

***Clear Channel Outdoor, Inc.***  
**v.**  
***Nancy Knupfer, Chapter 11 Trustee; DB Burbank, LLC***

**By John Matthew Trott and Erik M. North**

There are two ways of selling assets in a bankruptcy case: (1) pursuant to a confirmed plan of reorganization; or (2) pursuant to § 363 of Title 11 of the U.S. Code (the “Bankruptcy Code”). In recent years, more and more cases are being resolved by the sale of assets pursuant to Bankruptcy Code § 363 for a number of reasons, including that (i) a § 363 sale can be done far more quickly than confirming a plan of reorganization, (ii) until the recent *Clear Channel* case, it was clear that a sale under Bankruptcy Code § 363 was free and clear of all liens, claims and encumbrances and (iii) until the *Clear Channel* case, it was clear that unless a stay pending appeal is obtained, appeals of § 363 sales are generally going to be moot pursuant to Bankruptcy Code § 363(m).

The recent 9<sup>th</sup> Circuit Bankruptcy Appellate Panel (“BAP”) decision in *Clear Channel Outdoor, Inc. v. Nancy Knupfer, Chapter 11 Trustee; DB Burbank, LLC* (2008 WL 2840659 (9<sup>th</sup> Cir. BAP (Cal.)) casts doubt on two of the above reasons for conducting a § 363 sale. The BAP held that even though no stay pending appeal had been obtained, the appeal from a § 363 sale was not moot. The BAP also found that the sale was not, in fact, free and clear of all liens, claims and encumbrances.

*The Facts*

PW, LLC (“PW”), a single-asset real estate entity holding several contiguous parcels of land in Burbank, California (the “Property”), had obtained the necessary entitlements pursuant to a development agreement with the City of Burbank to develop a mixed-use complex of luxury condominiums and retail space. Due to “problems large and small,” the project did not progress as planned and, in July 2006, DB Burbank, LLC (“DB”), the holder of a claim for over \$40 million secured by a first-priority lien on the Property, initiated foreclosure proceedings. On November 20, 2006, just prior to foreclosure, PW filed a chapter 11 bankruptcy case. DB immediately moved for, and the bankruptcy court granted, the appointment of the trustee, Nancy Knupfer (“Trustee”).

Facing several immediate problems, including implementing the development agreement for the Property, the Trustee proposed to sell the Property and entered into negotiations with DB to accomplish the sale. These negotiations resulted in a “binding term sheet” between DB and the Trustee, establishing detailed procedures for an auction and sale of all of PW’s assets, including the Property. The term sheet provided that DB would serve as a stalking horse bidder for the Property. If there were no qualified overbidders, DB would buy the Property for a credit bid of approximately \$41.4 million. As a condition to the proposed sale, DB agreed to pay the Trustee a “Carve-Out Amount” of up to \$800,000 to be used for certain administrative fees and other expenses, and not to seek relief from the automatic stay.

The Trustee filed a motion to approve the sale of the Property free and clear of all liens, claims and encumbrances under § 363(f)(3) and (f)(5) of the Bankruptcy Code. The

Property was encumbered by a junior lien in favor of Clear Channel Outdoor, Inc. (“Clear Channel”), securing a claim of approximately \$2.5 million. Clear Channel opposed the motion, asserting that § 363(f) of the Code (*see below for text of § 363(f)*), was not applicable. Over Clear Channel’s objection, the bankruptcy court entered an order authorizing the sale free and clear of Clear Channel’s lien.

There were no qualified overbidders and on May 31, 2007, the bankruptcy court entered an order approving the sale and finding that DB was a purchaser in good faith. Clear Channel received no proceeds from the sale of the Property and timely filed an appeal of the order. The bankruptcy court declined to stay its order pending Clear Channel’s appeal.

### *Mootness of Clear Channel’s Appeal*

The BAP noted that there were three types of mootness that might apply to the sale: constitutional, equitable and statutory. Constitutional mootness arises from the constitutional limitations on the federal courts to adjudicate only live cases and controversies. A appeal is constitutionally moot if it is impossible to grant relief. *Church of Scientology of Cal. v. United States*, 506 U.S. 9, 12, 113 S.Ct. 447, 121 L.Ed.2d 313 (1992). The BAP concluded that the appeal was not constitutionally moot. Even though the sale was completed, the court could still fashion some relief, such as reversing the sale or reversing the stripping of Clear Channel’s lien.

