

# KIRKLAND ALERT

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## Buyer Beware: Free and Clear May Not be Free and Clear on Appeal

One of the undisputed benefits of purchasing assets out of a bankruptcy estate is the “free and clear” relief that a bankruptcy court order affords under section 363(f) of the Bankruptcy Code. If your purchase qualifies for section 363(f) relief, any liens, encumbrances, or interests that attach to the property are wiped off of the property and redirected to the proceeds of the sale.

If any party appeals a sale order, so long as it does not obtain a stay pending appeal, most purchasers close, relying on the mootness rule under Bankruptcy Code section 363(m). Section 363(m) generally provides that a sale order issued under section 363(b) or (c) of the Bankruptcy Code will not be overturned on appeal if no stay pending appeal is obtained so long as the purchaser is a good-faith purchaser.

The Ninth Circuit Bankruptcy Appellate Panel’s (“BAP”) opinion in *Clear Channel v. Knupfer*, 391 B.R. 25 (B.A.P. 9th Cir. 2008), threatens the sanctity of the mootness rule. In *Clear Channel*, the BAP held that section 363(m) does not extend to the “free and clear” relief under section 363(f). In short, under *Clear Channel*, a party on appeal can challenge the legality of the free and clear relief on appeal even if it did not obtain a stay pending appeal and even if the purchaser has already closed the sale.

### **The Clear Channel Decision**

In *Clear Channel*, the bankruptcy court approved a sale of property free and clear of Clear Channel’s junior \$2.5 million lien to a senior lienholder who bid \$41 million as a credit bid and \$800,000 in cash. Clear Channel objected to the sale and appealed. It petitioned for a stay pending appeal, which was denied. Shortly thereafter, the sale closed. The BAP determined that although the closing of the sale made review of the sale itself equitably moot, it could still reinstate Clear Channel’s lien and hear the case. Utilizing “plain language” statutory interpretation, the BAP held that because section 363(m) does not specifically refer to section 363(f), it must not apply to section 363(f).

The BAP then analyzed the “free and clear” relief in the sale order and held that the bankruptcy court had not applied the correct legal standard under section 363(f)(5). It then reversed the bankruptcy court, reinstated the \$2.5 million lien on the property, and held that the sale was not free and clear of Clear Channel’s lien after all.

### **The Clear Channel Decision is an Outlier**

The *Clear Channel* decision failed to follow controlling precedent. The Ninth Circuit itself has ruled that a challenge to a free and clear sale order issued pursuant to section 363(f) is mooted by section 363(m). In *Robert L. Helms Const. & Development Co., Inc.*, there were two related appeals involving an option to repurchase a ranch. The first appeal as to whether the option was an executory contract was ultimately vacated.

The second [appeal], between [purchaser] and [option holder], addressed whether, regardless of the ultimate validity of the option, the sale was free and clear under 11 U.S.C. § 363(f)

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

*In re Robert L. Helms Const. & Development Co., Inc.*, 139 F.3d 702, 704 n.2 (9th Cir. 1998) ("*Helms II*"). Thus, it appears that the Ninth Circuit in *Helms* addressed and decided the very issue considered by *Clear Channel*, i.e., does section 363(m) protect against challenges to sale orders under section 363(f)? Whereas *Clear Channel* held that section 363(m) does not apply to sale orders under section 363(f), the Ninth Circuit in *Helms* held otherwise. Although the Ninth Circuit only discussed the issue summarily in a footnote, the issue was nonetheless addressed and decided by the Ninth Circuit. Notably, the BAP in *Clear Channel* did not address or cite *Helms I* or *Helms II*.

As well, several other courts outside of the Ninth Circuit all hold that section 363(m) is broad enough to encompass section 363(f). *In re Colarusso*, 382 F.3d

51, 61-62 (1st Cir. 2004); *In re Wintz Companies*, 230 B.R. 840, 844-45 (B.A.P. 8th Cir. 1999); *International Union, et al. v. Morse Tool, Inc.*, 85 B.R. 666, 668 (D. Mass. 1988); *In re Lake Placid Co.*, 78 B.R. 131, 135 n.1 (W.D. Va. 1987); *In re Whatley*, 169 B.R. 698, 701 (D. Colo. 1994). None of these cases are mentioned in *Clear Channel* either.

## Conclusion

Purchasers of assets out of bankruptcy should be aware of the *Clear Channel* decision and its implications. *Clear Channel* invites disgruntled parties to challenge the "free and clear" provisions of section 363 sale orders without obtaining a stay pending appeal. In so doing, it cuts against the long-standing and well-established body of case law that holds that section 363(m) protection is necessary to promote finality of bankruptcy sales. Because *Clear Channel* conflicts with numerous cases, including precedent from the Ninth Circuit in *Helms*, we believe that *Clear Channel*, for the reasons discussed above, among others, should not be followed. But, until the case is affirmatively overruled, purchasers should proceed with caution if closing in the face of an appeal.

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