

BAP OPINION IN *CLEAR CHANNEL* LIKELY TO CHILL CREDIT BIDS

by

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Bankruptcy Code Section 363(f) allows debtors to maximize the value of their estates by selling their assets free and clear of all liens, claims and interests. The free and clear sale and the finality of bankruptcy court orders attract buyers that would otherwise hesitate to participate in bankruptcy auctions. A recent decision of the Bankruptcy Appellate Panel of the Ninth Circuit may significantly decrease buyers' willingness to rely on bankruptcy court orders.

Section 363(f) sets forth several grounds under which a "free and clear" order may be entered, including consent of the competing interest holder and that the sale is for "more than the value of the lien." Earlier opinions differed on whether this was to be read to require a sale above the value determined by the court for the collateral, or more than the entire debt that was asserted. *See, e.g., Richardson v. Pitt County (In re Stroud Wholesale, Inc.)*, 47 B.R. 999, 1002 (E.D.N.C. 1985), *aff'd mem.*, 983 F.2d 1057 (4th Cir. 1986) (free and clear sale not allowed unless the sale proceeds will fully compensate the all secured lienholders); *Scherer v. Fed. Nat'l Mortgage Ass'n (In re Terrace Chalet Apartments, Ltd.)*, 159 B.R. 821 (N.D. Ill. 1993) (same); *In re Perroncello*, 170 B.R. 189 (Bankr. D. Mass. 1994) (same); *In re Feinstein Family P'ship*, 247 B.R. 502 (Bankr. M.D. Fla. 2000) (same); *In re Canonigo*, 276 B.R. 257 (Bankr. N.D. Cal. 2002) (same); *Criimi Mae Servs. Ltd. P'ship v. WDH Howell, LLC (In re WDH Howell, LLC)*, 298 B.R. 527 (D.N.J. 2003) (same); *In re Healthco Int'l, Inc.*, 174 B.R. 174 (Bankr. D. Mass.

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1994) (same); *But see, e.g., In re Beker Indus. Corp.*, 63 B.R. 474, 476-77 (Bankr. S.D.N.Y. 1986) (allowing a sale free and clear of “out of the money” liens); *In re Terrace Gardens Park P’ship*, 96 B.R. 707 (Bankr. W.D. Tex. 1989) (same); *In re Oneida Lake Dev., Inc.*, 114 B.R. 352 (Bankr. N.D.N.Y. 1990) (same); *In re WPRV-TV, Inc.*, 143 B.R. 315, 320 (D.P.R. 1991) (same); *Milford Group, Inc. v. Concrete Step Units, Inc. (In re Milford Group, Inc.)*, 150 B.R. 904, 906 (Bankr. M.D. Pa. 1992) (same); *In re Collins*, 180 B.R. 447, 450-01 (Bankr. E.D. Va. 1995) (same). Writing for the three-panel BAP, Judge Markell held that the provision required a sale price above the amount of debt absent consent. *Clear Channel Outdoor, Inc. v. Nancy Knupfer*, 391 B.R. 25 (B.A.P. 9th Cir. 2008). More disturbing, the panel held that a buyer who relied in good faith on the sale order had very limited protection and could have a junior lien re-imposed on the property in the buyer’s hands.

In the *Clear Channel* case, the debtor owned and was in the process of developing several parcels of real estate when it filed for bankruptcy. DB Burbank, LLC held a first priority lien on substantially all of the assets of the debtor. Although DB did not seek relief from the stay, the court observed that because the case was a single asset real estate case, the bankruptcy court would have most likely granted DB relief from the stay to foreclose on the property. Instead, the Chapter 11 trustee negotiated with DB to arrange an auction of the assets with DB credit bidding and serving as the stalking horse bidder at the sale. There were no qualified overbids at the auction. The bankruptcy court approved the sale to DB free and clear of all liens and interests pursuant to Section 363(f) and found that DB was a good faith purchaser who could rely on the finality of the sale pursuant to Section 363(m).

Because the sale was based on a credit bid, no sale proceeds were available to compensate for the junior lien on the property held by Clear Channel Outdoor, Inc. Clear