The doctrine of equitable mootness applies when: (1) the appellant has failed to obtain a stay; and (2) even though relief on appeal is possible, the transactions that have taken place in the absence of a stay are too complex and difficult to unwind. The BAP agreed with DB and the Trustee that the doctrine of equitable mootness applied to the sale of the Property to DB. Citing *In re Popp*, 323 B.R. at 271, the BAP stated that “[e]quitable mootness requires the court to look beyond impossibility of a remedy to ‘the consequences of the remedy and the number of third parties who have changed their position in reliance on the order that is being appealed.’” The BAP noted that “[u]ltimately, the decision whether to unscramble the eggs turns on what is practical and equitable,” *Baker & Drake, Inc. v. Pub. Serv. Comm’n (In re Banker & Drake, Inc.)*, 35 F.3d 1348, 1352 (9<sup>th</sup> Cir. 1994). The BAP concluded that based on the actions taken by DB and the reliance on such actions by third parties, the transaction under consideration was too “complex and difficult to unwind” and declined to reverse the bankruptcy court’s order approving the sale.

That was a pyrrhic victory for DB, however, since the BAP did not find Clear Channel’s appeal as to the stripping of its lien moot. Finding that (a) the issues before the BAP regarding the sale of the Property free and clear of all liens, which resulted in the stripping of Clear Channel’s junior lien, were not complex, and (b) the reversal of this aspect of the bankruptcy court’s order did not negatively impact third parties, the BAP held that this aspect of the appeal was not equitably moot.

The BAP then analyzed whether Clear Channel’s appeal of the stripping of its lien was statutorily moot under § 363(m).

Section 363(m) protects sales of bankruptcy estate property, stating:

The reversal or modification on appeal of an authorization under subsection (b) or (c) of [§ 363] of a sale or lease of property does not affect the validity of the 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.

Since Clear Channel did not obtain a stay pending its appeal of the court's order, DP and the Trustee asserted that the BAP was prevented from reversing the bankruptcy court's order that the Property be sold free and clear of all liens. The BAP disagreed, and, applying an exceptionally literal reading of the statute, noted that § 363(m) on its face only applies to subsections (b) and (c) of § 363. Since the lien-stripping was ordered under § 363(f), the BAP held that the § 363(m) protection did not apply.

The BAP also noted that the language of § 363(f) refers to authorizations to “use, sell or lease . . . property of the estate,” while § 363(b) only limits the ability to “affect the validity of a *sale* or *lease* under such authorization . . . .” The BAP reasoned that by omitting “use” along side “sale and lease” in § 363(m), Congress only intended to extend such protection to “changes of title or other essential attributes of a sale, together with the changes of authorized possession that occur with leases.” Accordingly, the BAP held that while § 363(m) protects the actual sales from appellate review, the terms of such sales, specifically, in this case, lien-stripping, are not afforded such statutory protection.

#### *Lien-Stripping under § 363(f) of the Bankruptcy Code*

The BAP's analysis of the bankruptcy court's stripping Clear Channel of its junior lien centered on § 363(f), which states:

(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 property 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 or such interest.

The BAP restricted its analysis to subsections (3) and (5), finding that subsections (1), (2) and (4) were inapplicable to the facts of the case (i.e., (1) applicable California law would preserve Clear Channel's lien in the event the Property was sold, (2) Clear Channel did not consent to the transfer free and clear of its lien, and (4) Clear Channel's lien was not in dispute).

The question was whether subsection (3) of § 363(f) allowed a sale free and clear of all liens, claims and encumbrances when the Property sold for less than the total amount of the claims that it secured. The answer to this question turned on the phrase "aggregate value of all liens."

DB and the Trustee asserted that the phrase "aggregate value of all liens" meant the economic value of the liens, not their face value. The BAP disagreed, finding that in the context of the Code, "aggregate value of all liens" as it appears in § 363(f)(3) does not mean "the *economic* value of such liens, rather than their face value" (i.e., the value of the secured claims).

