors, "but merely from the super-priority financing itself." Any failure by the debtors to meet the requirements of the postpetition financing, or to finish and sell the project, would endanger the payments to West LB and result in West LB losing value in its secured interest because priming lender would receive payment in full before any payment on West LB's debt. Therefore, such payments were "speculative and risky" and did not offer adequate protection. The debtors had not offered, and, due to lack of equity and lack of unencumbered assets, could not offer, additional or replacement liens. Finally, the proposals to pay the debt of West LB beginning over two years from the present, with final payment to be made two years after that, did "not offer the indubitable equivalent of West LB's current lien interest. Rather, West LB would have to "wait years for repayment, at a time when no plan of reorganization has been proposed, and on a basis which, for the reasons noted above," was "speculative and vague."

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[408] *In re Sargent Ranch, LLC*, 2011 WL 1884149 *2.

[409] *In re DB Capital Holdings, LLC*, 454 B.R. 804, 822 (Bankr.D.Colo. 2011), citing cases.

[410] *In re DB Capital Holdings, LLC*, 454 B.R. 804, 822 (Bankr.D.Colo. 2011), quoting *In re Tashjian*, 72 B.R. 968, 973 (Bankr.E.D.Pa.1987).

Therefore, the court found that the debtors had not met the requirements of § 364(d)(1)(B), and denied the motion to borrow.[411]

By contrast, in *In re Olde Prairie Block Owner, LLC* the debtor sought to prime a prepetition lien held by CenterPoint in the approximate amount of $48.7 million with an approximately $4.0 million postpetition DIP loan. The bankruptcy court found that the debtor's property had a value of approximately $81.2 million, and the value found represented "a large equity cushion" in the court's view. The court recognized that, while "accepted methods were used with expert help to value the real estate, those sources are only a substitute for testing the market to obtain actual sales or funding." Nonetheless, it was clear that CenterPoint's security interest in debtor's property and cash was adequately protected, even when reduced by the priming lien.[412]

In *In re Hudson*, a Chapter 12 case, the debtors sought approval of a loan to construct a litter shed in connection with their poultry operation, which would prime their existing loan from Wells Fargo. The bankruptcy court observed that "the concept of adequate protection is intended to protect a creditor's interest in the collateral, it is susceptible to differing applications over a wide range of factual situations." The court found that the debtors, based on their agreement with their chicken supplier, had to build a new litter shed or the supplier would not supply flocks. Without flocks, the poultry operation would cease and there would be no way for the debtors to make payments on Wells Fargo's lien. Both appraisers testified and reported that the poultry operation was the best use of the farm under their Income Approach valuations. The construction of the litter shed would improve the poultry operation and would add value to Wells Fargo's security (farm and broiler houses). The court found that this was sufficient to provide adequate protection to Wells Fargo.[413]

In *In re Lagoon Breeze Development Corp*. the debtor sought bankruptcy court approval of a postpetition secured loan with priority over the lien of the debtor's prepetition bank. The bank asserted that the court should not have *sua sponte* limited the bank's entitlement to adequate protection to safeguarding only the value of its collateral on the petition date. The bank "would have preferred that both its secured and unsecured claims

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[411] *In re DB Capital Holdings, LLC*, 454 B.R. 804, 823.

[412] *In re Olde Prairie Block Owner, LLC*, 2011 WL 1692145 *8 (Bankr.N.D. Ill.).

[413] *In re Hudson*, 2011 WL 1004630 *9 (Baknr.M.D.Tenn.).

received adequate protection." Though the debtor had not raised the issue, the court was bound by § 506(a) to protect only the bank's secured claim. The bank's unsecured claim was entitled to neither interest, attorney's fees, nor adequate protection. The court's adequate protection analysis thus required it to "determine the amount of the secured claim that [was] entitled to adequate protection. To do otherwise would be error."[414]

The court analyzed the effect on the value to the bank's collateral—an unfinished condominium project—of the $2.0 million priming loan, and concluded that the value would increase by about $4.0 million. The court concluded that the bank was adequately protected, though it did grant additional adequate protection requested by the bank including (1) a date certain for the loan closing, (2) certain controls over disbursement of the new loan, including a budget, and of sale proceeds obtain from sales of condominium units, (3) payment of property taxes, homeowners association fees and insurance by the debtor, and (4) periodic reporting by the debtor regarding the construction and sale of the units.[415]

Other Financing Terms

The bankruptcy court in *In re Olde Prairie Block Owner, LLC* applied the business judgment test of section 363(b) to its consideration of the terms of the financing requiring payment by the debtor of the fees of the lender's professionals.[416]

Finality of Financing Order—Appeals Under § 364(e)

Bankruptcy Code § 364(e) is the safe harbor provision for postpetition financing orders that essentially parallels the protections for sale orders set forth in section 363(m) discussed in § III, above. Section 364(e)[417] provides that:

> (e) The reversal or modification on appeal of an authorization under this section to obtain credit or incur debt, or the grant under this section of a priority or a lien, does not affect the validity of any debt so incurred, or any priority or lien so granted, to an entity that extended such credit in good faith, whether or not such entity knew of the pendency of the appeal, unless such authorization and the incurring of such debt, or the granting of such priority or lien, were stayed pending appeal.