Channel appealed the sale order and the BAP reversed the free and clear order and remanded to the bankruptcy court for reconsideration. The Chapter 11 trustee and DB argued that the appeal was moot. Addressing the threshold questions of mootness, the BAP held that although the sale was complete, the appeal was not moot because the court could fashion some relief by either reversing the entire sale or reversing the free and clear aspects of the sale and reinstating the liens. The BAP recognized that equitable mootness barred the reversal of the sale but held that neither constitutional, equitable, nor statutory mootness barred a reinstatement of the junior lien. While Bankruptcy Code Section 363(m) provides that a sale to a good faith purchaser may not be reversed on appeal and the bankruptcy court found that DB was a good faith purchaser, the BAP narrowly construed this provision to apply only to the overall sale but not to the specific terms of the sale. In other words, while Section 363(m) prohibits reversal of a sale to a good faith purchaser on appeal, it does not prevent reversal of the free and clear terms of that sale. This ruling is the most disturbing of the opinion, and severely narrows the scope of Section 363(m). Under the Court's interpretation, as long as the property remains with the buyer an appellate court can apparently alter representations, warranties and perhaps even pricing. This narrow ruling is in marked contrast to well developed case law on the parallel provision in Section 364(e) governing debtor in possession financing, which holds that Section 364(e) protects all portions of the financing "deal." *Clear Channel*, 391 B.R. at 36 (distinguishing the language of Section 364(e) from Section 363(m)); *see, also, Weinstein, Eisen & Weiss, LLP v. Gill (In re Cooper Commons, LLP)*, 424 F.3d 963, 968 (9th Cir. 2005), *citing In re Adams Apple, Inc.*, 829 F.2d 1484 (9th Cir. 1987) (holding that Section 364(e) "broadly protects any requirement or obligation that was part of a post-petition creditor's agreement to finance").

Finding that the appeal was not moot, the BAP then reversed the provisions of the sale order that allowed the transfer free of the junior interest. Bankruptcy Code Section 363(f) allows a transfer of property free and clear of liens, claims and interests if the sale meets one of five elements of that section. Examining each of these elements, the BAP held that (1) applicable non-bankruptcy law does not permit the sale of property free and clear of the junior lien; (2) the junior lienholder did not consent to the free and clear sale; (3) the sale price was not greater than the aggregate value of all liens; (4) the junior lien was not in bona fide dispute; and (5) the junior lienholder could not be compelled in any proceeding to accept money satisfaction of its interest. The BAP's initial finding that California real property law does not permit a sale free and clear of a junior lien is inconsistent with state foreclosure law. Citing *Nguyen v. Calhoun*, 105 Cal. App. 4th 428, 437 (Cal. App. 6th Dist. 2003) for the general proposition that real property is transferable subject to a deed of trust, the BAP ignored the well-established law holding that when a senior lienholder forecloses upon the secured property, the sale extinguishes junior liens unless the purchase price is high enough to pay off all liens. *See, e.g., Jones v. Sacramento Sav. & Loan Assoc.*, 248 Cal. App. 2d 522 (Cal. App. 3d Dist. 1967); *Fpci Re-Hab 01 v. E & G Invs.*, 207 Cal. App. 3d 1018, 1023 (Cal. App. 2d Dist. 1989); *S. Bay Bldg. v. Riviera Lend-Lease*, 72 Cal. App. 4th 1111, 1121 (Cal. App. 2d Dist. 1999).

The bulk of the opinion relates to Section 363(f)(3) where the BAP takes a literal approach to the statutory language. Section 363(f)(3) allows the free and clear sale if the interest is a lien and the sale price is greater than the aggregate value of all liens on the property. Instead of interpreting the "aggregate value of all liens" to mean the economic value of the security interest, which would be zero for a junior lienholder if the property is worth less than the senior

lien, the BAP interprets the phrase to mean the aggregate amount of all claims held by creditors who hold a lien or security interest in the property being sold. *Id.* at 32 - 33.

Finally, the BAP suggests that the junior lienholder could not be compelled in a legal or equitable proceeding to accept money satisfaction of its interest pursuant to Section 363(f)(5). The BAP rejected the view that the ability to confirm a “cramdown” plan that paid the interest satisfied this provision. Instead, the BAP held that the focus of the provision is whether there is a non-bankruptcy proceeding in which the lienholder could be compelled to take less than the value of the claim secured by the interest. Because the parties did not identify a proceeding under non-bankruptcy law and the bankruptcy court did not make a finding, the BAP held that Section 363(f)(5) was not met. This appears to involve a failure to point the court to a California judicial foreclosure in which a junior lienholder can indeed be compelled to accept a monetary judgment less than its lien. *See, e.g.*, California Civil Code § 2924k (describing distribution of non-judicial foreclosure sale proceeds).

The BAP’s narrow interpretation of Sections 363(f) and 363(m) is problematic. Prior to the *Clear Channel* opinion, these Bankruptcy Code provisions attracted buyers to auctions and encouraged senior lienholders not to seek relief from the stay to foreclose. Creditors and other buyers agreed to participate in bankruptcy auctions because the buyer could rely on the order stating the property is free and clear of liens, claims and interests. While the BAP stated that DB knew or should have known that Section 363(f) lien-stripping might not work, prior to this opinion, buyers in bankruptcy sales routinely relied on the finality of Section 363(f) orders when they received a Section 363(m) good faith finding. If the BAP decision is followed, buyers no longer have such security in bankruptcy sales. As such, the opinion is likely to have a chilling affect on bankruptcy sales.