The BAP further reasoned that because subsection (3) permits a free and clear sale only when "the price at which such property is to be sold is *greater* than the aggregate value of all liens," "the paragraph could *never* be used to authorize a sale free and clear...when the claims exceed the value of the collateral that secures them," because "[I]n any case in which the value of the property being sold is less than the total amount of claims held by secured creditors, the total of all allowed secured claims will *equal*, not exceed, the sale price [of the property], and [§ 363(f)(3)] requires the price to be "greater than" the "value of all liens.'" Therefore, the BAP held that "§ 363(f)(3) does not authorize the sale free and clear of a lienholder's interest if the price of the estate property is equal to or less than the aggregate amount of all claims held by creditors who hold a lien or security interest in the property being sold."

The BAP then turned to § 363(f)(5), which was the basis of the bankruptcy court's order. The BAP determined that § 363(f)(5) did not support stripping Clear Channel's lien from the Property.

In an effort to avoid § 363(f)(5), Clear Channel argued that its lien was not an interest. The BAP was not swayed by this argument and determined that Clear Channel's lien was an "interest" (a term not defined in the Code) for the purposes of § 363(f)(5). The BAP then addressed whether Clear Channel "could be compelled...to accept a money satisfaction" of such interest.

The bankruptcy court had found that § 363(f)(5) is satisfied whenever a claim or interest can be satisfied with money. The BAP found this analysis too simplistic. The BAP noted that this analysis would, in essence, subsume § 363(f)(3) since payment of money would satisfy most claims and interests.

In order not to have § 363(f)(5) subsume § 363(f)(3), the BAP assumed for its analysis that § 363(f)(5) referred to "a legal and equitable proceeding in which the nondebtor could be compelled to take *less* than the value of the claim secured by the interest," (i.e., "the existence of another legal mechanism by which a lien could be extinguished without full satisfaction of the secured debt."). The BAP stated that this narrow interpretation prevented an

overlap with § 363(f)(3), but nonetheless preserved a role for § 363(f)(5) in such circumstances as buy-out arrangements among partners or joint venturers or in cases where liquidated damages could be used as a remedy in place of specific performance. Accordingly, the BAP held that a “bankruptcy court must make a finding of the existence of such a mechanism and the trustee must demonstrate how satisfaction of the lien ‘could be compelled’.”

Finally, in clarifying its finding that there must be at least the possibility of an applicable proceeding at law or equity “in which a nondebtor could be forced to accept money in satisfaction of its interest,” the BAP held that a cramdown under § 1129(b)(2) of the Code is not an applicable procedure for the purpose of § 363(f)(5). The BAP reasoned that if the cramdown proceeding were sufficient in and of itself, there would have been no Congressional purpose in including § 363(f)(5) in the Code.

Having decided that Clear Channel’s appeal to reverse the bankruptcy court’s stripping of its junior lien was neither equitably nor statutorily moot and that the bankruptcy court did not apply the correct legal standard under § 363(f)(5) in ordering the Property’s sale free and clear of all liens, the BAP reversed the lien-stripping part of the bankruptcy court’s order and remanded the case, providing the parties the opportunity to identify provisions of state law, if any, that would allow for the sale of the Property free and clear of Clear Channel’s lien.

While the *Clear Channel* case has yet to be published, it nonetheless casts a shadow across chapter 11 cases in which extinguishing existing liens on estate property is an important component of the economics of the sale. The result in *Clear Channel* is that DB ended up owning the Property subject to the \$2.5 million lien in favor of Clear Channel. Obviously, this is not the result DB desired, nor would this have been the result had DB foreclosed under its first-priority lien.

By severely limiting the protection provided to good faith buyers under § 363(m), the BAP’s holding may cause potential purchasers of chapter 11 properties to think twice before engaging in a § 363(f) transaction in cases where a lien holder could rise from the dead even after such a sale is completed.

John Matthew Trott is a partner and Erik M. North is an associate in the Los Angeles office of Cox, Castle & Nicholson LLP, where they represent parties in commercial real estate transactions.