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[414] *In re Lagoon Breeze Development Corp.*, 2011 WL 939016, *1 (Bankr. S.D. Cal. 2011).

[415] *In re Lagoon Breeze Development Corp.*, 2011 WL 939016, *1–2 (Bankr. S.D. Cal. 2011).

[416] *In re Olde Prairie Block Owner, LLC*, 2011 WL 1692145 *7.

[417] 11 U.S.C. § 364(e).

The purpose of § 364(e) is "to encourage lenders to extend credit to debtors in bankruptcy by eliminating the risk that any lien securing the loan will be modified on appeal."[418]

Section 364(e) moots an appeal from an unstayed order authorizing a financing and thus protects the lender from reversal or modification unless the lender did not act in good faith.[419]

In *In re Olde Prairie Block Owner, LLC* the bankruptcy court approved postpetition financing secured by a lien that primed the lien of the debtor's prepetition secured lender, CenterPoint. The primed lender appealed and sought a stay from the bankruptcy court. The court framed the requirements for grant of a stay as follows: "whether the movant is likely to succeed on the merits of the appeal; (2) whether the movant will suffer irreparable injury absent a stay; (3) whether a stay would substantially harm other parties; and (4) whether a stay is in the public interest."[420] The court found that (1) CenterPoint could not demonstrate the likelihood of success on the merits here, especially since the equity cushion found by the court to constitute adequate protection for the priming lien was substantial, (2) CenterPoint would not be irreparably harmed if a stay was not granted, because in addition to the large equity cushion, the financing order authorized CenterPoint to repay the new loan and cancel out the new lender's priming lien should the Chapter 11 bankruptcy case fail and be dismissed, (3) the debtor would suffer harm if the financing order was stayed, because it would be unable to fund many projects and services that were necessary to continue its development and to obtain a refinancing of CenterPoint's loan, and would allow CenterPoint success in its obvious effort to block confirmation, and (4) blocking the loan and priming lien would prevent the debtor from obtaining needed financing and "kill the Chapter

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[418] *In re Foreside Management Co., LLC*, 402 B.R. 446, 451 (1st Cir. BAP 2009). See also e.g., *In re Cooper Commons, LLC*, 424 F.3d 963, 45 Bankr. Ct. Dec. (CRR) 80, 54 Collier Bankr. Cas. 2d (MB) 1473, Bankr. L. Rep. (CCH) P 80356 (9th Cir. 2005), opinion amended and superseded, 430 F.3d 1215 (9th Cir. 2005) (quoting *Matter of EDC Holding Co.*, 676 F.2d 945, 947, 9 Bankr. Ct. Dec. (CRR) 137, 6 Collier Bankr. Cas. 2d (MB) 882, Bankr. L. Rep. (CCH) P 68654, 94 Lab. Cas. (CCH) P 13530 (7th Cir. 1982)).

[419] *In re Foreside Management Co., LLC*, 402 B.R. 446, 451 (1st Cir. BAP 2009). Section 363(e) does not protect a transaction that falls outside of the scope of the order. See, e.g., *In re Audre, Inc.*, 138 Fed. Appx. 17 (9th Cir. 2005).

[420] *In re Olde Prairie Block Owner, LLC*, 447 B.R. 578, 580 (Bankr.N.D.Ill. ,2011), citing *In re Forty-Eight Insulations, Inc.*, 115 F.3d 1294, 1300 (7th Cir. 1997).

11 reorganization." For these reasons the bankruptcy court denied the motion for stay.[421]

The DIP financing order remained unstayed.[422] On appeal, the district court rejected the appellant's argument that section 364(e) did not apply because the postpetition DIP financing order did not contain an explicit finding of good faith. The district court adopted the standard that an implicit finding of good faith is sufficient, stating that there was nothing in the record that suggested the loan authorized by the DIP financing order "was, or the bankruptcy court believed it to be, anything other than an arms-length transaction between independent entities seeking to further their own commercial interests."[423] The district court also rejected the Third Circuit's holding in its *Swedeland* decision, that section 364(e) protects a postpetition lender only with respect to money that it already has disbursed at the time of the ruling on the appeal, noting that the expectations of a postpetition DIP lender that the *Swedeland* court "so lightly dismissed are the foundation of contract law, see Restatement (Second) of Contracts § 337, and the animating force behind § 364(e)." The district court concluded that the prepetition lender's failure to obtain a stay deprived the court of subject matter jurisdiction over the appeal.[424]

The Ninth Circuit, by contrast, follows the *Swedeland* rule. In *In re Villalobos*, the individual Chapter 11 debtor sought and obtained approval of postpetition financing allowable as an administrative expense under section 503(b). The IRS appealed to the Ninth Circuit BAP but did not obtain a stay. The BAP observed that if the loan "fell within the scope of § 364(e)," it would be required to dismiss the appeal of the section 364 order as moot. At oral argument on the appeal, however, the parties informed the BAP court that no proceeds had been advanced under the loan. Therefore, the court's concern that the appeal was moot was "allayed."[425] Because no funds had been advanced, the DIP lender would "not be prejudiced in any way" by reversal,

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[421] *In re Olde Prairie Block Owner, LLC*, 447 B.R. at 580.

[422] *In re Olde Prairie Block Owner, LLC*, 460 B.R. 500, 503 (N.D.Ill. 2011).

[423] *In re Olde Prairie Block Owner, LLC*, 460 B.R. at 509.

[424] *In re Olde Prairie Block Owner, LLC*, 460 B.R. at 510.

[425] *In re Villalobos*, 2011 WL 4485793 *7, *Transamerica Commercial Fin. Corp. v. Citibank, N.A. (In re Sun Runner Marine, Inc.)*, 945 F.2d 1089, 1094 (9th Cir.1991).

and section 364(e) did not render moot the IRS's appeal of the section 364 order.[426]

The BAP court stated that "[d]ebt incurred under § 364(b) is allowable as an administrative expense under § 503(b)(1) only if it is an actual, necessary cost or expense of preserving the estate, and that an order granted pursuant to § 364(b) must be supported by such a finding." The IRS argued that section 364 "allows a debtor to incur a debt only if all of the proceeds of that debt are used to pay expenses that qualify as administrative expense claims under § 503(b)(1)." The BAP court noted that the "case law is not clear regarding whether the bankruptcy court must determine that the claim created by the *loan itself* meets the requirements for administrative expense priority under § 503(b)(1), or, whether a debtor must show that *all the expenses* he intends to pay from the proceeds of the loan meet the requirements." The BAP determined that it did not need not resolve this issue "because the bankruptcy court did not make any factual findings or legal conclusions at the Hearing or in the § 364 Order regarding whether the Loan, or the expenses to be paid from its proceeds, were actual, necessary cost of preserving the estate."[427]

The bankruptcy court's failure to provide findings of fact and conclusions of law on this issue warranted reversal under Rule 7052, the BAP held, "unless a full understanding of the question [was] possible without the aid of separate findings."[428] It was unclear to the BAP court, from the hearing and the order what legal rule the bankruptcy court applied. Because there was "no articulated legal standard," the court was "unable to review whether the bankruptcy court abused its discretion in approving" the financing motion. On remand, the bankruptcy court could "decide to apply either of the standards asserted by the IRS or the Debtor, or any other applicable legal standard, and should provide sufficient factual findings so that its decision [could] be evaluated on appeal."[429]

Interim orders may be different. In *In re Telecontinuity, Inc.* the plaintiffs sought to subordinate the liens of the postpetition lender to those of other creditors. The lender defended that the provisions of the interim order approving the postpetition financ-

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[426]*In re Villalobos*, 2011 WL 4485793 *7.

[427]*In re Villalobos*, 2011 WL 4485793 *7 (9th Cir.BAP).

[428]*In re Villalobos*, 2011 WL 4485793 *7, quoting *Vance v. Am. Haw. Cruises, Inc.*, 789 F.2d 790, 792 (9th Cir.1986).

[429]*In re Villalobos*, 2011 WL 4485793 *7.

ing, which expressly barred any subordination of the lender's liens, were "unassailable" by operation of section 364(e).[430] The bankruptcy court disagreed. "By its terms, this Order was an Interim Order. No final order was entered, and interim orders may be subject to revision, particularly," as in the case before the court, "in the face of allegations that the court must accept as true at this stage of the proceedings that Defendants were acting in bad faith and concealed their true intentions." The court denied the defendants motion to dismiss.[431]

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[430] *In re Telecontinuity, Inc.*, 2011 WL 806097 *1 (Bankr.D.Md.).

[431] *In re Telecontinuity, Inc.*, 2011 WL 806097 *2–3.